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

Form 10-K/A
(Amendment No. 3)

(Mark One)



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

For the fiscal year ended December 31, 2004

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 1-7176

El Paso CGP Company

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

74-1734212

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

El Paso Building

1001 Louisiana Street

Houston, Texas

(Address of Principal Executive Offices)

77002

(Zip Code)

Telephone Number: (713) 420-2600

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant: None

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Common Stock, par value \$1 per share. Shares outstanding on April 15, 2005: 1,000

EL PASO CGP COMPANY MEETS THE CONDITIONS OF GENERAL INSTRUCTION I(1) (a) AND (b) TO FORM 10-K AND IS, THEREFORE, FILING THIS REPORT WITH A REDUCED DISCLOSURE FORMAT AS PERMITTED BY SUCH INSTRUCTION.

Documents Incorporated by Reference: None

EXPLANATORY NOTE

This amendment on Form 10-K/A constitutes Amendment No. 3 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, which was originally filed with the SEC on April 15, 2005. We are filing this Form 10-K/A to amend the Report of Independent Registered Public Accounting Firm for Great Lakes Transmission Limited Partnership set forth in Item 15 to refer to the standards of the Public Company Accounting Oversight Board and to update the footnotes of Midland Cogeneration Venture Limited Partnership for a subsequent event.

This amendment relates to the items specified above. It does not otherwise affect the original consolidated financial statements and related footnotes of El Paso CGP Company, Great Lakes Transmission Limited Partnership or Midland Cogeneration Venture Limited Partnership as filed in the Annual Report and does not, except as mentioned above, reflect events occurring after the original filing date of April 15, 2005.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) The following documents are filed as part of this report:

1. Financial statements.

Our consolidated financial statements are included in Part II, Item 8 of our Annual Report on Form 10-K, as amended:

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⁽¹⁾ The financial statements of Khulna Power Company Limited (Khulna) are prepared in accordance with International Financial Reporting Standards (IFRS). In 2002, Khulna incurred \$641,418 of legal and other expenses associated with certain debt financing. These costs were expensed in accordance with IFRS; however, such costs would have been capitalized under generally accepted accounting principles in the United States. There are no other material reconciling differences to prepare these statements in accordance with generally accepted accounting principles in the United States.

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Schedules other than those listed above are omitted because they are not applicable.

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⁽²⁾ During 2002, Saba Power Company (Private) Limited (Saba) changed its accounting year-end to December 31 from June 30.

PRICEWATERHOUSECOOPERS LLP

Report of Independent Registered Public Accounting Firm

To the Partners and the Management Committee of
Midland Cogeneration Venture Limited Partnership:

We have completed an integrated audit of Midland Cogeneration Venture Limited Partnership 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its December 31, 2003 and December 31, 2002 financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, partners' equity and cash flows present fairly, in all material respects, the financial position of the Midland Cogeneration Limited Partnership (a Michigan limited partnership) and its subsidiaries (MCV) at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the MCV's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As explained in Note 2 to the financial statements, effective April 1, 2002, Midland Cogeneration Venture Limited Partnership changed its method of accounting for derivative and hedging activities in accordance with Derivative Implementation Group ("DIG") Issue C-16.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting (not presented herein), that the MCV maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the MCV maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The MCV's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the MCV's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Detroit, Michigan
February 25, 2005

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31,
(In Thousands)

	<u>2004</u>	<u>2003</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 125,781	\$ 173,651
Accounts and notes receivable — related parties	54,368	43,805
Accounts receivable	42,984	38,333
Gas inventory	17,509	20,298
Unamortized property taxes	18,060	17,672
Derivative assets	94,977	86,825
Broker margin accounts, and prepaid gas costs and expenses	13,147	8,101
Total current assets	<u>366,826</u>	<u>388,685</u>
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment	2,466,944	2,463,931
Pipeline	21,432	21,432
Total property, plant and equipment	2,488,376	2,485,363
Accumulated depreciation	<u>(1,062,821)</u>	<u>(991,556)</u>
Net property, plant and equipment	<u>1,425,555</u>	<u>1,493,807</u>
OTHER ASSETS:		
Restricted investment securities held-to-maturity	139,410	139,755
Derivative assets non-current	24,337	18,100
Deferred financing costs, net of accumulated amortization of \$18,498 and \$17,285, respectively	6,467	7,680
Prepaid gas costs, spare parts deposit, materials and supplies	17,782	21,623
Total other assets	<u>187,996</u>	<u>187,158</u>
TOTAL ASSETS	<u><u>\$ 1,980,377</u></u>	<u><u>\$2,069,650</u></u>
LIABILITIES AND PARTNERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 82,693	\$ 57,368
Gas supplier funds on deposit	19,613	4,517
Interest payable	47,738	53,009
Current portion of long-term debt	76,548	134,576
Total current liabilities	<u>226,592</u>	<u>249,470</u>
NON-CURRENT LIABILITIES:		
Long-term debt	942,097	1,018,645
Other	1,712	2,459
Total non-current liabilities	<u>943,809</u>	<u>1,021,104</u>
COMMITMENTS AND CONTINGENCIES (Notes 7 and 8)		
TOTAL LIABILITIES	<u>1,170,401</u>	<u>1,270,574</u>
PARTNERS' EQUITY	<u>809,976</u>	<u>799,076</u>
TOTAL LIABILITIES AND PARTNERS' EQUITY	<u><u>\$ 1,980,377</u></u>	<u><u>\$2,069,650</u></u>

The accompanying notes are an integral part of these statements.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31,
(In Thousands)**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
OPERATING REVENUES:			
Capacity	\$ 405,415	\$ 404,681	\$ 404,713
Electric	225,154	162,093	177,569
Steam	<u>19,090</u>	<u>17,638</u>	<u>14,537</u>
Total operating revenues	<u>649,659</u>	<u>584,412</u>	<u>596,819</u>
OPERATING EXPENSES:			
Fuel costs	413,061	254,988	255,142
Depreciation	88,712	89,437	88,963
Operations	18,769	16,943	16,642
Maintenance	13,508	15,107	12,666
Property and single business taxes	28,834	30,040	27,087
Administrative, selling and general	<u>11,236</u>	<u>9,959</u>	<u>8,195</u>
Total operating expenses	<u>574,120</u>	<u>416,474</u>	<u>408,695</u>
OPERATING INCOME	<u>75,539</u>	<u>167,938</u>	<u>188,124</u>
OTHER INCOME (EXPENSE):			
Interest and other income	5,460	5,100	5,555
Interest expense	<u>(104,618)</u>	<u>(113,247)</u>	<u>(119,783)</u>
Total other income (expense), net	<u>(99,158)</u>	<u>(108,147)</u>	<u>(114,228)</u>
NET INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	(23,619)	59,791	73,896
Cumulative effect of change in method of accounting for derivative option contracts (to April 1, 2002) (Note 2)	<u>—</u>	<u>—</u>	<u>58,131</u>
NET INCOME (LOSS)	<u>\$ (23,619)</u>	<u>\$ 59,791</u>	<u>\$ 132,027</u>

The accompanying notes are an integral part of these statements.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
CONSOLIDATED STATEMENTS OF PARTNERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31,
(In Thousands)

	<u>General Partners</u>	<u>Limited Partners</u>	<u>Total</u>
BALANCE, DECEMBER 31, 2001	\$468,972	\$ 82,740	\$551,712
Comprehensive Income			
Net Income	114,947	17,080	132,027
Other Comprehensive Income			
Unrealized gain on hedging activities since beginning of period ...	33,311	4,950	38,261
Reclassification adjustments recognized in net income above	<u>10,717</u>	<u>1,593</u>	<u>12,310</u>
Total other comprehensive income	<u>44,028</u>	<u>6,543</u>	<u>50,571</u>
Total Comprehensive Income	<u>158,975</u>	<u>23,623</u>	<u>182,598</u>
BALANCE, DECEMBER 31, 2002	\$627,947	\$106,363	\$734,310
Comprehensive Income			
Net Income	52,056	7,735	59,791
Other Comprehensive Income			
Unrealized gain on hedging activities since beginning of period ...	34,484	5,125	39,609
Reclassification adjustments recognized in net income above	<u>(30,153)</u>	<u>(4,481)</u>	<u>(34,634)</u>
Total other comprehensive income	<u>4,331</u>	<u>644</u>	<u>4,975</u>
Total Comprehensive Income	<u>56,387</u>	<u>8,379</u>	<u>64,766</u>
BALANCE, DECEMBER 31, 2003	\$684,334	\$114,742	\$799,076
Comprehensive Income			
Net Loss	(20,563)	(3,056)	(23,619)
Other Comprehensive Income			
Unrealized gain on hedging activities since beginning of period ...	62,292	9,256	71,548
Reclassification adjustments recognized in net income above	<u>(32,239)</u>	<u>(4,790)</u>	<u>(37,029)</u>
Total other comprehensive income	<u>30,053</u>	<u>4,466</u>	<u>34,519</u>
Total Comprehensive Income	<u>9,490</u>	<u>1,410</u>	<u>10,900</u>
BALANCE, DECEMBER 31, 2004	<u>\$693,824</u>	<u>\$116,152</u>	<u>\$809,976</u>

The accompanying notes are an integral part of these statements.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,
(In Thousands)**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ (23,619)	\$ 59,791	\$ 132,027
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	89,925	90,792	90,430
Cumulative effect of change in accounting principle	—	—	(58,131)
(Increase) decrease in accounts receivable	(15,214)	(1,211)	48,343
(Increase) decrease in gas inventory	2,789	(732)	133
(Increase) decrease in unamortized property taxes	(388)	683	(1,730)
(Increase) decrease in broker margin accounts and prepaid expenses	(5,046)	(4,778)	31,049
(Increase) decrease in derivative assets	20,130	4,906	(20,444)
(Increase) decrease in prepaid gas costs, materials and supplies	3,841	(8,704)	1,376
Increase (decrease) in accounts payable and accrued liabilities ..	25,775	(712)	8,774
Increase in gas supplier funds on deposit	15,096	4,517	—
Decrease in interest payable	(5,271)	(3,377)	(3,948)
Increase (decrease) in other non-current liabilities	(1,197)	311	(24)
Net cash provided by operating activities	<u>106,821</u>	<u>141,486</u>	<u>227,855</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Plant modifications and purchases of plant equipment	(20,460)	(33,278)	(29,529)
Maturity of restricted investment securities held-to-maturity	674,553	601,225	377,192
Purchase of restricted investment securities held-to-maturity	<u>(674,208)</u>	<u>(602,279)</u>	<u>(374,426)</u>
Net cash used in investing activities	<u>(20,115)</u>	<u>(34,332)</u>	<u>(26,763)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayment of financing obligation	<u>(134,576)</u>	<u>(93,928)</u>	<u>(182,084)</u>
Net cash used in financing activities	<u>(134,576)</u>	<u>(93,928)</u>	<u>(182,084)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(47,870)	13,226	19,008
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>173,651</u>	<u>160,425</u>	<u>141,417</u>
CASH AND EQUIVALENTS AT END OF PERIOD	<u>\$ 125,781</u>	<u>\$ 173,651</u>	<u>\$ 160,425</u>

The accompanying notes are an integral part of these statements.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) The Partnership and Associated Risks

MCV was organized to construct, own and operate a combined-cycle, gas-fired cogeneration facility (the “Facility”) located in Midland, Michigan. MCV was formed on January 27, 1987, and the Facility began commercial operation in 1990.

In 1992, MCV had acquired the outstanding common stock of PVCO Corp., a previously inactive company. MCV and PVCO Corp. then entered into a partnership agreement to form MCV Gas Acquisition General Partnership (“MCV GAGP”) for the purpose of buying and selling natural gas on the spot market and other transactions involving natural gas activities. PVCO Corp. and MCV GAGP were dissolved on January 30, 2004 and July 2, 2004, respectively, due to inactivity.

The Facility has a net electrical generating capacity of approximately 1500 MW and approximately 1.5 million pounds of process steam capacity per hour. MCV has entered into three principal energy sales agreements. MCV has contracted to (i) supply up to 1240 MW of electric capacity (“Contract Capacity”) to Consumers Energy Company (“Consumers”) under the Power Purchase Agreement (“PPA”), for resale to its customers through 2025, (ii) supply electricity and steam to The Dow Chemical Company (“Dow”) through 2008 and 2015, respectively, under the Steam and Electric Power Agreement (“SEPA”) and (iii) supply steam to Dow Corning Corporation (“DCC”) under the Steam Purchase Agreement (“SPA”) through 2011. From time to time, MCV enters into other sales agreements for the sale of excess capacity and/or energy available above MCV’s internal use and obligations under the PPA, SEPA and SPA. Results of operations are primarily dependent on successfully operating the Facility at or near contractual capacity levels and on Consumers’ ability to perform its obligations under the PPA. Sales pursuant to the PPA have historically accounted for over 90% of MCV’s revenues.

The PPA permits Consumers, under certain conditions, to reduce the capacity and energy charges payable to MCV and/or to receive refunds of capacity and energy charges paid to MCV if the Michigan Public Service Commission (“MPSC”) does not permit Consumers to recover from its customers the capacity and energy charges specified in the PPA (the “regulatory-out” provision). Until September 15, 2007, however, the capacity charge may not be reduced below an average capacity rate of 3.77 cents per kilowatt-hour for the available Contract Capacity notwithstanding the “regulatory-out” provision. Consumers and MCV are required to support and defend the terms of the PPA.

The Facility is a qualifying cogeneration facility (“QF”) originally certified by the Federal Energy Regulatory Commission (“FERC”) under the Public Utility Regulatory Policies Act of 1978, as amended (“PURPA”). In order to maintain QF status, certain operating and efficiency standards must be maintained on a calendar-year basis and certain ownership limitations must be met. In the case of a topping-cycle generating plant such as the Facility, the applicable operating standard requires that the portion of total energy output that is put to some useful purpose other than facilitating the production of power (the “Thermal Percentage”) be at least 5%. In addition, the Facility must achieve a PURPA efficiency standard (the sum of the useful power output plus one-half of the useful thermal energy output, divided by the energy input (the “Efficiency Percentage”)) of at least 45%. If the Facility maintains a Thermal Percentage of 15% or higher, the required Efficiency Percentage is reduced to 42.5%. Since 1990, the Facility has achieved the applicable Thermal and Efficiency Percentages. For the twelve months ended December 31, 2004, the Facility achieved a Thermal Percentage of 15.6% and an Efficiency Percentage of 47.6%. The loss of QF status could, among other things, cause MCV to lose its rights under PURPA to sell power from the Facility to Consumers at Consumers’ “avoided cost” and subject MCV to additional federal and state regulatory requirements.

The Facility is wholly dependent upon natural gas for its fuel supply and a substantial portion of the Facility’s operating expenses consist of the costs of natural gas. MCV recognizes that its existing gas contracts are not sufficient to satisfy the anticipated gas needs over the term of the PPA and, as such, no assurance can be given as to the availability or price of natural gas after the expiration of the existing gas contracts. In

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

addition, to the extent that the costs associated with production of electricity rise faster than the energy charge payments, MCV's financial performance will be negatively affected. The extent of such impact will depend upon the amount of the average energy charge payable under the PPA, which is based upon costs incurred at Consumers' coal-fired plants and upon the amount of energy scheduled by Consumers for delivery under the PPA. However, given the unpredictability of these factors, the overall economic impact upon MCV of changes in energy charges payable under the PPA and in future fuel costs under new or existing contracts cannot accurately be predicted.

At both the state and federal level, efforts continue to restructure the electric industry. A significant issue to MCV is the potential for future regulatory denial of recovery by Consumers from its customers of above market PPA costs Consumers pays MCV. At the state level, the MPSC entered a series of orders from June 1997 through February 1998 (collectively the "Restructuring Orders"), mandating that utilities "wheel" third-party power to the utilities' customers, thus permitting customers to choose their power provider. MCV, as well as others, filed an appeal in the Michigan Court of Appeals to protect against denial of recovery by Consumers of PPA charges. The Michigan Court of Appeals found that the Restructuring Orders do not unequivocally disallow such recovery by Consumers and, therefore, MCV's issues were not ripe for appellate review and no actual controversy regarding recovery of costs could occur until 2008, at the earliest. In June 2000, the State of Michigan enacted legislation which, among other things, states that the Restructuring Orders (being voluntarily implemented by Consumers) are in compliance with the legislation and enforceable by the MPSC. The legislation provides that the rights of parties to existing contracts between utilities (like Consumers) and QFs (like MCV), including the rights to have the PPA charges recovered from customers of the utilities, are not abrogated or diminished, and permits utilities to securitize certain stranded costs, including PPA charges.

In 1999, the U.S. District Court granted summary judgment to MCV declaring that the Restructuring Orders are preempted by federal law to the extent they prohibit Consumers from recovering from its customers any charge for avoided costs (or "stranded costs") to be paid to MCV under PURPA pursuant to the PPA. In 2001, the United States Court of Appeals ("Appellate Court") vacated the U.S. District Court's 1999 summary judgment and ordered the case dismissed based upon a finding that no actual case or controversy existed for adjudication between the parties. The Appellate Court determined that the parties' dispute is hypothetical at this time and the QFs' (including MCV) claims are premised on speculation about how an order might be interpreted by the MPSC, in the future.

Two significant issues that could affect MCV's future financial performance are the price of natural gas and Consumers' ability/obligation to pay PPA charges. Natural gas prices have historically been volatile and presently there is no consensus among forecasters on the price or range of future prices of natural gas. Even with the approved Resource Conservation Agreement and Reduced Dispatch Agreement, if gas prices continue at present levels or increase, the economics of operating the Facility may be adversely affected. Consumers' ability/obligation to pay PPA charges may be affected by an MPSC order denying Consumers recovery from ratepayers. This issue is likely to be addressed in the timeframe of 2007 or beyond. MCV continues to monitor and participate in these matters as appropriate, and to evaluate potential impacts on both cash flows and recoverability of the carrying value of property, plant and equipment. MCV management cannot, at this time, predict the impact or outcome of these matters.

(2) Significant Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Following is a discussion of MCV's significant accounting policies.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Principles of Consolidation

The consolidated financial statements included the accounts of MCV and its wholly-owned subsidiaries, PVCO Corp. and MCV GAGP. Previously, all material transactions and balances among entities, which comprise MCV, had been eliminated in the consolidated financial statements. The 2004 dissolution of these wholly-owned subsidiaries had no impact on the financial position and results of operations.

Revenue Recognition

MCV recognizes revenue for the sale of variable energy and fixed energy when delivered. Capacity and other installment revenues are recognized based on plant availability or other contractual arrangements.

Fuel Costs

MCV's fuel costs are those costs associated with securing natural gas, transportation and storage services necessary to generate electricity and steam from the Facility. These costs are recognized in the income statement based upon actual volumes burned to produce the delivered energy. In addition, MCV engages in certain cost mitigation activities to offset the fixed charges MCV incurs for these activities. The gains or losses resulting from these activities have resulted in net gains of approximately \$6.7 million, \$7.7 million and \$3.9 million for the years ended 2004, 2003 and 2002, respectively. These net gains are reflected as a component of fuel costs.

In July 2000, in response to rapidly escalating natural gas prices and since Consumers' electric rates were frozen, MCV entered into a series of transactions with Consumers whereby Consumers agreed to reduce MCV's dispatch level and MCV agreed to share with Consumers the savings realized by not having to generate electricity ("Dispatch Mitigation"). On January 1, 2004, Dispatch Mitigation ceased and Consumers began dispatching MCV pursuant to a 915 MW settlement and a 325 MW settlement "availability caps" provision (i.e., minimum dispatch of 1100 MW on- and off-peak ("Forced Dispatch")). In 2004, MCV and Consumers entered into a Resource Conservation Agreement ("RCA") and a Reduced Dispatch Agreement ("RDA") which, among other things, provides that Consumers will economically dispatch MCV, if certain conditions are met. Such dispatch is expected to reduce electric production from what is occurring under the Forced Dispatch, as well as decrease gas consumption by MCV. The RCA provides that Consumers has a right of first refusal to purchase, at market prices, the gas conserved under the RCA. The RCA and RDA provide for the sharing of savings realized by not having to generate electricity. The RCA and RDA were approved by an order of the MPSC on January 25, 2005 and MCV and Consumers accepted the terms of the MPSC order making the RCA and RDA effective as of January 27, 2005. This MPSC order is subject to appeal by other parties. MCV management cannot predict the final outcome of any such appeal. While awaiting approval of this order, effective October 23, 2004, MCV and Consumers entered into an interim Dispatch Mitigation program for energy dispatch above 1100 MW up to 1240 MW of Contract Capacity under the PPA. This interim program, which was structured very similarly to the RCA and RDA, was terminated on January 27, 2005 with the effective date of the RCA/RDA. For the twelve months ended December 31, 2004, 2003 and 2002, MCV estimates that these programs have resulted in net savings of approximately \$1.6 million, \$13.0 million and \$2.5 million, a portion of which is realized in reduced maintenance expenditures in future years.

Accounts Receivable

Accounts receivable and accounts receivable-related parties are recorded at the billed amount and do not bear interest. MCV evaluates the need for an allowance for doubtful accounts using MCV's best estimate of the amount of probable credit losses. At December 31, 2004 and 2003, no allowance was provided since typically all receivables are collected within 30 days of each month end.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Inventory

MCV's inventory of natural gas is stated at the lower of cost or market, and valued using the last-in, first-out ("LIFO") method. Inventory includes the costs of purchased gas, variable transportation and storage. The amount of reserve to reduce inventories from first-in, first-out ("FIFO") basis to the LIFO basis at December 31, 2004 and 2003, was \$10.3 million and \$8.4 million, respectively. Inventory cost, determined on a FIFO basis, approximates current replacement cost.

Materials and Supplies

Materials and supplies are stated at the lower of cost or market using the weighted average cost method. The majority of MCV's materials and supplies are considered replacement parts for MCV's Facility.

Depreciation

Original plant, equipment and pipeline were valued at cost for the constructed assets and at the asset transfer price for purchased and contributed assets, and are depreciated using the straight-line method over an estimated useful life of 35 years, which is the term of the PPA, except for the hot gas path components of the GTGs which are primarily being depreciated over a 25-year life. Plant construction and additions, since commercial operations in 1990, are depreciated using the straight-line method over the remaining life of the plant which currently is 22 years. Major renewals and replacements, which extend the useful life of plant and equipment are capitalized, while maintenance and repairs are expensed when incurred. Major equipment overhauls are capitalized and amortized to the next equipment overhaul. Personal property is depreciated using the straight-line method over an estimated useful life of 5 to 15 years. The cost of assets and related accumulated depreciation are removed from the accounts when sold or retired, and any resulting gain or loss reflected in operating income.

Federal Income Tax

MCV is not subject to Federal or State income taxes. Partnership earnings are taxed directly to each individual partner.

Statement of Cash Flows

All liquid investments purchased with a maturity of three months or less at time of purchase are considered to be current cash equivalents.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents and short-term investments approximate fair value because of the short maturity of these instruments. MCV's short-term investments, which are made up of investment securities held-to-maturity, as of December 31, 2004 and December 31, 2003 have original maturity dates of approximately one year or less. The unique nature of the negotiated financing obligation discussed in Note 6 makes it unnecessary to estimate the fair value of the Owner Participants' underlying debt and equity instruments supporting such financing obligation, since SFAS No. 107 "Disclosures about Fair Value of Financial Instruments" does not require fair value accounting for the lease obligation.

Accounting for Derivative Instruments and Hedging Activities

Effective January 1, 2001, MCV adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" which was issued in June 1998 and then amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of SFAS No. 133," SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities — An

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

amendment of FASB Statement No. 133” and SFAS No. 149 “Amendment of Statement 133 on Derivative Instruments and Hedging Activity (collectively referred to as “SFAS No. 133”). SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in a derivative’s fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges in some cases allows a derivative’s gains and losses to offset related results on the hedged item in the income statement or permits recognition of the hedge results in other comprehensive income, and requires that a company formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

Electric Sales Agreements

MCV believes that its electric sales agreements currently do not qualify as derivatives under SFAS No. 133, due to the lack of an active energy market (as defined by SFAS No. 133) in the State of Michigan and the transportation cost to deliver the power under the contracts to the closest active energy market at the Cinergy hub in Ohio and as such does not record the fair value of these contracts on its balance sheet. If an active energy market emerges, MCV intends to apply the normal purchase, normal sales exception under SFAS No. 133 to its electric sales agreements, to the extent such exception is applicable.

Natural Gas Supply Contracts

MCV management believes that its long-term natural gas contracts, which do not contain volume optionality, qualify under SFAS No. 133 for the normal purchases and normal sales exception. Therefore, these contracts are currently not recognized at fair value on the balance sheet.

The FASB issued DIG Issue C-16, which became effective April 1, 2002, regarding natural gas commodity contracts that combine an option component and a forward component. This guidance requires either that the entire contract be accounted for as a derivative or the components of the contract be separated into two discrete contracts. Under the first alternative, the entire contract considered together would not qualify for the normal purchases and sales exception under the revised guidance. Under the second alternative, the newly established forward contract could qualify for the normal purchases and sales exception, while the option contract would be treated as a derivative under SFAS No. 133 with changes in fair value recorded through earnings. At April 1, 2002, MCV had nine long-term gas contracts that contained both an option and forward component. As such, they were no longer accounted for under the normal purchases and sales exception and MCV began mark-to-market accounting of these nine contracts through earnings. As of January 31, 2005, only four contracts of the original nine contracts, which contained an option and forward component remain in effect. In addition, as a result of implementing the RCA/RDA, effective January 27, 2005, MCV has determined that as of the effective date of the RCA/RDA, an additional nine long term contracts (for a total of 13) will no longer be accounted for under the normal purchases and sales exception, per SFAS No. 133 and will result in additional mark-to-market activity in 2005 and beyond. MCV expects future earnings volatility on both the remaining long term gas contracts that contain volume optionality as well as the long term gas contracts under the RCA/RDA that will require mark-to-market recognition on a quarterly basis.

Based on the natural gas prices, at the beginning of April 2002, MCV recorded a \$58.1 million gain for the cumulative effect of this accounting change. From April 2002 to December 2004, MCV recorded an additional net mark-to-market loss of \$2.3 million for these gas contracts. The cumulative mark-to-market gain through December 31, 2004 of \$55.8 million is recorded as a current and non-current derivative asset on the balance sheet, as detailed below. These assets will reverse over the remaining life of these gas contracts, ranging from 2005 to 2007. For the twelve months ended December 31, 2004 and 2003, MCV recorded in “Fuel costs” losses of \$19.2 million and \$5.0 million, respectively, for net mark-to-market adjustments

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

associated with these contracts. In addition, as of December 31, 2004 and 2003, MCV recorded “Derivative assets” in Current Assets in the amount of \$31.4 million and \$56.9 million, respectively, and for the same periods recorded “Derivative assets non-current” in Other Assets in the amount of \$24.3 million and \$18.1 million, respectively, representing the mark-to-market value on these long-term natural gas contracts.

Natural Gas Supply Futures and Options

To manage market risks associated with the volatility of natural gas prices, MCV maintains a gas hedging program. MCV enters into natural gas futures contracts, option contracts, and over the counter swap transactions (“OTC swaps”) in order to hedge against unfavorable changes in the market price of natural gas in future months when gas is expected to be needed. These financial instruments are being utilized principally to secure anticipated natural gas requirements necessary for projected electric and steam sales, and to lock in sales prices of natural gas previously obtained in order to optimize MCV’s existing gas supply, storage and transportation arrangements.

These financial instruments are derivatives under SFAS No. 133 and the contracts that are utilized to secure the anticipated natural gas requirements necessary for projected electric and steam sales qualify as cash flow hedges under SFAS No. 133, since they hedge the price risk associated with the cost of natural gas. MCV also engages in cost mitigation activities to offset the fixed charges MCV incurs in operating the Facility. These cost mitigation activities include the use of futures and options contracts to purchase and/or sell natural gas to maximize the use of the transportation and storage contracts when it is determined that they will not be needed for Facility operation. Although these cost mitigation activities do serve to offset the fixed monthly charges, these cost mitigation activities are not considered a normal course of business for MCV and do not qualify as hedges under SFAS No. 133. Therefore, the resulting mark-to-market gains and losses from cost mitigation activities are flowed through MCV’s earnings.

Cash is deposited with the broker in a margin account at the time futures or options contracts are initiated. The change in market value of these contracts requires adjustment of the margin account balances. The margin account balance as of December 31, 2004 and 2003 was recorded as a current asset in “Broker margin accounts and prepaid expenses,” in the amount of \$1.4 million and \$4.1 million, respectively.

For the twelve months ended December 31, 2004, MCV has recognized in other comprehensive income, an unrealized \$34.5 million increase on the futures contracts and OTC swaps, which are hedges of forecasted purchases for plant use of market priced gas. This resulted in a net \$65.8 million gain in other comprehensive income as of December 31, 2004. This balance represents natural gas futures, options and OTC swaps with maturities ranging from January 2005 to December 2009, of which \$33.4 million of this gain is expected to be reclassified into earnings within the next twelve months. MCV also has recorded, as of December 31, 2004, a \$63.6 million current derivative asset in “Derivative assets,” representing the mark-to-market gain on natural gas futures for anticipated projected electric and steam sales accounted for as hedges. In addition, for the twelve months ended December 31, 2004, MCV has recorded a net \$36.5 million gain in earnings from hedging activities related to MCV natural gas requirements for Facility operations and a net \$1.8 million gain in earnings from cost mitigation activities.

For the twelve months ended December 31, 2003, MCV recognized an unrealized \$5.0 million increase in other comprehensive income on the futures contracts, which are hedges of forecasted purchases for plant use of market priced gas, which resulted in a \$31.3 million gain balance in other comprehensive income as of December 31, 2003. As of December 31, 2003, MCV had recorded a \$29.9 million current derivative asset in “Derivative assets.” For the twelve months ended December 31, 2003, MCV had recorded a net \$35.0 million gain in earnings from hedging activities related to MCV natural gas requirements for Facility operations and a net \$1.0 million gain in earnings from cost mitigation activities.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

New Accounting Standard

In 2003, the Emerging Issues Task Force (“EITF”) issued EITF 03-1 “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments”. EITF 03-1 addresses how to determine the meaning of other-than-temporary impairment of certain debt and equity securities, the measurement of an impairment loss and accounting and disclosure considerations subsequent to the recognition of an other-than-temporary impairment. The various sections of EITF 03-1 became effective at various times during 2004. MCV has adopted this guidance and does not expect the application to materially affect its financial position or results of operations, since MCV’s investments approximate fair value due to the short maturity of its permitted investments.

(3) Restricted Investment Securities Held-to-Maturity

Non-current restricted investment securities held-to-maturity have carrying amounts that approximate fair value because of the short maturity of these instruments and consist of the following at December 31 (in thousands):

	<u>2004</u>	<u>2003</u>
Funds restricted for rental payments pursuant to the Overall Lease		
Transaction	\$138,150	\$137,296
Funds restricted for management non-qualified plans	<u>1,260</u>	<u>2,459</u>
Total	<u>\$139,410</u>	<u>\$139,755</u>

(4) Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following at December 31 (in thousands):

	<u>2004</u>	<u>2003</u>
Accounts payable		
Related parties	\$12,772	\$ 7,386
Trade creditors	53,476	34,786
Property and single business taxes	11,833	12,548
Other	<u>4,612</u>	<u>2,648</u>
Total	<u>\$82,693</u>	<u>\$57,368</u>

(5) Gas Supplier Funds on Deposit

Pursuant to individual gas contract terms with counterparties, deposit amounts or letters of credit may be required by one party to the other based upon the net amount of exposure. The net amount of exposure will vary with changes in market prices, credit provisions and various other factors. Collateral paid or received will be posted by one party to the other based on the net amount of the exposure. Interest is earned on funds on deposit. As of December 31, 2004, MCV is supplying credit support to two gas suppliers; one in the form of a letter of credit in the amount of \$2.4 million; and cash on deposit with the other in the amount of \$7.3 million. As of December 31, 2004, MCV is holding \$19.6 million of cash on deposit from two of MCV’s brokers. In addition as of December 31, 2004, MCV is also holding letters of credit totaling \$208.6 million from two gas suppliers, of which \$184.0 million is a letter of credit from El Paso Corporation (“El Paso”), a related party.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(6) Long-Term Debt

Long-term debt consists of the following at December 31 (in thousands):

	<u>2004</u>	<u>2003</u>
Financing obligation, maturing through 2015, payable in semi-annual installments of principal and interest, collateralized by property, plant and equipment	\$1,018,645	\$1,153,221
Less current portion	<u>(76,548)</u>	<u>(134,576)</u>
Total long-term debt	<u>\$ 942,097</u>	<u>\$1,018,645</u>

Financing Obligation

In June 1990, MCV obtained permanent financing for the Facility by entering into sale and leaseback agreements (“Overall Lease Transaction”) with a lessor group, related to substantially all of MCV’s fixed assets. Proceeds of the financing were used to retire borrowings outstanding under existing loan commitments, make a capital distribution to the Partners and retire a portion of notes issued by MCV to MEC Development Corporation (“MDC”) in connection with the transfer of certain assets by MDC to MCV. In accordance with SFAS No. 98, “Accounting For Leases,” the sale and leaseback transaction has been accounted for as a financing arrangement.

The financing obligation utilizes the effective interest rate method, which is based on the minimum lease payments required through the end of the basic lease term of 2015 and management’s estimate of additional anticipated obligations after the end of the basic lease term. The effective interest rate during the remainder of the basic lease term is approximately 9.4%.

Under the terms of the Overall Lease Transaction, MCV sold undivided interests in all of the fixed assets of the Facility for approximately \$2.3 billion, to five separate owner trusts (“Owner Trusts”) established for the benefit of certain institutional investors (“Owner Participants”). U.S. Bank National Association (formerly known as State Street Bank and Trust Company) serves as owner trustee (“Owner Trustee”) under each of the Owner Trusts, and leases undivided interests in the Facility on behalf of the Owner Trusts to MCV for an initial term of 25 years. CMS Midland Holdings Company (“CMS Holdings”), currently a wholly owned subsidiary of Consumers, acquired a 35% indirect equity interest in the Facility through its purchase of an interest in one of the Owner Trusts.

The Overall Lease Transaction requires MCV to achieve certain rent coverage ratios and other financial tests prior to a distribution to the Partners. Generally, these financial tests become more restrictive with the passage of time. Further, MCV is restricted to making permitted investments and incurring permitted indebtedness as specified in the Overall Lease Transaction. The Overall Lease Transaction also requires filing of certain periodic operating and financial reports, notification to the lessors of events constituting a material adverse change, significant litigation or governmental investigation, and change in status as a qualifying facility under FERC proceedings or court decisions, among others. Notification and approval is required for plant modification, new business activities, and other significant changes, as defined. In addition, MCV has agreed to indemnify various parties to the sale and leaseback transaction against any expenses or environmental claims asserted, or certain federal and state taxes imposed on the Facility, as defined in the Overall Lease Transaction.

Under the terms of the Overall Lease Transaction and refinancing of the tax-exempt bonds, approximately \$25.0 million of transaction costs were a liability of MCV and have been recorded as a deferred cost. Financing costs incurred with the issuance of debt are deferred and amortized using the interest method over the remaining portion of the 25-year lease term. Deferred financing costs of approximately \$1.2 million, \$1.4 million and \$1.5 million were amortized in the years 2004, 2003 and 2002, respectively.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Interest and fees incurred related to long-term debt arrangements during 2004, 2003 and 2002 were \$103.4 million, \$111.9 million and \$118.3 million, respectively.

Interest and fees paid during 2004, 2003 and 2002 were \$108.6 million, \$115.4 million and \$122.1 million, respectively.

Minimum payments due under these long-term debt arrangements over the next five years are (in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 76,548	\$ 97,835	\$174,383
2006	63,459	92,515	155,974
2007	62,916	87,988	150,904
2008	67,753	83,163	150,916
2009	<u>70,335</u>	<u>76,755</u>	<u>147,090</u>
	<u>\$341,011</u>	<u>\$438,256</u>	<u>\$779,267</u>

Revolving Credit Agreement

MCV has also entered into a working capital line (“Working Capital Facility”), which expires August 27, 2005. Under the terms of the existing agreement, MCV can borrow up to the \$50.0 million commitment, in the form of short-term borrowings or letters of credit collateralized by MCV’s natural gas inventory and earned receivables. At any given time, borrowings and letters of credit are limited by the amount of the borrowing base, defined as 90% of earned receivables and 50% of natural gas inventory, capped at \$15 million. MCV did not utilize the Working Capital Facility during the year 2004, except for letters of credit associated with normal business practices. At December 31, 2004, MCV had \$47.6 million available under its Working Capital Facility. As of December 31, 2004, MCV’s borrowing base was capped at the maximum amount available of \$50.0 million and MCV had outstanding letters of credit in the amount of \$2.4 million. MCV believes that amounts available to it under the Working Capital Facility along with available cash reserves will be sufficient to meet any working capital shortfalls that might occur in the near term.

Intercreditor Agreement

MCV has also entered into an Intercreditor Agreement with the Owner Trustee, Working Capital Lender, U.S. Bank National Association as Collateral Agent (“Collateral Agent”) and the Senior and Subordinated Indenture Trustees. Under the terms of this agreement, MCV is required to deposit all revenues derived from the operation of the Facility with the Collateral Agent for purposes of paying operating expenses and rent. In addition, these funds are required to pay construction modification costs and to secure future rent payments. As of December 31, 2004, MCV has deposited \$138.2 million into the reserve account. The reserve account is to be maintained at not less than \$40 million nor more than \$137 million (or debt portion of next succeeding basic rent payment, whichever is greater). Excess funds in the reserve account are periodically transferred to MCV. This agreement also contains provisions governing the distribution of revenues and rents due under the Overall Lease Transaction, and establishes the priority of payment among the Owner Trusts, creditors of the Owner Trusts, creditors of MCV and the Partnership.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(7) Commitments and Other Agreements

MCV has entered into numerous commitments and other agreements related to the Facility. Principal agreements are summarized as follows:

Power Purchase Agreement

MCV and Consumers have executed the PPA for the sale to Consumers of a minimum amount of electricity, subject to the capacity requirements of Dow and any other permissible electricity purchasers. Consumers has the right to terminate and/or withhold payment under the PPA if the Facility fails to achieve certain operating levels or if MCV fails to provide adequate fuel assurances. In the event of early termination of the PPA, MCV would have a maximum liability of approximately \$270 million if the PPA were terminated in the 12th through 24th years. The term of this agreement is 35 years from the commercial operation date and year-to-year thereafter.

Steam and Electric Power Agreement

MCV and Dow executed the SEPA for the sale to Dow of certain minimum amounts of steam and electricity for Dow's facilities.

If the SEPA is terminated, and Consumers does not fulfill MCV's commitments as provided in the Backup Steam and Electric Power Agreement, MCV will be required to pay Dow a termination fee, calculated at that time, ranging from a minimum of \$60 million to a maximum of \$85 million. This agreement provides for the sale to Dow of steam and electricity produced by the Facility for terms of 25 years and 15 years, respectively, commencing on the commercial operation date and year-to-year thereafter.

Steam Purchase Agreement

MCV and DCC executed the SPA for the sale to DCC of certain minimum amounts of steam for use at the DCC Midland site. Steam sales under the SPA commenced in July 1996. Termination of this agreement, prior to expiration, requires the terminating party to pay to the other party a percentage of future revenues, which would have been realized had the initial term of 15 years been fulfilled. The percentage of future revenues payable is 50% if termination occurs prior to the fifth anniversary of the commercial operation date and 33 $\frac{1}{3}$ % if termination occurs after the fifth anniversary of this agreement. The term of this agreement is 15 years from the commercial operation date of steam deliveries under the contract and year-to-year thereafter.

Gas Supply Agreements

MCV has entered into gas purchase agreements with various producers for the supply of natural gas. The current contracted volume totals 238,531 MMBtu per day annual average for 2005. As of January 1, 2005, gas contracts with U.S. suppliers provide for the purchase of 173,336 MMBtu per day while gas contracts with Canadian suppliers provide for the purchase of 65,195 MMBtu per day. Some of these contracts require MCV to pay for a minimum amount of natural gas per year, whether or not taken. The estimated minimum commitments under these contracts based on current long term prices for gas for the years 2005 through 2009 are \$384.6 million, \$402.1 million, \$436.7 million, \$358.8 million and \$324.0 million, respectively. A portion of these payments may be utilized in future years to offset the cost of quantities of natural gas taken above the minimum amounts.

Gas Transportation Agreements

MCV has entered into firm natural gas transportation agreements with various pipeline companies. These agreements require MCV to pay certain reservation charges in order to reserve the transportation capacity.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

MCV incurred reservation charges in 2004, 2003 and 2002, of \$35.5 million, \$34.8 million and \$35.1 million, respectively. The estimated minimum reservation charges required under these agreements for each of the years 2005 through 2009 are \$34.3 million, \$30.0 million, \$21.6 million, \$21.6 million and \$21.6 million, respectively. These projections are based on current commitments.

Gas Turbine Service Agreements

Under a Service Agreement, as amended, with Alstom, which commenced on January 1, 1990 and was set to expire upon the earlier of the completion of the sixth series of major GTG inspections or December 31, 2009, Alstom sold MCV an initial inventory of spare parts for the GTGs and provided qualified service personnel and supporting staff to assist MCV, to perform scheduled inspections on the GTGs, and to repair the GTGs at MCV's request. The Service Agreement was terminated for cause by MCV in February 2004. Alstom disputed MCV's right to terminate for cause. The parties settled the dispute and the agreement terminated in February 2004. MCV has a maintenance service and parts agreement with General Electric International, Inc. ("GEII"), which commenced July 1, 2004 ("GEII Agreement"). GEII will provide maintenance services and hot gas path parts for MCV's twelve GTGs, including providing an initial inventory of spare parts for the GTGs and providing qualified service personnel and supporting staff to assist MCV, to perform scheduled inspections on the GTGs, and to repair the GTGs at MCV's request. Under terms and conditions similar to the MCV/Alstom Service Agreement, as described above the GEII Agreement will cover four rounds of major GTG inspections, which are expected to be completed by the year 2015, at a savings to MCV as compared to the Service Agreement with Alstom. MCV is to make monthly payments over the life of the contract totaling approximately \$207 million (subject to escalations based on defined indices). The GEII Agreement can be terminated by either party for cause or convenience. Should termination for convenience occur, a buy out amount will be paid by the terminating party with payments ranging from approximately \$19.0 million to \$.9 million, based upon the number of operating hours utilized since commencement of the GEII Agreement.

Steam Turbine Service Agreement

MCV entered into a nine year Steam Turbine Maintenance Agreement with General Electric Company effective January 1, 1995, which is designed to improve unit reliability, increase availability and minimize unanticipated maintenance costs. In addition, this contract includes performance incentives and penalties, which are based on the length of each scheduled outage and the number of forced outages during a calendar year. Effective February 1, 2004, MCV and GE amended this contract to extend its term through August 31, 2007. MCV will continue making monthly payments over the life of the contract, which will total \$22.3 million (subject to escalation based on defined indices). The parties have certain termination rights without incurring penalties or damages for such termination. Upon termination, MCV is only liable for payment of services rendered or parts provided prior to termination.

Site Lease

In December 1987, MCV leased the land on which the Facility is located from Consumers ("Site Lease"). MCV and Consumers amended and restated the Site Lease to reflect the creation of five separate undivided interests in the Site Lease as of June 1, 1990. Pursuant to the Overall Lease Transaction, MCV assigned these undivided interests in the Site Lease to the Owner Trustees, which in turn subleased the undivided interests back to MCV under five separate site subleases.

The Site Lease is for a term which commenced on December 29, 1987, and ends on December 31, 2035, including two renewal options of five years each. The rental under the Site Lease is \$.6 million per annum, including the two five-year renewal terms.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(8) Contingencies

Property Taxes

In 1997, MCV filed a property tax appeal against the City of Midland at the Michigan Tax Tribunal contesting MCV's 1997 property taxes. Subsequently, MCV filed appeals contesting its property taxes for tax years 1998 through 2004 at the Michigan Tax Tribunal. A trial was held for tax years 1997-2000. The appeals for tax years 2001-2004 are being held in abeyance. On January 23, 2004, the Michigan Tax Tribunal issued its decision in MCV's tax appeal against the City of Midland for tax years 1997 through 2000 and has issued several orders correcting errors in the initial decision (together the "MTT Decision"). MCV management has estimated that the MTT Decision will result in a refund to MCV for the tax years 1997 through 2000 of at least approximately \$35.3 million in taxes plus \$9.6 million of interest as of December 31, 2004. The MTT Decision has been appealed to the Michigan Appellate Court by the City of Midland. MCV has filed a cross-appeal at the Michigan Appellate Court. MCV management cannot predict the outcome of these legal proceedings. MCV has not recognized any of the above stated refunds (net of approximately \$16.1 million of deferred expenses) in earnings at this time.

NOx Allowances

The United States Environmental Protection Agency ("US EPA") has approved the State of Michigan's — State Implementation Plan ("SIP"), which includes an interstate NOx budget and allowance trading program administered by the US EPA beginning in 2004. Each NOx allowance permits a source to emit one ton of NOx during the seasonal control period, which for 2004 was from May 31 through September 30. NOx allowances may be bought or sold and unused allowances may be "banked" for future use, with certain limitations. MCV estimates that it will have excess NOx allowances to sell under this program. Consumers has given notice to MCV that it believes the ownership of the NOx allowances under this program belong, at least in part, to Consumers. MCV has initiated the dispute resolution process pursuant to the PPA to resolve this issue and the parties have entered into a standstill agreement deferring the resolution of this dispute. However, either party may terminate the standstill agreement at any time and reinstate the PPA's dispute resolution provisions. MCV management cannot predict the outcome of this issue. As of December 31, 2004, MCV has sold 1,200 tons of 2004 allowances for \$2.7 million, which is recorded in "Accounts payable and accrued liabilities", pending resolution of ownership of these credits.

Environmental Issues

On July 12, 2004 the Michigan Department of Environmental Quality ("DEQ"), Air Quality Division, issued MCV a "Letter of Violation" asserting that MCV violated its Air Use Permit to Install No. 209-02 ("PTI") by exceeding the carbon monoxide emission limit on the Unit 14 GTG duct burner and failing to maintain certain records in the required format. On July 13, 2004 the DEQ, Water Division, issued MCV a "Notice Letter" asserting MCV violated its National Pollutant Discharge Elimination System Permit by discharging heated process waste water into the storm water system, failure to document inspections, and other minor infractions ("alleged NPDES violations").

MCV has declared all duct burners as unavailable for operational use (which reduces the generation capability of the Facility by approximately 100 MW) and is assessing the duct burner issue and has begun other corrective action to address the DEQ's assertions. MCV disagrees with certain of the DEQ's assertions. MCV filed responses to these DEQ letters in July and August 2004. On December 13, 2004, the DEQ informed MCV that it was pursuing an escalated enforcement action against MCV regarding the alleged violations of MCV's PTI. The DEQ also stated that the alleged violations are deemed federally significant and, as such, placed MCV on the United States Environmental Protection Agency's High Priority Violators List ("HPVL"). The DEQ and MCV are pursuing voluntary settlement of this matter, which will satisfy state and federal requirements and remove MCV from the HPVL. Any such settlement is likely to involve a fine,

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

but the DEQ has not, at this time, stated what, if any, fine they will seek to impose. At this time, MCV management cannot predict the financial impact or outcome of these issues, however, MCV believes it has resolved all issues associated with the alleged NPDES violations and does not expect any further MDEQ actions on this NPDES matter.

(9) Voluntary Severance Program

In July 2004, MCV announced a Voluntary Severance Program (“VSP”) for all employees (union and non-union employees), subject to certain eligibility requirements. The VSP entitled participating employees, upon termination, to a lump sum payment, based upon number of years of service up to a maximum of 52 weeks of wages. Nineteen employees elected to participate in the VSP and MCV has recorded \$1.7 million of severance costs in “Operating Expenses” related to the nineteen employees.

(10) Retirement Benefits

Postretirement Health Care Plans

In 1992, MCV established defined cost postretirement health care plans (“Plans”) that cover all full-time employees, excluding key management. The Plans provide health care credits, which can be utilized to purchase medical plan coverage and pay qualified health care expenses. Participants become eligible for the benefits if they retire on or after the attainment of age 65 or upon a qualified disability retirement, or if they have 10 or more years of service and retire at age 55 or older. The Plans granted retroactive benefits for all employees hired prior to January 1, 1992. This prior service cost has been amortized to expense over a five-year period. MCV annually funds the current year service and interest cost as well as amortization of prior service cost to both qualified and non-qualified trusts. The MCV accounts for retiree medical benefits in accordance with SFAS 106, “Employers Accounting for Postretirement Benefits Other Than Pensions.” This standard required the full accrual of such costs during the years that the employee renders service to the MCV until the date of full eligibility. The accumulated benefit obligation of the Plans were \$4.9 million at December 31, 2004 and \$3.3 million at December 31, 2003. The measurement date of these Plans was December 31, 2004.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the “Act”) was signed into law in December 2003. The Act expanded Medicare to include, for the first time, coverage for prescription drugs. At December 31, 2003, based upon FASB staff position, SFAS No. 106-1, “Employers Accounting for Postretirement Benefits Other Than Pensions,” MCV had elected to defer financial recognition of this legislation until issuance of final accounting guidance. The final SFAS No. 106-2 was issued in second quarter 2004 and supersedes SFAS No. 106-1, which MCV adopted during this same period. The adoption of this standard had no impact to MCV’s financial position because MCV does not consider its Plans to be actuarially equivalent. The Plans benefits provided to eligible participants are not annual or on-going in nature, but are a readily exhaustible, lump-sum amount available for use at the discretion of the participant.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table reconciles the change in the Plans' benefit obligation and change in Plan assets as reflected on the balance sheet as of December 31 (in thousands):

	<u>2004</u>	<u>2003</u>
<u>Change in benefit obligation:</u>		
Benefit obligation at beginning of year	\$ 3,276.0	\$2,741.9
Service cost	232.1	212.5
Interest cost	174.8	178.2
Actuarial gain (loss)	1,298.0	147.4
Benefits paid during year	<u>(8.3)</u>	<u>(4.0)</u>
Benefit obligation at end of year	<u>4,972.6</u>	<u>3,276.0</u>
<u>Change in Plan assets:</u>		
Fair value of Plan assets at beginning of year	2,826.8	2,045.8
Actual return on Plan assets	292.7	527.5
Employer contribution	206.5	257.5
Benefits paid during year	<u>(8.3)</u>	<u>(4.0)</u>
Fair value of Plan assets at end of year	<u>3,317.7</u>	<u>2,826.8</u>
Unfunded (funded) status	1,654.9	449.2
Unrecognized prior service cost	(155.9)	(170.3)
Unrecognized net gain (loss)	<u>(1,499.0)</u>	<u>(278.9)</u>
Accrued benefit cost	<u>\$ —</u>	<u>\$ —</u>

Net periodic postretirement health care cost for years ending December 31, included the following components (in thousands):

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<u>Components of net periodic benefit cost:</u>			
Service cost	\$ 232.1	\$ 212.5	\$ 197.3
Interest cost	174.8	178.2	188.7
Expected return on Plan assets	(216.1)	(163.7)	(167.0)
Amortization of unrecognized net (gain) or loss	<u>15.7</u>	<u>30.5</u>	<u>14.3</u>
Net periodic benefit cost	<u>\$ 206.5</u>	<u>\$ 257.5</u>	<u>\$ 233.3</u>

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects (in thousands):

	<u>1-Percentage- Point Increase</u>	<u>1-Percentage Point Decrease</u>
Effect on total of service and interest cost components	\$ 51.6	\$ 44.7
Effect on postretirement benefit obligation	\$514.8	\$447.1

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Assumptions used in accounting for the Post-Retirement Health Care Plan were as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Discount rate	5.75%	6.00%	6.75%
Long-term rate of return on Plan assets	8.00%	8.00%	8.00%
Inflation benefit amount			
1998 through 2004	0.00%	0.00%	0.00%
2005 and later years	5.00%	4.00%	4.00%

The long-term rate of return on Plan assets is established based on MCV's expectations of asset returns for the investment mix in its Plan (with some reliance on historical asset returns for the Plans). The expected returns for various asset categories are blended to derive one long-term assumption.

Plan Assets. Citizens Bank has been appointed as trustee ("Trustee") of the Plan. The Trustee serves as investment consultant, with the responsibility of providing financial information and general guidance to the MCV Benefits Committee. The Trustee shall invest the assets of the Plan in the separate investment options in accordance with instructions communicated to the Trustee from time to time by the MCV Benefit Committee. The MCV Benefits Committee has the fiduciary and investment selection responsibility for the Plan. The MCV Benefits Committee consists of MCV Officers (excluding the President and Chief Executive Officer).

The MCV has a target allocation of 80% equities and 20% debt instruments. These investments emphasis total growth return, with a moderate risk level. The MCV Benefits Committee reviews the performance of the Plan investments quarterly, based on a long-term investment horizon and applicable benchmarks, with rebalancing of the investment portfolio, at the discretion of the MCV Benefits Committee.

MCV's Plan's weighted-average asset allocations, by asset category are as follows as of December 31:

	<u>2004</u>	<u>2003</u>
Asset Category:		
Cash and cash equivalents	1%	11%
Fixed income	19%	17%
Equity securities	<u>80%</u>	<u>72%</u>
Total	<u>100%</u>	<u>100%</u>

Contributions. MCV expects to contribute approximately \$.4 million to the Plan in 2005.

Retirement and Savings Plans

MCV sponsors a defined contribution retirement plan covering all employees. Under the terms of the plan, MCV makes contributions to the plan of either five or ten percent of an employee's eligible annual compensation dependent upon the employee's age. MCV also sponsors a 401(k) savings plan for employees. Contributions and costs for this plan are based on matching an employee's savings up to a maximum level. In 2004, 2003 and 2002, MCV contributed \$1.4 million, \$1.3 million and \$1.2 million, respectively under these plans.

Supplemental Retirement Benefits

MCV provides supplemental retirement, postretirement health care and excess benefit plans for key management. These plans are not qualified plans under the Internal Revenue Code; therefore, earnings of the trusts maintained by MCV to fund these plans are taxable to the Partners and trust assets are included in the assets of MCV.

(11) Partners' Equity and Related Party Transactions

The following table summarizes the nature and amount of each of MCV's Partner's equity interest, interest in profits and losses of MCV at December 31, 2004, and the nature and amount of related party

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

transactions or agreements that existed with the Partners or affiliates as of December 31, 2004, 2003 and 2002, and for each of the twelve month periods ended December 31 (in thousands).

Beneficial Owner, Equity Partner, Type of Partner and Nature of Related Party	Equity Interest	Interest	Related Party Transactions and Agreements	2004	2003	2002
CMS Energy Company						
CMS Midland, Inc.	<u>\$396,888</u>	<u>49.0%</u>	Power purchase agreements	\$601,535	\$513,774	\$557,149
General Partner; wholly-owned subsidiary of Consumers Energy Company			Purchases under gas transportation agreements	9,349	14,294	23,552
			Purchases under spot gas agreements	—	663	3,631
			Purchases under gas supply agreements	—	2,330	11,306
			Gas storage agreement	2,563	2,563	2,563
			Land lease/easement agreements	600	600	600
			Accounts receivable	50,364	40,373	44,289
			Accounts payable	1,031	1,025	3,502
			Sales under spot gas agreements	—	3,260	1,084
El Paso Corporation	\$141,397	18.1%				
Source Midland Limited Partnership ("SMLP")			Purchase under gas transportation agreements	12,334	13,023	12,463
General Partner; owned by subsidiaries of El Paso Corporation			Purchases under spot gas agreement	—	610	15,655
			Purchases under gas supply agreement	70,000	54,308	47,136
			Gas agency agreement	264	238	365
			Deferred reservation charges under gas purchase agreement	3,152	4,728	—
			Accounts receivable	—	—	523
			Accounts payable	10,997	5,751	7,706
			Sales under spot gas agreements	—	3,474	14,007
El Paso Midland, Inc. ("El Paso Midland") . .	84,838	10.9	See related party activity listed under SMLP.			
General Partner; wholly-owned subsidiary of El Paso Corporation						
MEI Limited Partnership ("MEI")			See related party activity listed under SMLP.			
A General and Limited Partner; 50% interest owned by El Paso Midland, Inc. and 50% interest owned by SMLP						
General Partnership Interest	70,701	9.1				
Limited Partnership Interest	7,068	.9				
Micogen Limited Partnership ("MLP")	35,348	4.5	See related party activity listed under SMLP.			
Limited Partner, owned subsidiaries of El Paso Corporation						
Total El Paso Corporation	<u>\$339,352</u>	<u>43.5%</u>				
The Dow Chemical Company						
The Dow Chemical Company	<u>\$ 73,735</u>	<u>7.5%</u>	Steam and electric power agreement	39,055	36,207	29,385
Limited Partner			Steam purchase agreement — Dow Corning Corp (affiliate)	4,289	4,017	3,746
			Purchases under demineralized water supply agreement	8,142	6,396	6,605
			Accounts receivable	4,003	3,431	3,635
			Accounts payable	744	610	1,016
			Standby and backup fees	766	731	734
			Sales of gas under tolling agreement	—	—	6,442
Alanna Corporation						
Alanna Corporation	<u>\$ 1⁽¹⁾</u>	<u>.00001%</u>	Note receivable	1	1	1
Limited Partner; wholly-owned subsidiary of Alanna Holdings Corporation						

Footnotes to Partners' Equity and Related Party Transactions

(1) Alanna's capital stock is pledged to secure MCV's obligation under the lease and other overall lease transaction documents.

MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(12) SUBSEQUENT EVENT (Unaudited)

SFAS No. 144 “Accounting for the Impairment or Disposal of Long-Lived Assets” requires that MCV review, on a forward-looking basis, the recoverability of its long-lived assets (such as property, plant and equipment) whenever events or circumstances indicate that the carrying amount of the long-lived assets may not be recoverable. Recoverability of “assets to be held and used” is measured by a comparison of the carrying amount of the assets to the estimated undiscounted future cash flows expected to be generated by the assets, over their remaining useful life. If the carrying amount of the assets exceeds the estimated undiscounted future cash flows expected to be generated, an impairment charge is recognized in the amount by which the carrying amount of the long-lived assets exceed their fair value.

The single largest cost to MCV of producing electricity is the cost of natural gas. Natural gas prices have increased substantially in recent months. As a result, MCV has continuously monitored trends in and forecasts of natural gas prices and their estimated effect on the economics of operating the Facility. In April 2005, MCV performed its usual semi-annual economic analysis using then current market prices and apparent trends in and forecasts of natural gas prices; the results of this update of its economic analysis did not indicate an impairment of MCV’s long-lived assets.

Since the April 2005 economic analysis was performed, natural gas prices continued to rise dramatically as a result of events and circumstances, which created tight supply and higher market demand for natural gas. For example, hurricane disruptions in the supply of gas in the third quarter of 2005 drastically reduced Gulf Coast natural gas production and distribution, causing a further upward spike in NYMEX forward natural gas prices, as well as third-parties’ forecasts for natural gas prices. As a result, MCV determined that updating its impairment analysis in the third quarter of 2005, considering revised forward natural gas price assumptions and third parties’ forecasts of natural gas prices, among other circumstances was appropriate to evaluate the recoverability of the asset group. The asset group under SFAS No. 144 represents all assets and liabilities that impact the lowest level of identifiable cash flows to be generated to recover MCV’s long-lived assets. For MCV, the asset group included net property, plant and equipment and the fair value of derivative assets, both of which impact management’s estimate of the net cash flows to be generated by MCV to recover these long-lived assets. Based on MCV’s updated impairment analysis, MCV concluded that the carrying value of MCV’s assets group exceeded cash flows that would be generated by the Facility on an undiscounted basis and therefore, under SFAS No. 144, an impairment adjustment was required to reduce the carrying value to the estimated fair value. The fair value of the asset group was determined by discounting a set of probability-weighted streams of future cash flows at a 4.3% risk free interest rate. This impairment adjustment was recorded in the third quarter of 2005 for \$1,159.0 million. MCV will continue to monitor the current and long-term trends in natural gas prices and other factors, as appropriate. Should natural gas prices remain at present levels or increase, the results of operating the Facility would be adversely affected and could result in MCV failing to meet its financial obligations under the sale and leaseback transactions and other contracts.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Partners of Javelina Company:

In our opinion, the accompanying balance sheets and the related statements of operations, partners' capital and cash flows present fairly, in all material respects, the financial position of Javelina Company (the Partnership) at December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

April 15, 2005
Houston, Texas

JAVELINA COMPANY
BALANCE SHEETS

	December 31,	
	2004	2003
	(In Thousands of Dollars)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 20,435	\$ 8,038
Accounts receivable, net		
Trade	30,778	10,613
Affiliates	3,281	6,770
Product inventory	941	—
Materials and supplies inventory	1,959	1,885
Prepaid expense	15	15
Total current assets	57,409	27,321
Property, plant and equipment, at cost		
Land	4,203	4,203
Liquids extraction plant	199,425	198,316
Accumulated depreciation	(125,347)	(116,655)
Total property, plant and equipment, net	78,281	85,864
Total assets	\$ 135,690	\$ 113,185
LIABILITIES AND PARTNERS' CAPITAL		
Current liabilities		
Accounts payable		
Trade	\$ 12,681	\$ 7,663
Affiliates	12,563	9,470
Ad valorem taxes payable	1,445	1,491
Accrued expenses	1,257	1,182
Total current liabilities	27,946	19,806
Commitments and contingencies		
Partners' capital	107,744	93,379
Total liabilities and partners' capital	\$ 135,690	\$ 113,185

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

JAVELINA COMPANY
STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	2004	2003	2002
	<i>(In Thousands of Dollars)</i>		
Operating revenue			
Product revenue	\$284,049	\$181,318	\$135,720
Other revenue			
Interest income and other	<u>142</u>	<u>105</u>	<u>331</u>
	284,191	181,423	136,051
Operating Expenses			
Cost of product	171,913	137,726	86,675
Plant operating expenses	66,792	47,239	38,039
General and administrative	484	327	429
Depreciation	8,692	8,268	8,360
Ad valorem taxes	1,445	1,491	1,511
Bad debt expense	<u>—</u>	<u>—</u>	<u>197</u>
	<u>249,326</u>	<u>195,051</u>	<u>135,211</u>
Net income (loss)	<u>\$ 34,865</u>	<u>\$ (13,628)</u>	<u>\$ 840</u>

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

JAVELINA COMPANY
STATEMENTS OF PARTNERS' CAPITAL
Years Ended December 31, 2004, 2003 and 2002

	El Paso Javelina, L.P. (40%)	El Paso Field Operations Company (40%)	K-M Javelina, L.P. (40%)	Valero Javelina, L.P. (20%)	Total	Accumulated Other Comprehensive Income
			<i>(In Thousands of Dollars)</i>			
Balances at January 1, 2002	\$ 44,747	\$ —	\$44,747	\$22,375	\$111,869	\$ 702
Net income	336	—	336	168	840	—
Distributions	(2,000)	—	(2,000)	(1,000)	(5,000)	—
Other comprehensive income — realized gain on cash flow hedges	<u>(281)</u>	<u>—</u>	<u>(281)</u>	<u>(140)</u>	<u>(702)</u>	<u>(702)</u>
Balances at December 31, 2002	42,802	—	42,802	21,403	107,007	—
Net loss	(9,876)	4,425	(5,451)	(2,726)	(13,628)	—
Sale of interests from El Paso Javelina, L.P. to El Paso Field Operations Company	<u>(32,926)</u>	<u>32,926</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Balances at December 31, 2003	—	37,351	37,351	18,677	93,379	—
Net income	—	13,946	13,946	6,973	34,865	—
Distributions	<u>—</u>	<u>(8,200)</u>	<u>(8,200)</u>	<u>(4,100)</u>	<u>(20,500)</u>	<u>—</u>
Balances at December 31, 2004	<u>\$ —</u>	<u>\$43,097</u>	<u>\$43,097</u>	<u>\$21,550</u>	<u>\$107,744</u>	<u>\$ —</u>

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

JAVELINA COMPANY
STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2004	2003	2002
	<i>(In Thousands of Dollars)</i>		
Cash flows from operating activities			
Net income (loss)	\$ 34,865	\$ (13,628)	\$ 840
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities			
Depreciation	8,692	8,268	8,360
Gain from sales of property, plant and equipment	—	—	(2)
Market value adjustment for derivative instruments	—	—	(539)
Changes in operating assets and liabilities			
Accounts receivable	(16,676)	(2,105)	(3,148)
Product inventory	(941)	—	3,112
Materials and supplies inventory	(74)	10	38
Accounts payable	8,111	3,802	(2,466)
Ad valorem taxes payable	(46)	(20)	1,511
Accrued expenses	75	(678)	184
Net cash provided by (used in) operating activities	<u>34,006</u>	<u>(4,351)</u>	<u>7,890</u>
Cash flows from investing activities			
Purchases of property, plant and equipment	(1,109)	(1,911)	(616)
Proceeds from sale of property, plant and equipment	<u>—</u>	<u>—</u>	<u>2</u>
Net cash used in investing activities	<u>(1,109)</u>	<u>(1,911)</u>	<u>(614)</u>
Cash flows from financing activities			
Distributions to partners	(20,500)	—	(5,000)
Net cash used in financing activities	<u>(20,500)</u>	<u>—</u>	<u>(5,000)</u>
Change in cash and cash equivalents	12,397	(6,262)	2,276
Cash and cash equivalents at beginning of year	<u>8,038</u>	<u>14,300</u>	<u>12,024</u>
Cash and cash equivalents at end of year	<u>\$ 20,435</u>	<u>\$ 8,038</u>	<u>\$14,300</u>

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

JAVELINA COMPANY
NOTES TO FINANCIAL STATEMENTS

1. Organization and Nature of Business

Javelina Company (the Partnership) was organized on November 4, 1988 as a Texas general partnership under a Partnership Agreement with a minimum term of 25 years for the purposes of acquiring, planning, designing, engineering, constructing, owning and operating a refinery off-gas processing plant located in the Corpus Christi, Texas area. The Partnership is owned 40 percent by El Paso Field Operations Company (El Paso Field, a wholly owned indirect subsidiary of El Paso Corporation); 40 percent by K-M Javelina, L.P. (Kerr-McGee, a wholly owned subsidiary of Kerr-McGee Corporation); and 20 percent by Valero Javelina, L.P. (Valero, a wholly owned subsidiary of Valero Energy Corporation). El Paso Javelina, L.P. (a wholly owned indirect subsidiary of El Paso Corporation) sold its 40 percent interest in the Partnership to El Paso Field in August 2003.

2. Significant Accounting Policies

Basis of Presentation

The Partnership's financial statements are prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosures in these financial statements. Actual results can, and often do, differ from the estimates and assumptions used.

Cash and Cash Equivalents

Short-term investments with little risk of changes in value because of changes in interest rates and purchased with original maturity of less than three months are considered to be cash equivalents.

Accounts Receivable

Allowances for doubtful accounts are established using the specific identification method. Accounts receivable — trade are reported in the balance sheets net of allowance for doubtful accounts of \$292,500 as of December 31, 2004 and 2003. Accounts receivable — trade includes \$24,486,000 and \$10,064,000 of unbilled receivables as of December 31, 2004 and 2003, all of which were billed after year end. Accounts receivable — affiliates includes \$3,281,000 and \$6,770,000 of unbilled receivables as of December 31, 2004 and 2003, all of which were billed after year end.

Gas Imbalances

Gas imbalances result from over or under delivery of gas under various processing and sales agreements. Gas imbalances are settled in the following month with delivery or receipt of makeup gas or by cash in accordance with contractual terms. Gas imbalances are valued at the Partnership's current month average purchase cost of gas and may be impacted by changes in natural gas prices. As of December 31, 2003, accounts receivable — trade included \$494,000 of gas imbalances receivable. As of December 31, 2004, accounts payable — trade included \$33,000 of gas imbalances payable. As of December 31, 2004 and 2003, accounts payable — affiliates included \$1,395,000 and \$452,000, respectively, of gas imbalances payable.

Inventories

The Partnership accounts for product inventory on a first-in, first-out basis and materials and supplies inventories at average cost. Both inventories are valued at the lower of average cost or market.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost and includes management fees paid on capital acquisition costs under the operating agreement (see Note 3). Expenditures that increase the capacity or operating efficiency or extend the useful life of an asset are capitalized. Depreciation is provided on a straight-line basis over lives ranging from 10 to 23 years. Assets retired, sold, or disposed are recorded by eliminating the related cost and accumulated depreciation with any resulting gain or loss reflected in income.

Impairment and Disposal of Long-lived Assets

The Partnership evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the projected undiscounted future cash flows from the use and eventual disposition of the asset is less than the asset's carrying amount, the asset is written down to its fair value and an impairment loss is recorded in the statement of operations.

Fair Value of Financial Instruments

The estimated fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate their carrying amounts due to the short-term maturity of these instruments.

Revenue Recognition

The Partnership recognizes revenue for the sale of products, excluding hydrogen, in the period of delivery. Under terms of a hydrogen sales contract, as consideration for hydrogen supplied to the customer, the customer is required to deliver natural gas containing 130% of the British Thermal Units contained in the hydrogen supplied to the customer. Such exchanges of product have been treated as non-monetary exchanges in accordance with Accounting Principles Board (APB) Opinion No. 29, *Accounting for Nonmonetary Transactions*, and accordingly, no sales or purchases of product are reflected in the statements of operations. The value of these exchanges were \$27.2 million, \$19.2 million and \$12.1 million for the years ended December 31, 2004, 2003 and 2002, respectively.

Repair and Maintenance Costs

The cost of most planned major repair and maintenance activity is accrued and charged to expense in a systematic and rational manner over the estimated period extending to the next planned major maintenance activity. Other repair and maintenance costs are charged to expense as incurred.

Federal Income Taxes

Javelina Company is organized as a partnership and is therefore, not subject to taxation for federal or state income tax purposes. The taxable income or loss resulting from the Partnership's operations will ultimately be included in the federal and state tax returns of the individual partners. Accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

Income Allocation and Distributions

Under the terms of the Partnership Agreement, all income, gains, losses, deductions, credits and distributions of excess cash are allocated to the partners based on their ownership interest in the Partnership. Distributions are determined by the Management Committee. In 2004 and 2002, the Partnership declared and paid cash distributions of \$20.5 million and \$5 million, respectively. No distribution was declared for the year ended December 31, 2003. In January and February 2005, the Partnership declared and paid cash distributions totalling \$11.3 million.

Derivative Instruments and Hedging Activities

In November 2000, as part of its risk management strategy to offset the variability of expected future cash flows as a result of changes in ethylene and natural gas commodity prices, the Partnership entered into derivative contracts expiring in December 2003 to sell ethylene and purchase natural gas. Effective January 2001, the Partnership accounted for these contracts under Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, that requires all derivative instruments be recorded on the balance sheet at their fair values. Gains and losses related to changes in fair values of derivatives that qualify, are designated, and are effective as cash flow hedges are deferred and recorded as components of other comprehensive income. Amounts in accumulated other comprehensive income are reclassified into earnings in the same period the hedged transaction affects earnings. Hedge accounting is discontinued prospectively when a derivative is terminated or no longer effective and related gains and losses are recognized immediately in current-period earnings. Amounts included in accumulated other comprehensive income at the time the derivative is terminated or no longer effective remain and are reclassified into earnings in the same period the hedged transaction affects earnings. In September 2001, the ethylene contract became ineffective as a result of credit risk with the counterparty. Under guidance provided by the Financial Accounting Standards Board's Derivatives Implementation Group in Issue G-10, hedge accounting was discontinued prospectively. In addition, no fair value was assigned to the contract and a loss equal to the value of the asset immediately prior to its ineffectiveness was recognized in earnings. In 2002, both contracts were terminated. Of the \$702,000 included in accumulated other comprehensive income as of December 31, 2001, \$163,000, related to changes in fair value, was recognized as a reduction of accumulated other comprehensive income through the date the natural gas contract was terminated, and \$539,000 was recognized in earnings in connection with the settlement of the contracts. The Partnership also recognized an additional \$275,000 in earnings in connection with the settlement of the contracts. Of these amounts recognized in earnings, \$736,000 was included in product revenue and \$78,000 was included as an offset to cost of product. There were no material gains or losses associated with hedged transactions in 2003.

3. Transactions With Affiliates

Transactions with partners are governed under the terms and conditions of the Partnership Agreement.

The Partnership has an operating agreement with El Paso Field. The agreement was transferred from El Paso Javelina, L.P. upon the sale of its 40 percent interest in the Partnership to El Paso Field. Under the agreement, El Paso Field, acting as project manager, generally pays costs and expenses incurred by the Partnership. El Paso Field is reimbursed 100 percent for all such costs and expenses and, in addition, receives a management fee equal to 15 percent of qualifying operating expenses and up to 10 percent of plant and equipment expenditures.

Under the terms of processing agreements with Valero Refining Company and Valero Refining and Marketing Company, wholly owned subsidiaries of Valero Energy Corporation, the Partnership pays processing fees equal to 25% of monthly profits derived from products extracted from refinery off gas received, if any, as defined. In addition, gas imbalance settlements are settled in the following month with delivery or receipt of makeup gas or by cash in accordance with contractual terms. Under the terms of a transportation agreement with Javelina Pipeline Company, a partnership owned by El Paso Field, Kerr McGee and Valero, Javelina Pipeline Company receives, transports and redelivers all or part of the Partnership's gas for a contractual price.

During 1989, the Partnership entered into a 25-year surface rental agreement with El Paso Merchant Energy-Petroleum Company, a wholly owned indirect subsidiary of El Paso Corporation. The remaining aggregate minimum lease payments under the long-term operating lease are \$77,880 per year for 2005 to 2008 and \$81,000 per year thereafter until the agreement ends in December 2013.

The following table summarizes transactions with affiliates related to these agreements and other sales of product or purchases of gas from affiliates as of and for the years ended December 31, 2004, 2003 and 2002.

	(In Thousands of Dollars)		
	2004	2003	2002
<i>Product revenue:</i>			
<i>El Paso Corporation</i>			
Sales to El Paso NGL Marketing Company, L.P., a wholly owned indirect subsidiary of El Paso Corporation	\$42,494	\$41,726	\$29,046
Sales to El Paso Merchant Energy — Petroleum Company . . .	—	237	6,891
<i>Valero Energy Corporation</i>			
Sales to Valero Refining Company	35,002	25,304	20,492
	<u>\$77,496</u>	<u>\$67,267</u>	<u>\$56,429</u>
<i>Cost of product:</i>			
<i>El Paso Corporation</i>			
Gas purchases from El Paso Industrial Energy, a wholly owned indirect subsidiary of El Paso Corporation	\$65,912	\$37,154	\$ 6,542
<i>Valero Energy Corporation</i>			
Gas imbalance settlements paid to Valero Refining Company	2,819	4,883	2,416
Gas imbalance settlements paid to (received from) Valero Refining and Marketing Company	8,336	(2,161)	(43)
	<u>\$77,067</u>	<u>\$39,876</u>	<u>\$ 8,915</u>
<i>Plant operating expenses:</i>			
<i>El Paso Corporation</i>			
Management fees paid to El Paso Field on qualifying expenses	\$ 1,347	\$ 1,333	\$ 1,302
Transportation fees paid to Javelina Pipeline Company	1,852	1,672	1,656
Surface rentals paid to El Paso Merchant Energy-Petroleum Company	78	75	84
<i>Valero Energy Corporation</i>			
Processing fees paid to Valero Refining Company	1,588	586	316
Processing fees paid to Valero Refining and Marketing Company	3,900	185	164
	<u>\$ 8,765</u>	<u>\$ 3,851</u>	<u>\$ 3,522</u>
<i>Accounts receivable — affiliates:</i>			
<i>El Paso Corporation</i>			
Accounts receivable due from El Paso NGL Marketing Company, L.P.	\$ —	\$ 4,308	
<i>Valero Energy Corporation</i>			
Accounts receivable due from Valero Refining Company	3,281	2,462	
	<u>\$ 3,281</u>	<u>\$ 6,770</u>	
<i>Property, plant and equipment:</i>			
Capitalized management fees paid to El Paso Field on plant and equipment expenditures	\$ 59	\$ 74	

(In Thousands of Dollars)		
	2004	2003
<i>Accounts payable — affiliates:</i>		
<i>El Paso Corporation</i>		
Accounts payable due to El Paso Industrial Energy for gas purchases	\$ 5,394	\$ 4,608
Accounts payable due to El Paso Field for reimbursable items and management fees	4,574	4,155
Accounts payable due to Javelina Pipeline Company for transportation fees	310	255
<i>Valero Energy Corporation</i>		
Accounts payable due to Valero Refining Company for gas imbalance settlements	331	361
Accounts payable due to Valero Refining and Marketing Company for gas imbalance settlements	1,064	91
Accounts payable due to Valero Refining and Marketing Company for processing fees	890	—
	<u>\$12,563</u>	<u>\$ 9,470</u>

4. Sales and Processing Agreements

The Partnership has entered into various sales agreements with terms up to three years whereby the customer has agreed to purchase certain base quantities of the Partnership's products at contractual prices based on market price indexes. In addition, one contract requires the Partnership to pay an access fee of \$90,000 per year and transportation fees to pipeline companies for delivery of product to the customer. These costs are included in plant operating expenses in the statements of operations.

The Partnership entered into processing fee agreements with certain refinery off gas suppliers. Under these agreements, the Partnership pays a processing fee equal to 25% of monthly profits derived from products extracted from off gas received, if any, as defined. In May 2003, under terms of the agreements, the Partnership notified the suppliers that it would terminate the processing agreements in six months. Since their termination, the agreements have been extended on a month to month basis pending renegotiation.

5. Commitments and Contingencies

In the normal course of business, the Partnership may become party to certain lawsuits and administrative proceedings before various courts and governmental agencies involving, for example, contractual matters and environmental issues. While the outcome of these items cannot be predicted with certainty, based on information known to date, management does not expect the ultimate resolution of any matters will have a material adverse effect on the Partnership's financial statements.

Management is not aware of any contingency that could have a material adverse effect on the Partnership's financial position, results of operations or cash flows as of December 31, 2004.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Partners and Management Committee
Great Lakes Gas Transmission Limited Partnership:

We have audited the accompanying consolidated balance sheets of Great Lakes Gas Transmission Limited Partnership and subsidiary (Partnership) as of December 31, 2004 and 2003, and the related consolidated statements of income and partners' capital, and cash flows for each of the years in the three year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Great Lakes Gas Transmission Limited Partnership and subsidiary as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2004 in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP
Detroit, Michigan
January 11, 2005

GREAT LAKES GAS TRANSMISSION LIMITED PARTNERSHIP

**CONSOLIDATED STATEMENTS OF
INCOME AND PARTNERS' CAPITAL**

	Years Ended December 31		
	2004	2003	2002
	<i>(Thousands of Dollars)</i>		
Transportation Revenues	\$ 284,327	\$ 279,208	\$ 277,515
Operating Expenses			
Operation and Maintenance	34,723	43,052	37,075
Depreciation	57,756	57,238	56,916
Income Taxes Payable by Partners	47,058	40,530	45,400
Property and Other Taxes	23,265	24,929	14,393
	162,802	165,749	153,784
Operating Income	121,525	113,459	123,731
Other Income (Expense)			
Interest on Long Term Debt	(37,718)	(40,239)	(44,539)
Other, Net	1,373	1,102	3,850
	(36,345)	(39,137)	(40,689)
Net Income	\$ 85,180	\$ 74,322	\$ 83,042
Partners' Capital			
Balance at Beginning of Year	\$ 452,007	445,512	443,640
Contributions by General Partners	29,398	22,459	25,432
Net Income	85,180	74,322	83,042
Current Income Taxes Payable by Partners Charged to Earnings	31,536	24,238	27,801
Distributions to Partners	(177,620)	(114,524)	(134,403)
Balance at End of Year	\$ 420,501	\$ 452,007	\$ 445,512

The accompanying notes are an integral part of these statements.

GREAT LAKES GAS TRANSMISSION LIMITED PARTNERSHIP
CONSOLIDATED BALANCE SHEETS

	As of December 31	
	2004	2003
	(Thousands of Dollars)	
ASSETS		
Current Assets		
Cash and Cash Equivalents	\$ 59,034	\$ 40,156
Accounts Receivable	44,137	34,747
Materials and Supplies, at Average Cost	10,043	10,020
Prepayments and Other	5,146	3,511
	118,360	88,434
Gas Utility Plant		
Property, Plant and Equipment	2,015,202	2,011,279
Less Accumulated Depreciation	919,287	870,356
	1,095,915	1,140,923
	\$1,214,275	\$1,229,357
LIABILITIES & PARTNERS' CAPITAL		
Current Liabilities		
Current Maturities of Long Term Debt	\$ 10,000	\$ 10,000
Accounts Payable	27,984	14,850
Property and Other Taxes	24,107	25,077
Accrued Interest and Other	13,580	14,025
	75,671	63,952
Long Term Debt	460,000	470,000
Other Liabilities		
Amounts Equivalent to Deferred Income Taxes	256,959	241,281
Other	1,144	2,117
	258,103	243,398
Partners' Capital	420,501	452,007
	\$1,214,275	\$1,229,357

The accompanying notes are an integral part of these statements.

GREAT LAKES GAS TRANSMISSION LIMITED PARTNERSHIP
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31		
	2004	2003	2002
	<i>(Thousands of Dollars)</i>		
Cash Flow Increase (Decrease) from:			
Operating Activities			
Net Income	\$ 85,180	\$ 74,322	\$ 83,042
Adjustments to Reconcile Net Income to Operating Cash Flows:			
Depreciation.....	57,756	57,238	56,916
Amounts Equivalent to Deferred Income Taxes	15,678	16,983	18,241
Allowance for Funds Used During Construction.....	(157)	(398)	(500)
Changes in Current Assets and Liabilities:			
Accounts Receivable.....	(9,390)	1,529	(6,250)
Accounts Payable	13,134	(1,642)	2,148
Property and Other Taxes	(970)	(1,687)	(1,131)
Other	(3,076)	(337)	678
	<u>158,155</u>	<u>146,008</u>	<u>153,144</u>
Investment in Utility Plant	(12,591)	(27,277)	(34,292)
Financing Activities			
Repayment of Long Term Debt	(10,000)	(41,500)	(47,250)
Contributions by General Partners	29,398	22,459	25,432
Current Income Taxes Payable by Partners Charged to Earnings	31,536	24,238	27,801
Distribution to Partners	(177,620)	(114,524)	(134,403)
	<u>(126,686)</u>	<u>(109,327)</u>	<u>(128,420)</u>
Change in Cash and Cash Equivalents.....	18,878	9,404	(9,568)
Cash and Cash Equivalents:			
Beginning of Year	<u>40,156</u>	<u>30,752</u>	<u>40,320</u>
End of Year	<u>\$ 59,034</u>	<u>\$ 40,156</u>	<u>\$ 30,752</u>
Supplemental Disclosure of Cash Flow Information			
Cash Paid During the Year for Interest			
(Net of Amounts Capitalized of \$48, \$150 and \$214, Respectively)	<u>\$ 37,903</u>	<u>\$ 40,576</u>	<u>\$ 45,004</u>

The accompanying notes are an integral part of these statements.

GREAT LAKES GAS TRANSMISSION LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 Organization and Management

Great Lakes Gas Transmission Limited Partnership (Partnership) is a Delaware limited partnership that owns and operates an interstate natural gas pipeline system. The Partnership transports natural gas for delivery to customers in the midwestern and northeastern United States and eastern Canada. Partnership ownership percentages are recalculated each year to reflect distributions and contributions.

The partners, their parent companies, and partnership ownership percentages are as follows:

<u>Partner (Parent Company)</u>	<u>Ownership %</u>	
	<u>2004</u>	<u>2003</u>
General Partners:		
El Paso Great Lakes, Inc. (El Paso Corporation)	46.61	46.33
TransCanada GL, Inc. (TransCanada PipeLines Ltd.)	46.61	46.33
Limited Partner:		
Great Lakes Gas Transmission Company (TransCanada PipeLines Ltd. and El Paso Corporation)	6.78	7.34

The day-to-day operation of Partnership activities is the responsibility of Great Lakes Gas Transmission Company (Company), which is reimbursed for its employee salaries, benefits and other expenses, pursuant to the Partnership's Operating Agreement with the Company.

2 Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Partnership and GLGT Aviation Company, a wholly owned subsidiary. GLGT Aviation Company owns a transport aircraft used principally for pipeline operations. Intercompany amounts have been eliminated.

For purposes of reporting cash flows, the Partnership considers all liquid investments with original maturities of three months or less to be cash equivalents.

The Partnership recognizes revenues from natural gas transportation in the period the service is provided.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect the amounts reported as assets, liabilities, revenues and expenses and the disclosures in these financial statements. Actual results can, and often do, differ from those estimates.

Regulation

The Partnership is subject to the rules, regulations and accounting procedures of the Federal Energy Regulatory Commission (FERC). The Partnership's accounting policies follow regulatory accounting principles prescribed under Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*. Regulatory assets and liabilities have been established and represent probable future revenue or expense which will be recovered from or refunded to customers.

Accounts Receivable

Accounts receivable are reported net of an allowance for doubtful accounts of \$1,200,000 and \$2,304,000 for 2004 and 2003, respectively. Accounts receivable are recorded at the invoiced amount. Late fees are recognized as income when earned. The Partnership establishes an allowance for losses on accounts receivable if it is determined that all or a portion of the outstanding balance will not be collected. The Partnership also

considers historical industry data and customer credit trends. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Gas Utility Plant and Depreciation

Gas utility plant is stated at cost and includes certain administrative and general expenses, plus an allowance for funds used during construction. The cost of plant retired is charged to accumulated depreciation. Depreciation of gas utility plant is computed using the straight-line method. The Partnership's principal operating assets are depreciated at an annual rate of 2.75%.

The allowance for funds used during construction represents the debt and equity costs of capital funds applicable to utility plant under construction, calculated in accordance with a uniform formula prescribed by the FERC. The rates used were 10.49%, 10.41% and 10.36% for years 2004, 2003, and 2002, respectively.

Asset Retirement Obligations

Effective January 1, 2003, the Partnership adopted SFAS No. 143 "Accounting for Asset Retirement Obligations" (Statement 143). Statement 143 requires recognition of the fair value of legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal operation of a long-lived asset. The Partnership has asset retirement obligations if it were to permanently retire all or part of the pipeline system; however, the fair value of the obligations cannot be determined because the end of the system life is indeterminable.

Income Taxes

The Partnership's tariff includes an allowance for income taxes, which the FERC requires the Partnership to record as if it were a corporation. The provisions for current and deferred income tax expense are recorded without regard to whether each partner can utilize its share of the Partnership's tax deductions. Income taxes are deducted in the Consolidated Statements of Income and the current portion of income taxes is returned to partners' capital. Recorded current income taxes are distributed to partners based on their ownership percentages.

Amounts equivalent to deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases at currently enacted income tax rates.

3 Affiliated Company Transactions

Affiliated company amounts included in the Partnership's consolidated financial statements, not otherwise disclosed, are as follows:

	(In Thousands)		
	2004	2003	2002
Accounts receivable	\$ 12,827	\$ 16,062	\$ 15,989
Accounts payable	1,845	1,135	622
Transportation revenues:			
TransCanada PipeLines Ltd. and affiliates	164,810	166,578	163,442
El Paso Corporation and affiliates	20,581	23,877	24,875

Affiliated transportation revenues are primarily provided under fixed priced contracts with remaining terms ranging from 1 to 8 years.

The Partnership reimburses the Company for salaries, benefits and other incurred expenses. Benefits include pension, savings plan, and other post-retirement benefits. Operating expenses charged by the Company in 2004, 2003 and 2002 were \$17,388,000, \$25,758,000 and \$17,888,000, respectively.

The Company makes contributions for eligible employees of the Company to a voluntary defined contribution plan sponsored by one of the parent companies. The Company's contributions, which are based on matching employee contributions, amounted to \$475,000, \$396,000, and \$770,000 in 2004, 2003 and 2002, respectively.

The Company participates in the El Paso Corporation cash balance pension plan and post-retirement plan. The Company accounts for pension and post-retirement benefits on an accrual basis. The net expense (income) for each of the plans are as follows:

	(In Thousands)		
	2004	2003	2002
Pension	\$ (743,000)	\$ (2,600,000)	\$ (5,400,000)
Post-Retirement	202,000	204,000	236,000

4 Debt

	(In Thousands)	
	2004	2003
Senior Notes, unsecured, interest due semiannually, principal due as follows:		
8.74% series, due 2003 to 2011	\$ 70,000	\$ 80,000
9.09% series, due 2012 to 2021	100,000	100,000
6.73% series, due 2009 to 2018	90,000	90,000
6.95% series, due 2019 to 2028	110,000	110,000
8.08% series, due 2021 to 2030	100,000	100,000
	470,000	480,000
Less current maturities	10,000	10,000
Total long term debt less current maturities	<u>\$460,000</u>	<u>\$470,000</u>

The aggregate estimated fair value of long term debt was \$559,800,000 and \$571,400,000 for 2004 and 2003, respectively. The fair value is determined using discounted cash flows based on the Partnership's estimated current interest rates for similar debt.

The aggregate annual required repayments of Senior Notes is \$10,000,000 for each year 2005 through 2008 and \$19,000,000 in 2009.

Under the most restrictive covenants in the Senior Note Agreements, approximately \$253,000,000 of partners' capital is restricted as to distributions as of December 31, 2004.

5 Income Taxes Payable by Partners

Income taxes payable by partners for the years ended December 31, 2004, 2003 and 2002 consists of:

	(In Thousands)		
	2004	2003	2002
Current			
Federal	\$30,187	\$23,201	\$26,612
State	1,349	1,037	1,189
	<u>31,536</u>	<u>24,238</u>	<u>27,801</u>
Deferred			
Federal	14,833	15,556	16,808
State	689	736	791
	<u>15,522</u>	<u>16,292</u>	<u>17,599</u>
	<u>\$47,058</u>	<u>\$40,530</u>	<u>\$45,400</u>

Income taxes payable by partners differs from the statutory rate of 35% due to the amortization of excess deferred taxes along with the effects of state and local taxes. The Partnership is required to amortize excess deferred taxes which had previously been accumulated at tax rates in excess of current statutory rates. Such amortization reduced income taxes payable by partners by \$575,000 for 2004 and \$900,000 for 2003 and 2002. The excess deferred taxes were fully amortized at December 31, 2004.

Amounts equivalent to deferred income taxes are principally comprised of temporary differences associated with excess tax depreciation on utility plant. As of December 31, 2004 and 2003, no valuation allowance is required. The deferred tax assets and deferred tax liabilities as of December 31, 2004 and 2003 are as follows:

	(In Thousands)	
	2004	2003
Deferred tax assets — other	\$ 4,889	\$ 5,168
Deferred tax liabilities — utility plant	(245,786)	(230,614)
Deferred tax liabilities — other	<u>(16,062)</u>	<u>(15,835)</u>
Net deferred tax liability	<u>\$ (256,959)</u>	<u>\$ (241,281)</u>

6 Severance Costs

In 2003, the Partnership implemented a reorganization plan to reduce the work force, and recorded severance costs of approximately \$6 million. All amounts were substantially paid by December 31, 2003. Severance costs have been included in Operation and Maintenance expense.

7 Use Tax Refunds

In the first quarter of 2002, Great Lakes received a favorable decision from the Minnesota Supreme Court on use tax litigation and has collected refunds and related interest on litigated claims and pending claims for 1994 to 2001. The total amount received was \$13.7 million. The refunds are reflected in Property and Other Taxes (\$10.9 million) and the interest included in Other, Net (\$2.8 million).

**Auditors' Report
to the Shareholders of
Khulna Power Company Limited**

We have audited the accompanying balance sheet of Khulna Power Company Limited as of 31 December 2004 and the related income statement, statement of changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an independent opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above, which have been properly prepared on the basis explained in note 2 to the financial statements, read in conjunction with the notes attached, present fairly the financial position of Khulna Power Company Limited as at 31 December 2004 and the results of its operations, cash flows and changes in equity for the year then ended.

/s/ Rahman Rahman Huq

Dhaka, 27 April 2005

KHULNA POWER COMPANY LTD.

BALANCE SHEET

		As at 31 December 2004	
		2004	2003
		US\$	US\$
	Notes		
ASSETS			
Non-current assets:			
Property, plant and equipment:	3		
Power plant		82,658,421	82,657,977
Furniture and fixtures		24,799	18,648
Building and construction		181,354	180,561
Vehicles		46,114	46,114
Office equipment		108,523	100,688
Office renovation		27,256	27,256
		<u>83,046,467</u>	<u>83,031,244</u>
Less: Accumulated depreciation		<u>17,320,521</u>	<u>14,529,660</u>
		65,725,946	68,501,584
Project development expenditure	4	12,597,244	12,597,244
Less: Accumulated amortisation		<u>5,012,606</u>	<u>4,106,414</u>
		<u>7,584,638</u>	<u>8,490,830</u>
		73,310,584	76,992,414
Current assets:			
Inventory	5	5,416,579	7,928,428
Trade and other receivables	6	9,986,401	10,266,590
Advances, deposits and prepayments	7	934,876	1,011,224
Cash and cash equivalents	8	<u>1,080,291</u>	<u>285,263</u>
		<u>17,418,147</u>	<u>19,491,505</u>
Total assets		<u><u>90,728,731</u></u>	<u><u>96,483,919</u></u>
EQUITY AND LIABILITIES			
Capital and reserves:			
Share capital	9	44,100,000	44,100,000
Retained earnings		<u>6,981,546</u>	<u>5,361,298</u>
		51,081,546	49,461,298
Non-current liabilities:	10		
Loan from shareholders		2,444,711	2,889,204
IFC loan		24,463,389	28,596,047
Deferred liability for gratuity		<u>53,040</u>	<u>27,836</u>
		26,961,140	31,513,087
Current liabilities:			
Accounts payable	11	5,541,268	5,396,187
Working capital loan payable	12	1,840,236	4,930,424
Accrued expenses and others	13	299,318	190,253
Payable for other financial charges	14	90,182	18,575
Payable for project implementation expenses	15	223,130	223,130
Current portion of shareholders' loan	10	444,493	444,493
Current portion of IFC loans	10	4,132,658	4,132,658
Interest payable		<u>114,760</u>	<u>173,814</u>
		<u>12,686,045</u>	<u>15,509,534</u>
Total equity and liabilities		<u><u>90,728,731</u></u>	<u><u>96,483,919</u></u>

The annexed notes 1 to 20 form an integral part of these financial statements.

KHULNA POWER COMPANY LTD.
INCOME STATEMENT

		For the Year Ended 31 December	
		2004 US\$	2003 US\$
	<u>Notes</u>		
Turnover	16	45,743,612	37,666,666
Cost of sales:			
Fuel	17	27,738,419	20,921,316
Plant operations and maintenance	18	5,090,754	4,973,328
Depreciation and amortization		<u>3,663,061</u>	<u>3,663,598</u>
		<u>36,492,234</u>	<u>29,558,242</u>
<i>Gross profit</i>		9,251,378	8,108,424
Other operating expenses:			
General and administrative		<u>(1,358,407)</u>	<u>(2,070,378)</u>
<i>Profit from operations</i>		7,892,971	6,038,046
Net financing cost		<u>(3,026,408)</u>	<u>(3,463,457)</u>
Gain/ (Loss) on currency translation		<u>(204,250)</u>	<u>3,016</u>
<i>Net profit for the year</i>		<u><u>4,662,313</u></u>	<u><u>2,577,605</u></u>

The annexed notes 1 to 20 form an integral part of these financial statements.

KHULNA POWER COMPANY LTD.

CASH FLOW STATEMENT

	For the Year Ended 31 December	
	2004 US\$	2003 US\$
A) Cash flows from operating activities		
Net income	4,662,313	2,577,605
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest expenses	2,865,661	3,298,810
Depreciation and amortization	<u>3,697,886</u>	<u>3,716,205</u>
	11,225,860	9,592,620
Change in operating assets and liabilities:		
Inventory	2,511,849	(1,772,428)
Trade and other receivables	280,189	(223,017)
Advances, deposits and prepayments	76,348	199,802
Interest paid	(2,924,715)	(3,358,148)
Accounts payable and accrued expenses	(2,739,231)	41,777
Accumulated depreciation of disposed assets	<u>(833)</u>	<u>(2,792)</u>
	<u>(2,796,393)</u>	<u>(5,114,806)</u>
<i>Net cash provided by operating activities</i>	<u>8,429,467</u>	<u>4,477,814</u>
B) Cash flows from investing activities:		
Expenditures for property, plant and equipment	(18,095)	(6,894)
Disposal of assets	<u>2,872</u>	<u>3,002</u>
<i>Net cash used in investing activities</i>	<u>(15,223)</u>	<u>(3,892)</u>
C) Cash flows from financing activities:		
Net proceeds from borrowings	(4,577,151)	(4,599,377)
Dividend paid for 2003	(2,772,260)	—
Dividend distribution tax paid for 2003	<u>(269,805)</u>	<u>—</u>
<i>Net cash out flow by financing activities</i>	<u>(7,619,216)</u>	<u>(4,599,377)</u>
D) Net increase/(decrease) in cash and cash equivalents (A+B+C)	795,028	(125,455)
E) Cash and cash equivalents at beginning of year	<u>285,263</u>	<u>410,718</u>
F) Cash and cash equivalents at end of year (D+E)	<u><u>1,080,291</u></u>	<u><u>285,263</u></u>

KHULNA POWER COMPANY LTD.
STATEMENT OF CHANGES IN EQUITY
As at 31 December 2004

Particulars	Retained Earnings US\$	Ordinary Shares					
		Class A Shares	Value	Class B Shares	Value	Total	
		No.	US\$	No.	US\$	Shares No.	Value US\$
Balance at 1 January 1999	(17,636)	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Net income for 1999	6,938,422	—	—	—	—	—	—
Balance at 31 December 1999 . .	6,920,786	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Dividend for 1999	(6,131,541)	—	—	—	—	—	—
	789,245	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Net income for 2000	2,889,622	—	—	—	—	—	—
Balance at 31 December 2000 . .	3,678,867	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Dividend for 2000	(3,678,867)	—	—	—	—	—	—
	—	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Net income for 2001	1,150,847	—	—	—	—	—	—
Balance at 31 December 2001 . .	1,150,847	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Net income for 2002	1,632,846	—	—	—	—	—	—
Balance at 31 December 2002 . .	2,783,693	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Net income for 2003	2,577,605	—	—	—	—	—	—
Balance at 31 December 2003 . .	5,361,298	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Net income for 2004	4,662,313	—	—	—	—	—	—
Dividend paid for 2003	(2,772,260)	—	—	—	—	—	—
Dividend distribution tax paid for 2003	(269,805)	—	—	—	—	—	—
Balance at 31 December 2004 . .	6,981,546	2,085,924	44,099,873	6	127	2,085,930	44,100,000

KHULNA POWER COMPANY LTD.
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2004

1. Organisation and background

1.1 Organisation

Khulna Power Company Limited, (the “Company”), was incorporated on 15 October 1997, as a limited liability company under the Bangladesh Companies Act of 1994. The Company was organized for the purpose of developing, constructing, owning and operating a nominal 110 Megawatt (“MW”) output, heavy fuel oil fired, barge mounted electric generating plant in Khulna, Bangladesh (the “Facility”). The Facility is required to change to natural gas as the primary fuel when it becomes available in the Khulna area.

The Company is owned 73.9% by El Paso Khulna Power ApS, (“EKPA”) an indirect wholly owned subsidiary of The El Paso Corporation, (“El Paso”), 10% by Summit Industrial and Mercantile Corporation (Pvt.) Ltd., (“Summit”), 10% by United Enterprises and Co. Ltd., (“United”), and 6.1% by Wartsila Development & Financial Services (Asia) Ltd., (“Wartsila”). Collectively, the Members.

Summit and United each contributed equity equivalent to a 5.5% ownership interest. EKPA and Wartsila contributed equity equivalent to the remaining 4.5% of each of their ownership interests in a 70:30 ratio and the shares were donated to Summit and United.

1.2 Significant contracts

The Company has entered into an Implementation Agreement (“IA”) with the Government of Bangladesh (“GOB”). Through the IA, the GOB guarantees, among other items, the payment of all sums due to the Company, full contractual performance, convertibility of funds into US dollars and certain tax and fiscal incentives. Among the tax and fiscal incentives are a fifteen-year corporate income tax exemption, stamp duty exemption and the ability to repatriate equity dividends and profits.

The Company has entered into a fifteen-year Power Purchase Agreement (“PPA”) with the Bangladesh Power Development Board (“BPDB”), whereby the BPDB agrees to purchase all of the net electrical output of the Facility generated in accordance with BPDB’s instructions. The PPA can be extended during the final twelve months of its term upon the mutual agreement of the Company and the BPDB.

The Company has entered in a fifteen-year Fuel Supply Agreement (“FSA”) with United Summit Coastal Oil Ltd., (“USCOL”) to provide heavy fuel oil to the Facility. USCOL is owned 50% by an indirect, wholly owned subsidiary of El Paso and 25% each by affiliates of Summit and United.

The Company has entered into an Engineering, Procurement and Construction Contract (“EPC” contract) with Wartsila NSD Finland OY (“Contractor”), an affiliate of Wartsila. The lump sum EPC contract calls for the Contractor to design, engineer, procure, install and commission the Facility in accordance with certain performance criteria.

The Company has entered into an Operations & Maintenance Agreement (“O&M agreement”) with Wartsila NSD Finland OY, an affiliate of Wartsila, to operate and maintain the Facility. This agreement has been assigned to and is being performed by Wartsila Bangladesh Ltd., also an affiliate of Wartsila.

The Company has entered into a Gas Conversion Contract with the Contractor for the modification of the Facility so that it can utilise natural gas as the primary fuel when it becomes available in the Khulna area.

The Company has entered into a Land Lease Agreement with the BPDB for the purpose of securing the rights to occupy the Facility site.

The Company has entered into an Investment Agreement with the IFC for the purpose of securing non-recourse financing for approximately 55% of the total cost of the Facility.

The company has entered into an agreement with Citibank, N.A. to minimize the risk of fluctuation of interest rate for payment of IFC B loan interest. This allows the company to pay interest at a capped LIBOR rate of 7.5% instead of floating LIBOR rate when the latter is higher than 7.5%.

2. Summary of significant accounting policies

The summary of significant accounting policies of the Company is presented to assist in understanding the company's financial statements.

2.1 Basis of presentation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All costs incurred relating to the construction of the Facility, obtaining financing and the development of the Company are considered recoverable and, accordingly, have been capitalized as project development expenditure.

The Company considers its functional currency to be the US dollar as the majority of the Company's activities and contractual agreements are denominated in, or indexed to US dollars, and the GOB has committed in the IA to guarantee the Company's conversion of Bangladesh taka into US dollars.

The Company maintains its financial records in Bangladesh taka and prepares statutorily required financial statements in accordance with Bangladesh Accounting Standards. Except for the depreciation provision on fixed assets and treatment of start-up costs, the statutory statements have been restated into US dollars to reflect the financial position and results of operations of the Company as if the accounting records had been maintained in US dollars, on the following basis. All monetary assets and liabilities denominated in Bangladesh taka have been remeasured into US dollars utilising the rate of each month end in 2004. All non-monetary assets and liabilities and related expenses denominated in Bangladesh taka were remeasured into US dollars utilising historical exchange rates. Ordinary share capital was converted utilizing the rate in effect on the date of issue. Income statement items denominated in BDT were converted into US dollars utilizing the month-average rate and items denominated in USD have been shown using historical rate during the year 2004.

As a result of the existence of a large number of foreign currency transactions during the year and foreign currency monetary assets and liabilities at the year end, the results of the statutorily prepared Bangladesh Taka Accounts will not be the same as these accounts.

In view of the intended use of these accounts, in the opinion of management, disclosure in these accounts is sufficient.

2.2 Property, plant and equipment

Property, plant and equipment are recorded at cost less depreciation. Depreciation is accounted for on the straight-line method from the month of acquisition. The generating plant is depreciated over thirty years, with other equipment and building being depreciated over a period of 4-10 years. Betterments and large renewals that extend the life of the asset are capitalised whereas maintenance, repairs and small renewals are expensed as incurred.

2.3 Capitalised interest

The company has capitalised, as components of fixed assets and capitalised development cost, interest cost incurred during the development and construction phases of the facility. Such interest costs totaled US\$ 282,876 and US\$ 3,876,235 respectively.

2.4 Income taxes

The Company has a fifteen-year exemption from income tax in Bangladesh through the provisions of the IA. Accordingly, no current or deferred income taxes have been provided.

2.5 Use of estimates

The preparation of the Company's financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of development costs and fixed assets. Actual results could differ from those estimates.

3. Property, plant and equipment

Particulars	Cost				Depreciation				Written Down Value at 31 December 2004
	Balance at 1 January 2004	Additions During the Year	Disposal/ Adjustment During the Year	Balance at 31 December 2004	Balance at 1 January 2004	Charged for the Year	Disposal/ Adjustment During the Year	Balance at 31 December 2004	
	US\$	US\$	US\$	US\$	US\$	US\$	US\$	US\$	US\$
Power plant	82,657,977	444	—	82,658,421	14,314,785	2,756,869	—	17,071,654	65,586,767
Furniture and fixtures	18,648	6,151	—	24,799	15,648	308	—	15,956	8,843
Building and construction	180,561	793	—	181,354	69,752	18,081	—	87,833	93,521
Vehicles	46,114	—	—	46,114	19,962	11,532	—	31,494	14,620
Office equipment	100,688	10,707	(2,872)	108,523	84,481	4,119	(833)	87,767	20,756
Office renovation	27,256	—	—	27,256	25,032	785	—	25,817	1,439
Total 2004	83,031,244	18,095	(2,872)	83,046,467	14,529,660	2,791,694	(833)	17,320,521	65,725,946
Total 2003	83,027,352	6,894	(3,002)	83,031,244	11,722,977	2,809,475	(2,792)	14,529,660	68,501,584

4. Project development expenditure

	2004 US\$	2003 US\$
Development cost:		
Foreign expenses	1,306,722	1,306,722
Fees and leasehold rent	57,661	57,661
Start-up expenses	91,475	91,475
Other development expenses	1,174,820	1,174,820
Development fee with interest	3,143,013	3,143,013
Legal fees	4,397,750	4,397,750
Environmental consulting	595,394	595,394
Pre-full commercial operation date (FCOD) surplus	(629,610)	(629,610)
	10,137,225	10,137,225
Fuel reservation fee	1,500,000	1,500,000
Social goodwill	182,086	182,086
Financing cost:		
IFC appraisal fees	250,000	250,000
Independent engineers for lenders	448,645	448,645
Additional financing fees	79,288	79,288
	777,933	777,933
	12,597,244	12,597,244
Less: Accumulated amortisation	5,012,606	4,106,414
	7,584,638	8,490,830

5. Inventory

Spare parts for plant maintenance (Note 5.1)	2,000,000	2,000,000
Fuel (Note 5.2)	<u>3,416,579</u>	<u>5,928,428</u>
	<u>5,416,579</u>	<u>7,928,428</u>

5.1 Spare parts inventory was acquired under a provision of the EPC contract. The provision called for the contractor to provide safety spare parts with a cost basis of US\$ 2,000,000. In addition to above safety spares, the operator maintains usual maintenance spares at their cost against variable fees paid to them.

5.2 Fuel oil inventories are valued at cost, utilising the first-in, first-out (FIFO) method.

6. Trade and other receivables

Operation and maintenance tariff, due from BPDB	4,703,690	4,629,405
Fuel tariff, due from BPDB	5,179,104	5,523,360
Coastal Fuji Oil	5,609	16,840
Bangladesh Power Development Board — Licence fees of BIWTA	<u>97,998</u>	<u>96,985</u>
	<u>9,986,401</u>	<u>10,266,590</u>

7. Advances, deposits and prepayments

This includes US\$ 377,250 paid as premium to Citibank, N.A., New York to arrange an interest rate cap over IFC B loan. This arrangement caps LIBOR to 7.5%. The payment made is not considered to be materially different from the fair value of the instrument.

8. Cash and cash equivalents

Cash and cash equivalents is comprised of bank deposits and offshore overnight investment of US dollars amounting to US\$ 11,003 and US\$ 928,065 respectively and Bangladesh taka equivalent to US\$ 141,223. The GOB, through the provisions of the IA, has agreed to make the Company whole for any losses resulting from changes in the exchange rate from the time that Bangladesh Taka are received until the time that any of the taka are converted to US dollars.

9. Share capital

The shareholding position as at the balance sheet date was as follows:

Name of shareholder	2004			Total value US\$	2003 Total value US\$
	Class A ordinary share	Class B ordinary share	Total ordinary share		
	No.	No.	No.		
El Paso Khulna Power ApS (formerly Coastal Khulna Power ApS) (incorporated in Denmark)	1,541,498	2	1,541,500	32,589,900	32,589,900
Wartsila Development & Financial Services (Asia) Ltd. (incorporated in Cayman Islands)	127,242	2	127,244	2,690,100	2,690,100
Summit Industrial & Mercantile Corporation (Pvt) Ltd. (incorporated in Bangladesh) ..	208,592	1	208,593	4,410,000	4,410,000
United Enterprises & Company Ltd. (incorporated in Bangladesh)	<u>208,592</u>	<u>1</u>	<u>208,593</u>	<u>4,410,000</u>	<u>4,410,000</u>
	<u>2,085,924</u>	<u>6</u>	<u>2,085,930</u>	<u>44,100,000</u>	<u>44,100,000</u>

The Members of the Company have an agreement stipulating, among other things, the terms under which the Company's stock can be sold or transferred. Any stockholder intending to dispose of an interest in the Company must first offer their stock to the other Members, indicating the number of shares and the price. If the other Members do not purchase the shares, they may be sold to other parties at not less than the price offered to the Members.

10. Non-current liabilities

	Current maturity portion US\$	Long term portion US\$	Total outstanding at 31 Dec. 2004 US\$
Term loans:			
El Paso Power Khulna Holding Ltd.	377,819	2,078,004	2,455,823
Wartsila Development & Financial Services (Asia) Ltd.	<u>66,674</u>	<u>366,707</u>	<u>433,381</u>
	<u>444,493</u>	<u>2,444,711</u>	<u>2,889,204</u>
IFC loans:			
'A' loan	1,733,769	11,269,500	13,003,269
'B' loan	<u>2,398,889</u>	<u>13,193,889</u>	<u>15,592,778</u>
	<u>4,132,658</u>	<u>24,463,389</u>	<u>28,596,047</u>

The above term loans are being repaid in semi-annual installments for a term of 9 years effective from 15 December 2002. Interest rate applicable is 10% per annum. Collateral includes a promissory note of the company.

It was the intent of the Company to obtain limited recourse financing for approximately 55% of the Facility's cost amounting to US\$ 51,968,000. To this end, the Company obtained financing from two sources:

- a) An IFC A loan in the amount of US\$ 22,539,000 was secured on 4 August 1999 with an interest rate of LIBOR plus 0.5% and a term of thirteen years. El Paso and Wartsila initially guaranteed the loan. On 28 February 2001 the Company met the required terms and conditions and the guarantees were released. At that time, the interest rate changed to LIBOR plus approximately 4% to be computed pursuant to section 1.1 ["A Loan interest rate" (ii)] of Article 1 of the Investment Agreement. As of 31 December 2004, US\$ 13,003,269, of which US\$ 54,776 in unpaid interest, was outstanding.
- b) An IFC B loan in the amount of US\$ 21,590,000 was secured on 25 October 2002 with an interest rate of LIBOR plus 3.5% and a term of nine years. As of 31 December 2004, US\$ 15,592,778, of which US\$ 42,898 in unpaid interest, was outstanding.
- c) A Bridge Loan in the amount of US\$ 25,014,650 and US\$ 4,414,350 was secured from El Paso Power Khulna Holding Ltd. and Wartsila respectively. The interest rate is 10% and payable in semi-annual installment. Unpaid interest is added to the outstanding principal and accrues interest at the stated rate. IFC B loan has been fully used for repaying the Bridge loan. As of 31 December 2004, US\$ 2,889,204 of which US\$ 12,841 in unpaid interest, was outstanding.

11. Accounts payable

	<u>2004</u>	<u>2003</u>
	US\$	US\$
CFO — Handling commission	786,863	1,710,810
CFO — Fuel cost	4,134,579	3,092,555
USCOL — Fuel carrying and storage	448,862	473,581
Wartsila — Operating and maintenance expenses	<u>170,964</u>	<u>119,241</u>
	<u>5,541,268</u>	<u>5,396,187</u>

12. Working capital loan payable

Taka Overdraft	940,236	2,831,607
US Dollar Revolving	<u>900,000</u>	<u>2,098,817</u>
	<u>1,840,236</u>	<u>4,930,424</u>

The above facilities are secured by a corporate guarantee amounting to USD 7 million provided by El Paso Corporation and Wartsila NSD Corporation in the proportion of 85% and 15% respectively.

13. Accrued expenses and others

Electricity, gas and water	243	338
Legal and audit fees — HVC, RRH and others	14,878	19,066
Telephone, fax and email	2,024	1,860
Provision for withholding tax/VAT for legal, professional & other fee	5	46,869
Wartsila Bangladesh Ltd. (WBL)	—	526
El Paso International	99,364	40,661
Chadbourne and Parke LLP — Legal fees	—	5,168
R W Becker — Independent Engineer for lenders	5,819	3,491
Late payment interest — Fuel (CFO)	62,172	36,733
SBLC charges — Fuel	104,629	35,000
Others	10,184	541
	<u>299,318</u>	<u>190,253</u>

14. Payable for other financial charges

Bank charge on performance bond (USD 1.5 million)	13,281	—
Bank charge on performance bond (USD 4.498 million)	76,901	18,575
	<u>90,182</u>	<u>18,575</u>

15. Payable for project implementation expenses

VAT on plant	<u>223,130</u>	<u>223,130</u>
	<u>223,130</u>	<u>223,130</u>

16. Turnover

	<u>2004</u>	<u>2003</u>
	US\$	US\$
Operation and maintenance tariff	20,892,671	18,862,499
Fuel tariff	<u>24,850,941</u>	<u>18,804,167</u>
	<u>45,743,612</u>	<u>37,666,666</u>

17. Fuel expenses

Heavy fuel oil	27,525,186	20,700,415
Light fuel oil	19,365	21,368
Fuel storage charges	<u>193,868</u>	<u>199,533</u>
	<u>27,738,419</u>	<u>20,921,316</u>

18. Plant operations and maintenance

O & M fixed fees:

Fixed fees	1,798,000	2,180,220
Variable expenses	3,009,075	2,532,816
Land lease fee — BPDB	51,463	81,313
Plant security	37,529	38,360
Performance bond and guarantee charges	175,051	123,594
Environmental compliance	19,335	16,769
Miscellaneous operating expenses	301	256
	<u>5,090,754</u>	<u>4,973,328</u>

19. Commitments and contingencies

19.1 Agreements

19.1.1 Implementation agreement

The IA states certain actions that if taken by the Company and not remedied within the prescribed period will cause the Company to be in default of the IA. These events are the abandonment of the Facility for 30 consecutive days or the passing of a resolution of winding up or voluntary bankruptcy. If the incidence of default is not remedied, the IA can be cancelled and the Company's performance bonds required by the PPA can be drawn. The GOB would also have the right to acquire the Company's interest in the plant upon the payment of compensation as defined in the PPA.

The IA also places certain restrictions on the sale and transfer of Company common stock for a period of five years unless approved by the GOB.

19.1.2 Power purchase agreement

The Company will deliver electricity only as requested by BPDB. The price paid by BPDB for electricity consists of a fuel cost recovery tariff and an operations and maintenance tariff.

The operations and maintenance tariff is structured to cover the operating, administrative and general expenses of the Company, as well as to provide a return on and of equity to the stockholders. It is indexed for changes in the Bangladesh taka to US dollar exchange rates. The operations and maintenance tariff is based on the number of kilowatt-hours of electricity delivered. The PPA establishes a minimum guaranteed operations and maintenance tariff equivalent to 50% of the Facility's generating capacity.

The PPA also imposes liquidated damages for each hour that the Facility is unable to deliver a minimum of 90 megawatts, after stated maintenance allowances. No damages have been assessed under this provision.

The PPA requires that the Company post initially two Performance Bonds one for US\$ 1,500,000 and other for US\$ 8,500,000 to ensure the Company's obligations under the PPA. The Performance Bond of US\$ 1,500,000 remains intact while the Performance Bond of US\$ 8,500,000 is reduced by US\$ 667,000 annually to a minimum of US\$ 1,500,000.

19.1.3 Operations and maintenance agreement

The Company has entered into a fifteen-year O&M Agreement with WBL to operate and maintain the Facility. WBL receives a fixed monthly fee plus a variable fee per megawatt produced as per agreement. A capacity bonus is paid when monthly net electrical output exceeds 85%. An availability penalty is assessed when monthly Facility availability falls below 85%.

19.1.4 Fuel supply agreement

The company has entered into a FSA with USCOL, to provide Heavy Fuel Oil to the Facility. The FSA has a fifteen-year term, but subject to termination within thirty days following the conversion to natural gas. If the BPDB terminates the PPA during the first five years of the FSA, the Company is obligated to make a Compensation Payment to USCOL of US\$ 5,000,000, prorated for the number of days remaining in the five-year period. There is no minimum purchase commitment under this agreement.

19.1.5 Gas conversion agreement

The Company has entered into a Gas Conversion Contract with the Contractor for the modification of the Facility to utilise natural gas as the primary fuel when it becomes available in the Khulna area. This agreement is for fifteen years beginning on Commercial Operations Date. It is a US\$ 10,000,000, lump sum agreement with a two-percent annual escalation beginning on the ninth anniversary of the agreement. Liquidated damages are provided for construction delays, and failure to meet stated heat rate and net power output parameters.

19.2 Guarantees by the sponsors in favour of the Company

19.2.1 Performance bond to Bangladesh Power Development Board (BPDB)

As required under section 16.6 of PPA, the Company has submitted two performance bonds to BPDB, one for US\$ 4.498 million and other for US\$ 1.5 million. Both the performance bonds have been issued by the schedule bank on the strength of the guarantee provided by the El Paso Corporation on behalf of the Company.

19.2.2 Catastrophic Maintenance Letter of Credit and Debt Service Letter of Credit submitted to the Trustee

As required under section 2.2(b) (ii) of the Investment Agreement, the Company has submitted two Letters of Credit to Trustee such as Catastrophic Maintenance Letter of Credit of US\$ 1 million and Debt Service Letter of Credit of US\$ 3.245 million. Both the Letters of Credit have been issued on the strength of the guarantee provided by El Paso Corporation on behalf of the Company.

19.2.3 Working capital facility

The Company has taken US\$ 7 million working capital facility from Citibank, N.A. For obtaining such facility, El Paso and Wartsila have provided guarantee of US\$ 5.95 million and US\$ 1.05 million respectively to the Citibank, N.A.

20. General

20.1 Previous year's figures have been rearranged, wherever considered necessary, to conform to current year's presentation.

20.2 Figures have been rounded off to the nearest US dollar.

KHULNA POWER COMPANY LTD.

BALANCE SHEET
(Unaudited)

	<u>Notes</u>	<u>As at December 31, 2002</u> US\$ (Restated)
<u>ASSETS</u>		
Non-Current Assets:	3	
Power plant		82,657,977
Furniture and fixtures		19,558
Building and construction		178,690
Vehicles		46,114
Office equipment		97,757
Office renovation		27,256
		<u>83,027,352</u>
Less: Accumulated depreciation		11,722,977
		<u>71,304,375</u>
Project development expenditure	4	12,597,244
Less: Accumulated amortisation		3,199,684
		<u>9,397,560</u>
		<u>80,701,935</u>
Current Assets:		
Inventory	5	6,156,000
Trade and other receivables	6	10,043,573
Advances, deposits and prepayments	7	1,211,026
Cash and cash equivalents	8	410,718
		<u>17,821,317</u>
Total Assets		<u><u>98,523,252</u></u>
<u>EQUITY AND LIABILITIES</u>		
Capital and Reserves:		
Share capital	9	44,100,000
Retained profit		2,783,693
		<u>46,883,693</u>
Non-Current Liabilities (Net of Current Maturity):	10	
Deferred liability for gratuity		18,340
Loan from shareholders		3,400,371
IFC loan		32,728,706
		<u>36,147,417</u>
Current Liabilities:		
Accounts payable	11	4,432,885
Working capital loan payable	12	5,857,442
Accrued expenses and others	13	183,746
Payable for other financial charges	14	29,085
Payable for project implementation expenses	15	223,130
Current portion of non-current liabilities		4,532,702
Interest payable		233,152
		<u>15,492,142</u>
Total Equity and Liabilities		<u><u>98,523,252</u></u>

The annexed notes 1 to 17 form an integral part of these financial statements.

KHULNA POWER COMPANY LTD.
INCOME STATEMENT
(Unaudited)

	For the year ended 31 December 2002
	US\$ (Restated)
Turnover	40,245,823
Cost of sales:	
Fuel	21,418,440
Plan operations and maintenance	5,301,242
Depreciation and amortization	<u>3,662,966</u>
	<u>30,382,648</u>
<i>Gross profit</i>	9,863,175
Other operating expenses:	
General and administrative	<u>(3,382,467)</u>
<i>Profit from operations</i>	6,480,708
Net financing cost	(4,792,183)
Loss on currency translation	<u>(55,679)</u>
<i>Net profit for the year</i>	1,632,846
Retained profit brought forward	<u>1,150,847</u>
Retained profit carried forward	<u><u>2,783,693</u></u>

The annexed notes 1 to 17 form an integral part of these financial statements.

KHULNA POWER COMPANY LTD.
CASH FLOW STATEMENT
(Unaudited)

	For the year ended 31 December 2002
	US\$ (Restated)
A) Operating activities	
Net income	1,632,846
Adjustments to reconcile net income to net cash provided by operating activities:	
Interest expenses	4,758,065
Depreciation and amortization	<u>3,717,823</u>
	10,108,734
Change in operating assets and liabilities:	
Trade and other receivables	(926,870)
Prepaid expenses and advances	(928,019)
Inventory	(1,557,569)
Interest paid	(5,074,096)
Accounts payable and accrued expenses	875,224
Accumulated depreciation of disposed assets	<u>(45,561)</u>
	<u>(7,656,891)</u>
<i>Net cash provided by operating activities</i>	<u>2,451,843</u>
B) Investing activities:	
Expenditures for property, plant and equipment	(54,774)
Disposal of assets	<u>47,539</u>
<i>Net cash used in investing activities</i>	<u>(7,235)</u>
C) Financing activities:	
Net proceeds from borrowings	<u>(4,412,757)</u>
<i>Net cash provided by financing activities</i>	<u>(4,412,757)</u>
D) Net increase in cash and cash equivalents (A+B+C)	(1,968,149)
E) Cash and cash equivalents at beginning of year	<u>2,378,867</u>
F) Cash and cash equivalents at end of year (D+E)	<u><u>410,718</u></u>

KHULNA POWER COMPANY LTD.
STATEMENT OF STOCKHOLDERS' EQUITY
AS AT 31 DECEMBER 2002
(Unaudited)

<u>Particulars</u>	<u>Retained Earnings</u> <u>US\$</u> <u>(Restated)</u>	<u>Common Stock</u>					
		<u>Class A</u>	<u>Value</u>	<u>Class B</u>	<u>Value</u>	<u>Total</u>	
		<u>Shares</u> <u>No.</u>	<u>US\$</u>	<u>Shares</u> <u>No.</u>	<u>US\$</u>	<u>Shares</u> <u>No.</u>	<u>Value</u> <u>US\$</u>
Balance at 31 December 2001	1,150,847	2,085,924	44,099,873	6	127	2,085,930	44,100,000
Net income for 2002	<u>1,632,846</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Balance at December 2002 . . .	<u><u>2,783,693</u></u>	<u><u>2,085,924</u></u>	<u><u>44,099,873</u></u>	<u><u>6</u></u>	<u><u>127</u></u>	<u><u>2,085,930</u></u>	<u><u>44,100,000</u></u>

The management have proposed a total cash distribution of US\$5.26 million as final dividend for 2002 to holders of all ordinary shares. This amount has been arrived at by reference to the company's statutory financial statements for 2002.

KHULNA POWER COMPANY LTD.
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2002
(Unaudited)

1. Organisation and background

1.1 Organisation

Khulna Power Company Limited, (the “Company”), was incorporated on 15 October 1997, as a limited liability company under the Bangladesh Companies Act of 1994. The Company was organized for the purpose of developing, constructing, owning and operating a nominal 110 Megawatt (“MW”) output, heavy fuel oil fired, barge mounted electric generating plant in Khulna, Bangladesh (the “Facility”). The Facility is required to change to natural gas as the primary fuel when it becomes available in the Khulna area.

The Company is owned 73.9% by El Paso Khulna Power ApS, (“EKPA”) an indirect wholly owned subsidiary of The El Paso Corporation, (“El Paso”), 10% by Summit Industrial and Mercantile Corp. (Pvt.) Ltd., (“Summit”), 10% by United Enterprises and Co. Ltd., (“United”), and 6.1% by Wartsila Development & Financial Services (Asia) Ltd., (“Wartsila”). Collectively, the Members.

Summit and United each contributed equity equivalent to a 5.5% ownership interest. EKPA and Wartsila contributed equity equivalent to the remaining 4.5% of each of their ownership interests in a 70:30 ratio and the shares were donated to Summit and United.

1.2 Significant contracts

The Company has entered into an Implementation Agreement (“IA”) with the Government of Bangladesh (“GOB”). Through the IA, the GOB guarantees, among other items, the payment of all sums due to the Company, full contractual performance, convertibility of funds into US dollars and certain tax and fiscal incentives. Among the tax and fiscal incentives are a fifteen-year corporate income tax exemption, stamp duty exemption and the ability to repatriate equity dividends and profits.

The Company has entered into a fifteen-year Power Purchase Agreement (“PPA”) with the Bangladesh Power Development Board (“BPDB”), whereby the BPDB agrees to purchase all of the net electrical output of the Facility generated in accordance with BPDB’s instructions. The PPA can be extended during the final twelve months of its term upon the mutual agreement of the Company and the BPDB.

The Company has entered in a fifteen-year Fuel Supply Agreement (“FSA”) with United Summit Coastal Oil Ltd., (“USCOL”) to provide heavy fuel oil to the Facility. USCOL is owned 50% by an indirect, wholly owned subsidiary of El Paso and 25% each by affiliates of Summit and United.

The Company has entered into an Engineering, Procurement and Construction Contract (“EPC” contract) with Wartsila NSD Finland OY (“Contractor”), an affiliate of Wartsila. The lump sum EPC contract calls for the Contractor to design, engineer, procure, install and commission the Facility in accordance with certain performance criteria.

The Company has entered into an Operations & Maintenance Agreement (“O&M agreement”) with Wartsila NSD Finland OY, an affiliate of Wartsila, to operate and maintain the Facility. This agreement has been assigned to and is being performed by Wartsila Bangladesh Ltd., also an affiliate of Wartsila.

The Company has entered into a Gas Conversion Contract with the Contractor for the modification of the Facility so that it can utilise natural gas as the primary fuel when it becomes available in the Khulna area.

The Company has entered into a Land Lease Agreement with the BPDB for the purpose of securing the rights to occupy the Facility site.

The Company has entered into an Investment Agreement with the IFC for the purpose of securing limited-recourse financing for approximately 55% of the total cost of the Facility.

The company has entered into an agreement with Citibank, N.A. to minimize the risk of fluctuation of interest rate for payment of IFC B loan interest. This allows the company to pay interest at a capped LIBOR rate of 7.5% instead of floating LIBOR rate when the latter is higher than 7.5%.

2. Summary of significant accounting policies

The summary of significant accounting policies of the Company is presented to assist in understanding the company's financial statements.

2.1 Basis of presentation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All costs incurred relating to the construction of the Facility, obtaining financing and the development of the Company are considered recoverable and, accordingly, have been capitalized as Property, Plant and Equipment.

The Company considers its functional currency to be the US dollar as the majority of the Company's activities and contractual agreements are denominated in, or indexed to US dollars, and the GOB has committed in the IA to guarantee the Company's conversion of Bangladesh taka into US dollars.

The Company maintains its financial records in Bangladesh taka and prepares statutorily required financial statements in accordance with Bangladesh Accounting Standards. Except for the depreciation provision on fixed assets and treatment of start-up costs, the statutory statements have been restated into US dollars to reflect the financial position and results of operations of the Company as if the accounting records had been maintained in US dollars, on the following basis. All monetary assets and liabilities denominated in Bangladesh taka have been remeasured into US dollars utilising the rate of each month end in 2002. All non-monetary assets and liabilities and related expenses denominated in Bangladesh taka were remeasured into US dollars utilising historical exchange rates. Common stock was converted utilizing the rate in effect on the date of issue. Income statement items denominated in BDT were converted into US dollars utilizing the month-average rate and items denominated in USD have been shown using historical rate during the year 2002.

As a result of the existence of a large number of foreign currency transactions during the year and foreign currency monetary assets and liabilities at the year end, the results of the statutorily prepared Bangladesh Taka Accounts will not be the same as these accounts.

In view of the intended use of these accounts, in the opinion of management disclosure in these accounts is sufficient.

2.1.1 Restatement

We have restated these financial statements to reflect legal and other fees associated with obtaining our debt financing in our income statement which were previously capitalized as project development costs. The effects of this restatement are shown below:

	For the Year Ended December 31, 2002	
	As Reported	As Restated
Income statement:		
Depreciation and amortization	3,687,343	3,662,966
General and administrative	2,741,049	3,382,467
Net profit	2,249,887	1,632,846
Balance sheet:		
Project development expenditure, net	10,014,601	9,397,560
Retained profit	3,400,734	2,783,693
Capital and reserves	47,500,734	46,883,693

2.2 Property, plant and equipment

Property, plant and equipment are recorded at cost less depreciation. Depreciation is accounted for on the straight-line method from the date of acquisition. The generating plant is depreciated over thirty years, with other equipment and building being depreciated over a period of 4-10 years. Betterments and large renewals that extend the life of the asset are capitalised whereas maintenance, repairs and small renewals are expensed as incurred.

2.3 Capitalised interest

The company has capitalised, as components of fixed assets and capitalised development cost, interest cost incurred during the development and construction phases of the facility. Such interest costs totaled US\$ 282,876 and US\$ 3,876,235 respectively.

2.4 Income taxes

The Company has a fifteen-year exemption from income tax in Bangladesh through the provisions of the IA. Accordingly, no current or deferred income taxes have been provided.

2.5 Use of estimates

The preparation of the Company's financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of development costs and fixed assets. Actual results could differ from those estimates.

3. Non-current assets

Particulars	Cost				Depreciation				Written Down Value at 31 December 2002
	Balance at 1 January 2002	Additions During the Year	Disposal/ Adjustment During the Year	Balance at 31 December 2002	Balance at 1 January 2002	Charged for the Year	Disposal/ Adjustment During the Year	Balance at 31 December 2002	
	US\$	US\$	US\$	US\$	US\$	US\$	US\$	US\$	US\$
Power plant	82,657,977	—	—	82,657,977	8,801,954	2,755,963	—	11,557,917	71,100,060
Furniture and fixtures . .	18,892	666	—	19,558	10,608	3,880	—	14,488	5,070
Building and construction	175,403	3,287	—	178,690	34,160	17,630	—	51,790	126,900
Vehicles	42,782	46,114	(42,782)	46,114	41,044	9,065	(41,993)	8,116	37,998
Office equipment	93,050	4,707	—	97,757	48,450	18,909	—	67,359	30,398
Office renovation	32,013	—	(4,757)	27,256	21,503	5,372	(3,568)	23,307	3,949
At 31 December 2002 . .	83,020,117	54,774	(47,539)	83,027,352	8,957,719	2,810,819	(45,561)	11,722,977	71,304,375

4. Project development expenses

	<u>2002</u> US\$
Development cost:	
Foreign expenses	1,306,722
Fees and leasehold rent	57,661
Start-up expenses	91,475
Other development expenses	1,174,820
Development fee with interest	3,143,013
Legal fees	4,397,750
Environmental consulting	595,394
Pre-full commercial operation date (FCOD) surplus	<u>(629,610)</u>
	10,137,225
Fuel reservation fee	1,500,000
Social goodwill	182,086
Financing cost:	
IFC appraisal fees	250,000
Independent engineers for lenders	448,645
Additional financing fees	<u>79,288</u>
	<u>777,933</u>
	12,597,244
Less: Accumulated amortisation	<u>3,199,684</u>
	<u><u>9,397,560</u></u>

5. Inventory

Spare parts for plant maintenance (Note 5.1)	2,000,000
Fuel (Note 5.2)	<u>4,156,000</u>
	<u><u>6,156,000</u></u>

5.1 Spare parts inventory was acquired under a provision of the EPC contract. The provision called for the contractor to provide spare parts with a cost basis of US\$2,000,000. It is the responsibility of the operator to maintain, at its expense, the spare parts inventory at the original cost level.

5.2 Fuel oil inventories are valued at cost, utilising the first-in, first-out (FIFO) method.

6. Trade and other receivables

Operation and maintenance tariff, due from BPDB	4,594,092
Fuel tariff, due from BPDB	5,197,524
Coastal Fuji Oil	87,285
United Enterprises & Company Ltd.	2,550
Bangladesh Inland Water Transport Authority — Licence fees	<u>162,122</u>
	<u><u>10,043,573</u></u>

7. Advances, deposits and prepayments

This includes US\$ 503,000 paid as fees to Citibank, N.A., Bangladesh to arrange an interest rate cap over IFC B loan. This arrangement caps LIBOR to 7.5%. The payment made is not considered to be materially different from the fair value of the instrument.

8. Cash and cash equivalents

Cash and cash equivalents is comprised of bank deposits and offshore overnight investment of US dollars amounting to US\$ 19,259 and US\$ 158,031 respectively and Bangladesh taka equivalent to US\$ 233,428. The GOB, through the provisions of the IA, has agreed to make the Company whole for any losses resulting from changes in the exchange rate from the time that Bangladesh Taka are received until the time that any of the taka are converted to US dollars.

9. Share capital

The shareholding position as at the balance sheet date was as follows:

Name of shareholder	2002			
	Class A	Class B	Total	Total
	No.	No.	shares	value
El Paso Khulna Power ApS (formerly Coastal Khulna Power ApS) (incorporated in Denmark)	1,541,498	2	1,541,500	32,581,209
Wartsila Development & Financial Services (Asia) Ltd. (incorporated in Cayman Islands)	127,242	2	127,244	2,698,263
Summit Industrial & Mercantile Corporation (Pvt) Ltd. (incorporated in Bangladesh)	208,592	1	208,593	4,410,264
United Enterprises & Company Ltd. (incorporated in Bangladesh)	208,592	1	208,593	4,410,264
	<u>2,085,924</u>	<u>6</u>	<u>2,085,930</u>	<u>44,100,000</u>

The Members of the Company have an agreement stipulating, among other things, the terms under which the Company's stock can be sold or transferred. Any stockholder intending to dispose of an interest in the Company must first offer their stock to the other Members, indicating the number of shares and the price. If the other Members do not purchase the shares, they may be sold to other parties at not less than the price offered to the Members

10. Non-current liabilities

It was the intent of the Company to obtain limited-resource financing for approximately 55% of the Facility's cost amounting to US\$ 51,968,000. To this end, the Company obtained financing from two sources:

- An IFC A loan in the amount of US\$ 22,539,000 was secured on 4 August 1999 with an interest rate of LIBOR plus 0.5% and a term of thirteen years. El Paso and Wartsila initially guaranteed the loan. On 28 February 2001 the Company met the required terms and conditions and the guarantees were released. At that time, the interest rate changed to LIBOR plus approximately 4% to be computed pursuant to section 1.1 ["A Loan interest rate" (ii)] of Article 1 of the Investment Agreement. As of 31 December 2002, US\$ 16,470,808, of which US\$ 64,758 in unpaid interest, was outstanding.
- An IFC B loan in the amount of US\$ 21,590,000 was secured on 25 October 2002 with an interest rate of LIBOR plus 3.5% and a term of nine years. As of 31 December 2002, US\$ 20,390,556, of which US\$ 39,046 in unpaid interest, was outstanding.

- c) A Bridge Loan in the amount of US\$ 25,014,650 and US\$ 4,414,350 was secured from El Paso Power Khulna Holding Ltd. and Wartsila respectively. The interest rate is 10% and payable in semi-annual instalment. Unpaid interest is added to the outstanding principal and accrues interest at the stated rate. IFC B loan has been fully used for repaying the Bridge loan. As of 31 December 2002, US\$ 3,800,414 of which US \$30,397 in unpaid interest, was outstanding.

11. Accounts payable

	<u>2002</u> US\$
CFO — Handling commission	1,016,165
CFO — Fuel cost	2,979,464
USCOL — Fuel carrying and storage	<u>437,256</u>
	<u>4,432,885</u>

12. Working capital loan payable

Taka Overdraft	1,860,660
US Dollar Revolving	<u>3,996,782</u>
	<u>5,857,442</u>

The above facilities are secured by a corporate guarantee amounting to USD 7 million provided by El Paso Corporation and Wartsila NSD Corporation in the proportion of 85% and 15% respectively.

13. Accrued expenses and others

	<u>2002</u> US\$
Electricity, gas and water	847
El Paso Khulna Power ApS	38
Legal and audit fees — HVC, RRH and others	23,802
Wartsila Development & Financial Services (Asia) Ltd.	5,042
Telephone, fax and email	2,794
Provision for withholding tax/VAT for legal, professional & other fee	6,346
Wartsila Bangladesh Ltd. (WBL)	4,229
El Paso International	9,043
Fulbright and Jaworski LLP — Legal fees	83,870
R W Beck — Independent Engineer for lenders	4,750
Chadbourne and Parke LLP — Legal fees	37,784
Others	<u>5,201</u>
	<u>183,746</u>

14. Payable for other financial expenses

Bank charge on performance bond (1.5 million US dollar)	783
Bank charge on performance bond (5.832 million US dollar)	<u>28,302</u>
	<u>29,085</u>

15. Payable for project implementation expenses

VAT on plant	223,130
	<u>223,130</u>

16. Commitments and contingencies

16.1 Agreements

16.1.1 Implementation agreement

The IA states certain actions that if taken by the Company and not remedied within the prescribed period will cause the Company to be in default of the IA. These events are the abandonment of the Facility for 30 consecutive days or the passing of a resolution of winding up or voluntary bankruptcy. If the incidence of default is not remedied, the IA can be cancelled and the Company's performance bonds required by the PPA can be drawn. The GOB would also have the right to acquire the Company's interest in the plant upon the payment of compensation as defined in the PPA.

The IA also places certain restrictions on the sale and transfer of Company common stock for a period of five years unless approved by the GOB.

16.1.2 Power purchase agreement

The Company will deliver electricity only as requested by BPDB. The price paid by BPDB for electricity consists of a fuel cost recovery tariff and an operations and maintenance tariff.

The operations and maintenance tariff is structured to cover the operating, administrative and general expenses of the Company, as well as to provide a return on and of equity to the stockholders. It is indexed for changes in the Bangladesh taka to US dollar exchange rates. The operations and maintenance tariff is based on the number of kilowatt-hours of electricity delivered. The PPA establishes a minimum guaranteed operations and maintenance tariff equivalent to 50% of the Facility's generating capacity.

The PPA also imposes liquidated damages for each hour that the Facility is unable to deliver a minimum of 90 megawatts, after stated maintenance allowances. No damages have been assessed under this provision.

The PPA requires that the Company post initially two Performance Bonds one for US\$ 1,500,000 and other for US\$ 8,500,000 to ensure the Company's obligations under the PPA. The Performance Bond of US\$ 1,500,000 remains intact while the Performance Bond of US\$ 8,500,000 is reduced by US\$ 667,000 annually to a minimum of US\$ 1,500,000.

16.1.3 Operations and maintenance agreement

The Company has entered into a fifteen-year O&M Agreement with WBL to operate and maintain the Facility. WBL receives a fixed monthly fee of US\$ 179,000 plus a variable fee at the rate of US\$ 5.99 per megawatt produced. A capacity bonus is paid when monthly net electrical output exceeds 85%. An availability penalty is assessed when monthly Facility availability falls below 85%.

16.1.4 Fuel supply agreement

The company has entered into a FSA with USCOL, to provide Heavy Fuel Oil to the Facility. The FSA has a fifteen-year term, but subject to termination within thirty days following the conversion to natural gas. If the BPDB terminates the PPA during the first five years of the FSA, the Company is obligated to make a Compensation Payment to USCOL of US\$ 5,000,000, prorated for the number of days remaining in the five-year period. There is no minimum purchase commitment under this agreement.

16.1.5 Gas conversion agreement

The Company has entered into a Gas Conversion Contract with the Contractor for the modification of the Facility to utilise natural gas as the primary fuel when it becomes available in the Khulna area. This agreement is for fifteen years beginning on Commercial Operations Date. It is a US\$ 10,000,000, lump sum agreement with a two-percent annual escalation beginning on the ninth anniversary of the agreement. Liquidated damages are provided for construction delays, and failure to meet stated heat rate and net power output parameters.

16.2 Guarantees by the sponsors in favour of the Company

16.2.1 Performance bond to Bangladesh Power Development Board (BPDB)

As required under section 16.6 of PPA, the Company has submitted two performance bonds to BPDB, one for US\$ 5.832 million and other for US\$ 1.5 million. Both the performance bonds have been issued by the schedule bank on the strength of the guarantee provided by the El Paso Corporation on behalf of the Company.

16.2.2 Catastrophic Maintenance Letter of Credit and Debt Service Letter of Credit submitted to the Trustee

As required under section 2.2(b)(ii) of the Investment Agreement, the Company has submitted two Letters of Credit to Trustee such as Catastrophic Maintenance Letter of Credit of US\$ 1 million and Debt Service Letter of Credit of US\$ 3.472 million. Both the Letters of Credit have been issued on the strength of the guarantee provided by El Paso Corporation on behalf of the Company

16.2.3 Working capital facility

The Company has taken US\$ 7 million working capital facility from Citibank, N.A. For obtaining such facility, El Paso and Wartsila have provided guarantee of US\$ 5.95 million and US\$1.0 million respectively to the Citibank, N.A.

17. General

17.1 Previous year's figures have been rearranged, wherever considered necessary, to conform to current year's presentation.

17.2 Figures have been rounded off to the nearest US dollar.

REPORT OF INDEPENDENT AUDITORS

To the Stockholders of Habibullah Coastal Power
Company (Private) Limited:

In our opinion, the accompanying balance sheets and the related statements of operations, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Habibullah Coastal Power Company (Private) Limited (the "Company") at December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Houston, Texas
May 27, 2005

HABIBULLAH COASTAL POWER COMPANY (PRIVATE) LIMITED
BALANCE SHEETS

	December 31,	
	2004	2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 20,322,632	\$ 17,907,942
Accounts receivable — trade	5,724,080	5,381,720
Accounts receivable — other	825,695	1,026,876
Fuel inventory	2,338,792	2,351,832
Supplies inventory	2,758,294	2,758,294
Prepaid and other current assets	250,796	840,503
Total current assets	32,220,289	30,267,167
Property, plant, and equipment:		
Land	2,700,000	2,700,000
Plant facility	139,628,710	139,558,410
Equipment	541,003	590,550
Subtotal	142,869,713	142,848,960
Less: accumulated depreciation	(24,597,099)	(19,927,499)
Total property, plant, and equipment, net	118,272,614	122,921,461
Other non-current assets:		
Tax deposits	2,120,716	1,444,539
Long term receivable	5,546,238	5,758,781
Total other non-current assets	7,666,954	7,203,320
Total Assets	\$158,159,857	\$160,391,948
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Interest payable	\$ 1,948,478	\$ 2,179,741
Accounts payable — trade	5,811,681	5,232,858
Accounts payable — affiliates	133,906	39,221
Current portion of contract payable	2,579,284	13,228,072
Current portion of note payable	10,868,650	9,972,154
Total current liabilities	21,341,999	30,652,046
Long-term debt		
Deferred contract payable	8,069,505	—
Notes payable	68,782,112	79,650,762
Total long-term debt	76,851,617	79,650,762
Stockholders' equity:		
Authorized share capital, 10 rupee par value: 174,000,000 shares		
Common stock, 10 rupees par value; 135,731,653 Class A shares issued	31,600,032	31,600,032
Common stock, 10 rupees par value; 36,080,641 Class B shares issued ..	8,400,032	8,400,032
Retained earnings	19,966,177	10,089,076
Total stockholders' equity	59,966,241	50,089,140
Total Liabilities and Stockholders' Equity	\$158,159,857	\$160,391,948

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER COMPANY (PRIVATE) LIMITED
STATEMENTS OF OPERATIONS

	For the Year Ended December 31,	
	2004	2003
Revenue		
Electric capacity	\$28,710,968	\$29,219,104
Electric energy	27,145,085	25,135,328
Total revenue	<u>55,856,053</u>	<u>54,354,432</u>
Operating expenses		
Fuel	24,526,389	23,010,876
Administrative and general	2,057,511	2,572,673
Operations and maintenance	5,655,520	6,655,212
Depreciation	4,669,600	4,668,795
Total operating expenses	<u>36,909,020</u>	<u>36,907,556</u>
Operating income	<u>18,947,033</u>	<u>17,446,876</u>
Other (income) expense		
Interest income	(520,307)	(1,219,267)
Interest expense — affiliate	7,616,150	8,485,833
Interest expense	589,613	1,941,521
Foreign exchange loss	1,384,476	206,376
Total other expense, net	<u>9,069,932</u>	<u>9,414,463</u>
Net income	<u>\$ 9,877,101</u>	<u>\$ 8,032,413</u>

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER COMPANY (PRIVATE) LIMITED
STATEMENTS OF CASH FLOWS

	For the Year Ended December 31,	
	2004	2003
Cash flows from operating activities		
Net income	\$ 9,877,101	\$ 8,032,413
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	4,669,600	4,668,795
Working capital changes		
Accounts receivable	(141,179)	5,893,316
Fuel inventory	13,040	136,357
Supplies inventory	—	(16,647)
Prepaid and other current assets	589,707	261,882
Interest payable	(231,263)	(1,342,565)
Accounts payable	673,508	(121,779)
Non-working capital changes		
Tax deposits	(676,177)	(559,264)
Long-term receivable	212,543	(2,002,725)
Net cash provided by operating activities	<u>14,986,880</u>	<u>14,949,783</u>
Cash flows from investing activities:		
Capital expenditures	<u>(20,753)</u>	<u>(438,161)</u>
Net cash used in investing activities	<u>(20,753)</u>	<u>(438,161)</u>
Cash flows from financing activities:		
Payments on deferred contract payable	(2,579,283)	(3,719,676)
Principal payments on note payable	(9,972,154)	(9,149,604)
Dividends paid	—	(7,409,322)
Net cash used in financing activities	<u>(12,551,437)</u>	<u>(20,278,602)</u>
Increase (decrease) in cash and cash equivalents	2,414,690	(5,766,980)
Cash and cash equivalents at beginning of period	17,907,942	23,674,922
Cash and cash equivalents at end of period	<u>\$ 20,322,632</u>	<u>\$ 17,907,942</u>
Supplemental cash flow data		
Interest paid	<u>\$ 8,323,052</u>	<u>\$ 10,649,827</u>

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER COMPANY (PRIVATE) LIMITED
STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock				Retained Earnings	Total
	Class A Shares	Amount	Class B Shares	Amount		
Balance, January 1, 2003	135,731,653	\$31,600,032	36,080,641	\$8,400,032	\$ 9,465,985	\$49,466,049
Dividends paid	—	—	—	—	(7,409,322)	(7,409,322)
Net income	—	—	—	—	8,032,413	8,032,413
Balance, December 31, 2003	135,731,653	31,600,032	36,080,641	8,400,032	10,089,076	50,089,140
Net income	—	—	—	—	9,877,101	9,877,101
Balance, December 31, 2004	<u>135,731,653</u>	<u>\$31,600,032</u>	<u>36,080,641</u>	<u>\$8,400,032</u>	<u>\$19,966,177</u>	<u>\$59,966,241</u>

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS

1. Organization and Background

We were organized on December 17, 1995, as a Pakistani private unlimited company under the Pakistani Companies Ordinance, 1984, and converted to a private limited company on September 15, 2003. Our primary purpose is the ownership and operation of a 126 megawatt, natural gas-fired, combined cycle power plant near Quetta, Pakistan (the “Facility”). We began full-time commercial operations in September 1999.

We are owned 99% by Quetta Power Holding Company I Ltd. (“Quetta I”) and 1% by Quetta Power Holding Company II Ltd. (“Quetta II”). Quetta I is owned 50% by Coastal Power International II Ltd. (“CPI 2”), an indirect wholly owned subsidiary of El Paso Corporation (“El Paso”), 25% by Habibullah Energy Limited (“HEL”), a Pakistani company, and 25% by H.E.I. Ltd., an affiliate of HEL. Quetta II is owned 98% by Quetta I, 1% by CPI 2 and 1% by HEL. Quetta I and Quetta II made periodic capital contributions to us in proportion to their ownership interest. In addition, Quetta I and Quetta II are allocated/receive 99% and 1%, respectively, of our net profits and distributions.

2. Summary of Significant Accounting Policies

Basis of Presentation

Our financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Use of Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses and disclosures of contingent assets and liabilities that exist at the date of the financial statements. Actual results could differ from those estimates.

Functional Currency

Our functional currency is the U.S. dollar since the majority of our activities and significant contractual agreements are denominated in U.S. dollars and based on the Government of Pakistan’s (“GOP”) commitment to guarantee our conversion of Pakistan rupees into U.S. dollars under the terms of the Implementation Agreement (“IA”) (See Note 6). All monetary assets and liabilities denominated in the Pakistan rupee have been remeasured into the U.S. dollar using the current exchange rates as of December 31, 2004, and December 31, 2003. All nonmonetary balance sheet items, income and related expenses denominated in the Pakistan rupee are remeasured into the U.S. dollar using historic exchange rates. Foreign exchange gains and losses resulting from remeasurement are recorded during the period and are recognized in the accompanying statement of operations.

Revenue Recognition

We recognize revenue when we deliver electric energy and provide electric capacity. Revenue is based on the quantity of electric energy delivered and electric capacity provided at rates specified in our Power Purchase Agreement (“PPA”).

Cash and Cash Equivalents

We consider all highly liquid investments with original maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable include all trade accounts receivable owed to us for capacity revenue and sales of energy. Periodically, we review the collectibility of our accounts receivable using the specific identification method and establish an allowance for amounts that are not expected to be collected. As of December 31, 2004 and 2003, there was no allowance for doubtful accounts recorded.

Inventory

Inventory, which consists of fuel, spare parts, materials, and supplies, is recorded at the lower of cost or market. Cost is determined on a first-in, first-out (“FIFO”) basis for fuel and a weighted average basis for spare parts, materials, and supplies.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Betterments of major units of property are capitalized, while repairs, maintenance and replacements and additions of minor units of property are expensed. Depreciation is calculated using the straight-line method. The estimated useful lives of our assets are 30 years for the plant, 10 years for office equipment, furniture and fixtures, and telecommunications, and 5 years for vehicles.

We evaluate the impairment of our long-lived assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 requires that long-lived assets be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When such events or changes in circumstances occur, an impairment loss is recognized if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. We did not record any asset impairments in 2004 or 2003.

Income Taxes

We are not subject to income tax in Pakistan due to the exemption granted under the IA (See Note 6). Accordingly, no current or deferred income taxes have been provided in the accompanying financial statements.

3. Stockholders’ Agreements

Our stockholders have an agreement stipulating, among other things, the terms under which our stock can be sold or transferred. Any stockholder intending to dispose of an interest in our stock must first offer their stock to us and then to the other stockholders. The price of such stock transfer shall be determined in accordance with the agreement, after receiving the unanimous consent of the non-transferring stockholders. On January 3, 2005, a dividend of \$7,094,595 was declared and was paid to our stockholders on February 9, 2005.

4. Long-Term Debt

Effective February 26, 1996, we entered into a \$115,521,000 loan agreement, with a group of banks, with Australia and New Zealand Banking Group acting as agent. Our obligations under the loan agreement were guaranteed by El Paso CGP Company (then Coastal Corporation), a wholly owned subsidiary of El Paso Corporation, through a Note Purchase Agreement. The banks called the loan under the Note Purchase Agreement on December 15, 2002, and El Paso CGP Company assumed the entire loan outstanding as of that date and became the lender as defined in the Loan Agreement. The interest on the term loan is 9% with

principal and interest payments made semi-annually through September 30, 2019. The following are the aggregate amounts of maturities of long-term debt for the next five years and in total thereafter:

<u>Year</u>	<u>Principal Amount</u>
2005	\$10,868,650
2006	11,845,742
2007	12,910,674
2008	14,071,344
2009	10,630,053
Thereafter	<u>19,324,299</u>
Total	<u>\$79,650,762</u>

Pursuant to the loan agreement, we are subject to certain restrictive covenants, which include maintaining certain financial ratios, including a ratio of debt to equity that is at all times less than 80 percent. At December 31, 2004 and 2003, the ratios of debt to equity were 69 percent and 72 percent.

5. Related Party Transactions

Long-Term Debt

Our long-term debt is held by El Paso CGP Company. As of December 31, 2004, and 2003, principal in the amount of \$79,650,762 and \$89,622,916, was payable under this agreement. See Note 4.

Administrative Services Agreement

We entered into an administrative services agreement with El Paso Technology Pakistan (“EPTP”), an indirect wholly-owned subsidiary of El Paso CGP Company. The agreement provides for EPTP to have general responsibility for managing our affairs. As consideration for services rendered, EPTP is reimbursed on a monthly basis for its actual costs incurred plus an annual fee of \$37,500, indexed for inflation. The agreement was executed in January 1997 and terminated on September 11, 2004. On January 3, 2005, this agreement was renewed for one year and will terminate on September 11, 2005. Costs were accrued from September 12, 2004 through January 3, 2005, and were paid when the contract was renewed on January 3, 2005. We may renew this agreement for three successive five year terms. For the years ended December 31, 2004 and 2003, we incurred \$414,056 and \$413,821, of administrative services costs. As of December 31, 2004 and 2003, \$133,906 and \$39,221, is payable under this agreement.

Local Advisory Services Agreement

We entered into a local advisory services agreement with Habibullah Mines (Private) Limited (“HML”), an associated company of HEL. The agreement provides for certain local advisory services, as requested from time to time by us. As consideration for services rendered, HML is reimbursed on a monthly basis for its actual costs incurred plus an annual fee of \$337,500, indexed for inflation. The agreement was executed in January 1997 and terminated on September 11, 2004. On January 3, 2005, this agreement was renewed for one year and will terminate on September 11, 2005. Costs were accrued from September 12, 2004 through January 3, 2005, and were paid when the contract was renewed on January 3, 2005. We may renew this agreement for three successive five year terms. For the years ended December 31, 2004 and 2003, we incurred \$444,378 and \$538,972, of local advisory services costs. There was no amount outstanding under this agreement at December 31, 2004 and 2003.

6. Commitments and Contingencies

EP Contract and Construction Contract

We entered into an Engineering and Procurement Contract (“EP Contract”), dated February 29, 1996, with Maire Engineering S.p.A. (“Maire”) (formerly Fiat Avio S.p.A.) to perform the design, engineering,

and procurement services necessary to complete the Facility. The EP Contract provided for bonuses and liquidated damages, as appropriate, depending on completion dates and certain output performance levels.

We also entered into a Construction Contract with Maire Pakistan Branch to perform the construction necessary to complete the Facility. The Construction Contract provided for liquidated damages depending on completion dates and certain output performance levels.

The project completion was substantially delayed by Maire and as a result, in September 1999, we delivered demand for payment of net liquidated damages of \$52,110,000. Maire did not agree to our claim and both parties sought arbitration. In April 2003, the Arbitration Panel issued an award in the net amount of \$8,762,520 (the "Award Amount") in our favor, but instructed the Award Amount be setoff against the then outstanding principal plus accrued interest of the Deferred Amount as discussed below. We recorded the award amount as an adjustment to the cost basis of our property, plant, and equipment in 2002.

Pursuant to our EP Contract, Maire agreed with us to defer payment of 37% of the amounts we owed them under this contract, up to an aggregate amount of \$30 million (the "Deferred Amount"). Such deferred contract payments and construction interest thereon were available to be converted to long-term notes ("Deferred Note") under the EP Contract. While the form and number of notes had not been agreed between the parties, principal and interest payments have been made since February 2001 based on semiannual payments and a twelve-year term provided in the EP Contract. Interest on the notes is paid at LIBOR plus 2.55%.

In February 2004, the Arbitration Panel delivered its final decision specifically addressing the terms and conditions for which Maire becomes a lender, along with El Paso CGP Company under our Loan Agreement and establishes the form of notes and repayment schedules for both lenders under the Loan Agreement. Accordingly, El Paso CGP Company and Maire entered into the Tenth Amendment to the Loan Agreement subject to approval of the Pakistan Private Power Infrastructure Board and the State Bank of Pakistan. Upon approval by the Pakistan Private Power Infrastructure Board, the net amount outstanding to Maire (\$13,228,072 at February 17, 2004) converted to a term loan as evidenced by a Series B Note, with interest accrued thereon from and including September 16, 2003, with semi-annual principal and interest payments and a final maturity date of March 15, 2009. The Tenth Amendment also requires us to maintain a cash balance equivalent of \$6,000,000 in our cash accounts in Pakistan at all times. Payments to Maire pursuant to the Series B Note under the agreement began on March 15, 2004. As of December 31, 2004 and 2003, principal in the amount of \$10,648,789 and \$13,228,072, was payable under this agreement.

As previously discussed, the Arbitration Panel required us to setoff liquidated damages awarded to us with the Deferred Amount owed to Maire. We continue to seek the approval of the State Bank of Pakistan. If we do not receive approval, the State Bank of Pakistan will have to approve all future payments.

The February 2004 final decision of the Arbitration Panel also changed the actual project acceptance date from August 2000 to March 2000. This shortened the period during which we were required to accrue interest on the Deferred Amount. Accordingly, we recorded a reduction of approximately \$895,000 of interest expense in 2003 and reduced our liability.

The Pakistan Income Tax Appellate Tribunal ("ITAT") assessed additional withholding taxes on our payments under the EP and Construction Contract made to Maire. Maire has acknowledged that they are responsible for these taxes under a 1996 Indemnification Agreement; however we and Maire are disputing that such taxes are owed. Our payment of such withholding taxes were subject to a Standstill Agreement, dated July 10, 2002 and acknowledged by Maire on September 3, 2002, however, we withdrew from the Standstill Agreement in 2004. The withholding taxes have been classified as a non-current asset in the accompanying balance sheet.

Implementation Agreement

We have entered into an IA under which the GOP agrees to use its best efforts to support our exclusive right to design, finance, insure, construct, complete, own, operate and maintain the Facility through the initial term of our PPA. The IA may be extended by mutual agreement. The IA grants us the ability to freely

transfer all funds to banks or other parties outside of Pakistan without foreign exchange restrictions with appropriate consents and/or approvals from the State Bank of Pakistan.

The IA imposes certain deadlines and other requirements, the violation of which will be considered an event of default, and may require us to sell and transfer the Facility to the GOP. If the Facility is transferred to the GOP in the event of such a default, we will be reimbursed for our outstanding debt by the GOP. Upon default, the IA will terminate and the GOP will have no further interest in or obligations under the IA. Some of the more significant possible events of default include: any material breach of the PPA or the Gas Supply Agreement (“GSA”) by us not remedied within 30 days after notice of the breach. We believe we are in compliance with all of the terms of the IA.

Power Purchase Agreement

We have entered into a 20-year PPA with the Pakistan Water and Power Development Authority (“WAPDA”), whereby WAPDA agrees to purchase up to 105% of the Facility’s dependable capacity of 123 net megawatts. The effective date of the PPA is September 11, 1999. The PPA has been extended for an additional 10 years as agreed upon by us and WAPDA and will expire on September 10, 2029.

We deliver electricity only as ordered by WAPDA. If, through a change in law or a political force majeure event (as defined in the PPA), we are required to repair or make changes to the Facility, we will be allowed to pass those charges through to WAPDA via a supplemental tariff.

The PPA imposes liquidated damages on us if certain contractual conditions are not met, which include reduction of the capacity payment for outages above a certain allowable limit in any operating year. During 2004 and 2003, we incurred liquidated damages of \$19,485 and \$123,061, respectively, related to excess outages. This amount has been recorded as a component of operations and maintenance expense in the accompanying statement of operations.

We will be considered to be in default and WAPDA may initiate termination of the PPA if, among other things, either of the following events occur: (a) cumulative operating losses (as determined under the IA) of at least 50% of the combined equity contributions and subordinated loans; or, (b) any material breach of the PPA or the GSA by us not remedied within 30 days after notice of the breach. We believe we are in compliance with all of the terms of the PPA.

The PPA imposes liquidated damages on WAPDA if certain contractual conditions are not met, including WAPDA’s failure to make payments for electricity to us within 30 days of notice. WAPDA shall pay to us the monthly demand charge, as stipulated in the GSA, paid by us to Sui Southern Gas Company Limited (“Sui”). Such payments shall continue until the date that the delay caused by WAPDA ceases.

We will receive a bonus of 0.08 rupees for each Kilowatt hour (“kWh”) of net electrical output above certain minimums during the months of January through June of each year. The amount of the bonus shall be indexed over the initial term of the PPA on the basis of changes in inflation and Pakistan rupee exchange rates. During 2004 and 2003, \$109,984 and \$94,894, respectively, was recorded as a component of electric energy revenue in the accompanying statement of operations.

Gas Supply Agreement and Backup Fuel Supply Agreement

We entered into a 20-year GSA with Sui, whereby Sui is our exclusive supplier of natural gas. The effective date of the GSA is September 11, 1999. The price of all natural gas delivered under the GSA is based on the price of natural gas as notified by the GOP from time to time. The GSA may be extended subject to the approval of GOP. A 20-year Backup Fuel Supply Agreement (“BFSA”), which became effective June 12, 1998, has been executed between us and Shell Pakistan Limited, a local Pakistani company, for the periodic delivery of high speed diesel (“HSD”) fuel oil for backup emergency purposes. The price of HSD has been deregulated by GOP and marketing companies determine the prices on a fortnightly basis.

O&M Agreement

We entered into a seven-year operations and maintenance agreement (the “O&M Agreement”) with General Electric International, Inc. (“GE”) executed in June 1998, to operate and maintain the Facility.

The O&M Agreement provided for reimbursement of services provided by GE during the mobilization stage. Once the Facility became operational in September 1999, GE began receiving a fixed monthly operations and maintenance fee of \$208,333 commencing the month after the combined cycle take over date. GE also receives a variable fee of \$46.59 per hour for the number of hours during which any of the covered units were actually synchronized to the WAPDA grid and generating energy from the Facility. The fixed and variable payment components are subject to a periodic price escalation based on the Materials Index and the US Labor Index. The agreement may be renewed for an additional seven-year term based on mutual agreement between us and GE. For the years ended December 31, 2004 and 2003, \$3,052,355 and \$3,577,612, was reported as a component of operations and maintenance expense in the accompanying statement of operations.

Due to the events of terrorist attacks in the United States on September 11, 2001, GE declared a force majeure event and informed us they planned to stop operations by October 31, 2001. We did not agree to the force majeure and temporarily amended the O&M Agreement whereby GE was indemnified from most of its liabilities in return for continuing to operate the plant while a more permanent amendment was negotiated. An Amended and Restated O&M Agreement was successfully negotiated and executed with GE, effective as of July 1, 2002. The amended and restated agreement addressed GE’s main concerns of allowing for subcontracting and limiting GE’s liability to \$1 million per year except for certain liabilities arising due to intentional torts, fraud, or bad faith and certain claims related to presence of hazardous materials resulting from the operator’s action or inaction.

LTS Agreement

We entered into a long-term service agreement (“LTS Agreement”), effective September 11, 1999, with GE to provide certain long-term parts and services for the Facility. The LTS Agreement also provides for a fixed monthly payment of \$20,167 per month commencing the month after the commercial operations date of September 11, 1999. The LTS Agreement also provides for a variable fee based on a rate of \$87.38 per hour for the number of fired hours run by each unit in the immediately preceding month. The fixed and variable payment components are subject to a periodic price escalation based on the Materials Index and the US Labor Index. The agreement will expire the later of 14 years following the effective date or after the completion of the planned maintenance. For the years ended December 31, 2004 and 2003, \$2,395,623 and \$2,423,363, was reported as a component of operations and maintenance expense in the accompanying statement of operations.

Tax Deposits

We have been assessed income tax on interest income against which we have filed an appeal with the ITAT and deposited the amount of tax assessed. This amount will be refunded to us if the ITAT decides in our favor. We believe we will receive a favorable decision in this matter. The balance of these deposits at December 31, 2004 and 2003 was \$2,120,716 and \$1,444,539.

7. Concentration of Credit Risk

Financial instruments, which potentially subject us to credit risk, consist of cash and accounts receivable. Our cash accounts are held by major financial institutions. Our receivables are concentrated with WAPDA, as they are the sole purchaser of our electrical output under the terms of PPA.

8. Fair Value of Financial Instruments

As of December 31, 2004 and 2003, the carrying value of financial instruments, including cash and cash equivalents, accounts receivable, and accounts payable, approximates fair value because of their short-term nature or the market-based nature of the instrument’s interest rate. While there is no liquid market for our long-term debt, we believe that the carrying value of our long-term debt approximates its fair value at December 31, 2004 and 2003.

HABIBULLAH COASTAL POWER (PRIVATE) COMPANY
BALANCE SHEET
(Unaudited)

	<u>December 31, 2002</u>
ASSETS	
Current Assets:	
Cash and cash equivalents	\$ 23,674,922
Accounts receivable	12,301,912
Fuel inventory	2,488,189
Supplies inventory	2,741,647
Prepaid and other current assets	<u>1,102,385</u>
Total current assets	<u>42,309,055</u>
Property, plant, and equipment:	
Land	2,700,000
Plant facility	139,169,796
Equipment	<u>541,003</u>
Subtotal	142,410,799
Less: accumulated depreciation	<u>(15,258,704)</u>
Total property, plant, and equipment	<u>127,152,095</u>
Other non-current assets:	
Tax deposits	885,275
Long term receivable	<u>3,756,056</u>
Total other non-current assets	<u>4,641,331</u>
Total Assets	<u><u>\$174,102,481</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Interest payable	\$ 2,693,488
Accounts payable, trade	5,291,199
Accounts payable, affiliates	102,659
Current portion of deferred contract — Fiat	17,776,566
Current portion of long term debt	<u>9,149,604</u>
Total current liabilities	<u>35,013,516</u>
Long-term debt and other obligations:	
Note payable	<u>89,622,916</u>
Total long-term liabilities	<u>89,622,916</u>
Commitments and contingencies	
Stockholders' equity:	
Authorized share capital, 10 rupee par value: 174,000,000	
Common stock, 10 rupees par value; 135,731,653 Class A shares issued	31,600,032
Common stock, 10 rupees par value; 36,080,641 Class B shares issued	8,400,032
Retained earnings	<u>9,465,985</u>
Total stockholders' equity	<u>49,466,049</u>
Total Liabilities and Stockholders' Equity	<u><u>\$174,102,481</u></u>

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER (PRIVATE) COMPANY
STATEMENT OF OPERATIONS
(Unaudited)

	For the Year Ended December 31, 2002
Revenue	
Electricity capacity	\$28,774,138
Electricity energy	<u>24,250,410</u>
Total revenue	<u>53,024,548</u>
Operating expenses	
Fuel	22,209,672
Administrative & general	6,412,434
Operating	9,893,625
Depreciation	<u>5,199,203</u>
Total operating expenses	<u>43,714,934</u>
Operating income	<u>9,309,614</u>
Other (income) expense	
Interest income	(1,241,831)
Interest expense	10,562,916
Foreign exchange gain	<u>(628,322)</u>
Total other expense	<u>8,692,763</u>
Net income	<u><u>\$ 616,851</u></u>

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER (PRIVATE) COMPANY
STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock				Retained Earnings	Total
	Class A Shares	Amount	Class B Shares	Amount		
Balance, January 1, 2002.....	135,731,653	\$31,600,032	36,080,641	\$8,400,032	\$8,849,134	\$48,849,198
Net Income.....	—	—	—	—	616,851	616,851
Balance, December 31, 2002	<u>135,731,653</u>	<u>\$31,600,032</u>	<u>36,080,641</u>	<u>\$8,400,032</u>	<u>\$9,465,985</u>	<u>\$49,466,049</u>

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER (PRIVATE) COMPANY
STATEMENT OF CASH FLOWS
(Unaudited)

	<u>For the Year Ended December 31, 2002</u>
Cash flows from operating activities	
Net income	\$ 616,851
Adjustments to reconcile net income to net cash provided by operating activities	
Depreciation and amortization	5,199,203
Accounts receivable	1,843,555
Fuel inventory	379,807
Supplies inventory	66,779
Prepaid and other current assets	198,069
Interest payable	(510,566)
Accounts payable — affiliates and other	<u>1,286,485</u>
Net cash provided by operating activities	<u>9,080,183</u>
Cash flows from investing activities:	
Plant facility	(2,184,497)
Proceeds from sale of equipment	<u>46,673</u>
Net cash used in investing activities	<u>(2,137,824)</u>
Cash flows from financing activities:	
Deferred contract payment	(2,653,908)
Payment of note payable	(8,394,903)
Dividends paid	<u>(8,457,923)</u>
Net cash used in financing activities	<u>(19,506,734)</u>
Net decrease in cash and cash equivalents	(12,564,375)
Cash and cash equivalents at beginning of period	<u>36,239,297</u>
Cash and cash equivalents at end of period	<u><u>\$ 23,674,922</u></u>

See the accompanying notes to these financial statements.

HABIBULLAH COASTAL POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Background

We were organized on December 17, 1995, as a Pakistani private unlimited company under the Pakistani Companies Ordinance, 1984, and converted to a private limited company on September 15, 2003. Our primary purpose is the ownership and operation of a 126 megawatt, natural gas-fired, combined cycle power plant near Quetta, Pakistan (the “Facility”). Construction was completed and we began full-time commercial operations in September 1999.

We are owned 99% by Quetta Power Holding Company I Ltd. (“Quetta I”) and 1% by Quetta Power Holding Company II Ltd. (“Quetta II”). Quetta I is owned 50% by Coastal Power International II Ltd. (“CPI 2”), an indirect wholly owned subsidiary of El Paso Corporation (“El Paso”), 25% by Habibullah Energy Limited (“HEL”), a Pakistani company, and 25% by H.E.I. Ltd., an affiliate of HEL. Quetta II is owned 98% by Quetta I, 1% by CPI 2 and 1% by HEL. Quetta I and Quetta II made periodic capital contributions to us in proportion to their ownership interest. In addition, Quetta I and Quetta II receive 99% and 1%, respectively, of our net profits and distributions.

2. Summary of Significant Accounting Policies

Basis of Presentation

Our financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Use of Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses and disclosures of contingent assets and liabilities that exist at the date of the financial statements. Actual results could differ from those estimates.

Functional Currency

Our functional currency is the U.S. dollar since the majority of our activities and significant contractual agreements are denominated in U.S. dollars and based on the Government of Pakistan’s (“GOP”) commitment to guarantee our conversion of Pakistan rupees into U.S. dollars under the terms of the Implementation Agreement (“IA”) (See Note 6). All monetary assets and liabilities denominated in the Pakistan rupee have been remeasured into the U.S. dollar using the current exchange rates as of December 31, 2002. All nonmonetary balance sheet items, income and related expenses denominated in the Pakistan rupee are remeasured into the U.S. dollar using historic exchange rates. Foreign exchange gains and losses resulting from remeasurement are recorded during the period and are recognized in the accompanying statement of operations.

Revenue Recognition

We recognize revenue when we deliver electric energy and provide electric capacity. Revenue is based on the quantity of electric energy delivered and electric capacity provided at rates specified in our Power Purchase Agreement (“PPA”).

Cash and Cash Equivalents

We consider all highly liquid investments with original maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable include all trade accounts receivable owed to us for capacity revenue and sales of energy. Periodically, we review the collectibility of our accounts receivable using the specific identification method and establish an allowance for amounts which are not expected to be collected. As of December 31, 2002, there was no allowance for doubtful accounts recorded.

Inventory

Inventory, which consists of fuel, spare parts, materials, and supplies, is recorded at the lower of cost or market. Cost is determined on a first-in, first-out (“FIFO”) basis for fuel and weighted average for spare parts, materials, and supplies.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Betterments of major units of property are capitalized, while repairs, maintenance and replacements and additions of minor units of property are expensed. Depreciation is calculated using the straight-line method based on an estimated useful life and an estimated salvage value. The estimated useful lives of our assets are 30 years for the plant, 10 years for office equipment, furniture and fixtures, and telecommunications, and 5 years for vehicles.

We evaluate the impairment of our long-lived assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 requires that long-lived assets be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When such events or changes in circumstances occur, an impairment loss is recognized if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. We did not record any asset impairment in 2002.

Income Taxes

We are not subject to income tax in Pakistan due to the exemption granted by the IA (See Note 6). Accordingly, no current or deferred income taxes have been provided in the accompanying financial statements.

Recent Accounting Pronouncements

Accounting for Asset Retirement Obligations

In August 2001, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. This statement requires companies to record a liability relating to the retirement and removal of assets used in their businesses. The liability is discounted to its present value, and the related asset value is increased by the amount of the resulting liability. Over the life of the asset, the liability will be accreted to its future value and eventually extinguished when the asset is taken out of service. The provisions of this statement are effective for fiscal years beginning after June 15, 2002.

3. Stockholders’ Agreements

Our stockholders have an agreement stipulating, among other things, the terms under which our stock can be sold or transferred. Any stockholder intending to dispose of an interest in our stock must first offer their stock to us and then to the other stockholders. The price of such stock transfer shall be determined in accordance with the agreement, after receiving the unanimous consent of the non-transferring stockholders.

4. Long-Term Debt

Effective February 26, 1996, we entered into a \$115,521,000 loan agreement, with a group of banks, with Australia and New Zealand Banking Group acting as agent. Our obligations under the loan agreement were guaranteed by El Paso CGP Company (then Coastal Corporation), a wholly owned subsidiary of El Paso

Corporation, through a Note Purchase Agreement. The banks called the loan under the Note Purchase Agreement on December 15, 2002, and El Paso CGP Company assumed the entire loan outstanding as of that date and became the lender as defined in the Loan Agreement. The interest on the term loan is 9% with principal and interest payments made semi-annually through September 30, 2019. The following are the aggregate amounts of maturities of long-term debt for the next five years and in total thereafter:

<u>Year</u>	<u>Principal Amount</u>
2003	\$ 9,149,604
2004	9,972,154
2005	10,868,650
2006	11,842,742
2007	12,910,674
Thereafter	<u>44,028,696</u>
Total	<u>\$98,772,520</u>

Pursuant to the loan agreement, we are subject to certain restrictive covenants, which include maintaining certain financial ratios.

5. Related Party Transactions

Long-Term Debt

Our long-term debt is held by El Paso CGP Company. As of December 31, 2002, principal in the amount of \$98,772,520 is payable under this agreement. See Note 4.

Administrative Services Agreement

We entered into an administrative services agreement with El Paso Technology Pakistan (“EPTP”), an indirect wholly-owned subsidiary of El Paso CGP Company. The agreement provides for EPTP to have general responsibility for managing our affairs. As consideration for services rendered, EPTP is reimbursed on a monthly basis for its actual costs incurred plus an annual fee of \$37,500, indexed for inflation. The agreement was executed in January 1997 and will terminate on September 11, 2004. We may renew this agreement for three successive five year terms. As of December 31, 2002, \$102,659 is payable under this agreement.

Local Advisory Services Agreement

We entered into a local advisory services agreement with Habibullah Mines (Private) Limited (“HML”), an associated company of HEL. The agreement provides for certain local advisory services, as requested from time to time by us. As consideration for services rendered, HML is reimbursed on a monthly basis for its actual costs incurred plus an annual fee of \$337,500, indexed for inflation. The agreement was executed in January 1997 and will terminate on September 11, 2004. We may renew this agreement for three successive five year terms. For the year ended December 31, 2002, \$382,740 of local advisory services costs were incurred. There was no amount outstanding under this agreement at December 31, 2002.

6. Commitments and Contingencies

EP Contract and Construction Contract

We entered into an Engineering and Procurement Contract (“EP Contract”), dated February 29, 1996, with Fiat Avio S.p.A. (“Fiat Avio”) to perform the design, engineering, and procurement services necessary to complete the Facility. The EP Contract provided for bonuses and liquidated damages, as appropriate, depending on completion dates and certain output performance levels.

We also entered into a Construction Contract with Fiat Avio Pakistan Branch to perform the construction necessary to complete the Facility. The Construction Contract provided for liquidated damages depending on completion dates and certain output performance levels.

The project completion was substantially delayed by Fiat Avio and as a result, in September 1999, we delivered demand for payment of net liquidated damages of \$52,110,000. Fiat Avio did not agree to our claim and both parties sought arbitration. In April 2003, the Arbitration Panel issued an award in the net amount of \$8,762,520 (the "Award Amount") in our favor, but instructed the Award Amount be setoff against the then outstanding principal plus accrued interest of the Deferred Amount as discussed below. We recorded the award amount as an adjustment to the cost basis of our property, plant, and equipment in 2002.

Pursuant to our EP Contract, Fiat Avio agreed with us to defer payment of 37% of the amounts we owed them under this contract, up to an aggregate amount of \$30 million (the "Deferred Amount"). Such deferred contract payments and construction interest thereon were available to be converted to long-term notes ("Deferred Note") under the EP Contract. While the form and number of notes had not been agreed between the parties, principal and interest payments have been made since February 2001 based on semiannual payments and a twelve-year term provided in the EP Contract. Interest on the notes is paid at LIBOR plus 2.55%.

The Pakistan Income Tax Appellate Tribunal ("ITAT") assessed additional withholding taxes on our payments under the EP and Construction Contract made to Fiat Avio. Fiat Avio has acknowledged that they are responsible for these taxes under a 1996 Indemnification Agreement; however we and Fiat Avio are disputing that such taxes are owed. Our payment of such withholding taxes are currently subject to a Standstill Agreement, dated July 10, 2002 and acknowledged by Fiat Avio on September 3, 2002 and have been classified as a non-current asset in the accompanying balance sheet.

Implementation Agreement

We have entered into an IA under which the GOP agrees to use its best efforts to support our exclusive right to design, finance, insure, construct, complete, own, operate and maintain the Facility through the initial term of our PPA. The IA may be extended by mutual agreement. The IA grants us the ability to freely transfer all funds to banks or other parties outside of Pakistan without foreign exchange restrictions with appropriate consents and/or approvals from the State Bank of Pakistan.

The IA imposes certain deadlines and other requirements, the violation of which will be considered an event of default, and may require us to sell and transfer the Facility to the GOP. If the Facility is transferred to the GOP in the event of such a default, we will be reimbursed for our outstanding debt by the GOP. Upon default, the IA will terminate and the GOP will have no further interest in or obligations under the IA. Some of the more significant possible events of default include: any material breach of the PPA or the Gas Supply Agreement ("GSA") by us not remedied within 30 days after notice of the breach. We believe we are in compliance with all of the terms of the IA.

Power Purchase Agreement

We have entered into a 20-year PPA with the Pakistan Water and Power Development Authority ("WAPDA"), whereby WAPDA agrees to purchase up to 105% of the Facility's dependable capacity of 123 net megawatts. The effective date of the PPA is September 11, 1999. The PPA has been extended for an additional 10 years as agreed upon by us and WAPDA and will expire on September 10, 2029.

We deliver electricity only as ordered by WAPDA. If, through a change in law or a political force majeure event (as defined in the PPA), we are required to repair or make changes to the Facility, we will be allowed to pass those charges through to WAPDA via a supplemental tariff.

The PPA imposes liquidated damages on us if certain contractual conditions are not met, which include reduction of the capacity payment for outages above a certain allowable limit in any operating year. During 2002, we incurred liquidated damages of \$153,688 related to excess outages. This amount has been recorded as a component of operations and maintenance expense in the accompanying statement of operations.

We will be considered to be in default and WAPDA may initiate termination of the PPA if, among other things, either of the following events occur: (a) cumulative operating losses (as determined under the IA) of at least 50% of the combined equity contributions and subordinated loans; or, (b) any material breach of the PPA or the GSA by us not remedied within 30 days after notice of the breach. We believe we are in compliance with all of the terms of the PPA.

The PPA imposes liquidated damages on WAPDA if certain contractual conditions are not met, including WAPDA's failure to make payments for electricity to us within 30 days of notice. WAPDA shall pay to us the monthly demand charge, as stipulated in the GSA, paid by us to Sui Southern Gas Company Limited ("Sui"). Such payments shall continue until the date that the delay caused by WAPDA ceases.

We will receive a bonus of 0.08 rupees for each Kilowatt hour ("kWh") of net electrical output above certain minimums during the months of January through June of each year. The amount of the bonus payable shall be indexed over the initial term of the PPA on the basis of changes in inflation and Pakistan rupee exchange rates. During 2002, we did not record any bonus revenue.

Gas Supply Agreement and Backup Fuel Supply Agreement

We entered into a 20-year GSA with Sui, whereby Sui is our exclusive supplier of natural gas. The effective date of the GSA is September 11, 1999. The price of all natural gas delivered under the GSA is based on the price of natural gas as notified by the GOP from time to time. The GSA may be extended subject to the approval of GOP. A 20-year Backup Fuel Supply Agreement ("BFSA"), which became effective June 12, 1998, has been executed between us and Shell Pakistan Limited, a local Pakistani company, for the periodic delivery of high speed diesel ("HSD") fuel oil for backup emergency purposes. The price of HSD has been deregulated by GOP and marketing companies determine the prices on a fortnightly basis.

O&M Agreement

We entered into a seven-year operations and maintenance agreement (the "O&M Agreement") with General Electric International, Inc. ("GE") executed in June 1998, to operate and maintain the Facility.

The O&M Agreement provided for reimbursement of services provided by GE during the mobilization stage. Once the Facility became operational in September 1999, GE began receiving a fixed monthly operations and maintenance fee of \$208,333 commencing the month after the combined cycle take over date. GE also receives a variable fee of \$46.59 multiplied by the number of hours during which any of the covered units were actually synchronized to the WAPDA grid and generating energy from the Facility. The fixed and variable payment components are subject to a periodic price escalation based on the Materials Index and the US Labor Index. The agreement may be renewed for an additional seven-year term based on mutual agreement between us and GE. For the year ended December 31, 2002, \$2,891,157 was reported as a component of operations and maintenance expense in the accompanying statement of operations.

Due to the events of terrorist attacks in the United States on September 11, 2001, GE declared a force majeure event and informed us they planned to stop operations by October 31, 2001. We did not agree to the force majeure and temporarily amended the O&M Agreement whereby GE was indemnified from most of its liabilities in return for continuing to operate the plant while a more permanent amendment was negotiated. An Amended and Restated O&M Agreement was successfully negotiated and executed with GE, effective as of July 1, 2002. The amended and restated agreement addressed GE's main concerns of allowing for subcontracting and limiting GE's liability to \$1 million per year except for certain liabilities arising due to intentional torts, fraud, or bad faith and certain claims related to presence of hazardous materials resulting from the operator's action or inaction.

LTS Agreement

We entered into a long-term service agreement ("LTS Agreement"), effective September 11, 1999, with GE to provide certain long-term parts and services for the Facility. The LTS Agreement also provides for a fixed monthly payment of \$20,167 commencing the month after the commercial operations date of September 11, 1999. The LTS Agreement also provides for a variable fee based on a rate of \$87.38 per the

number of fired hours run by each unit in the immediately preceding month. The fixed and variable payment components are subject to a periodic price escalation based on the Materials Index and the US Labor Index. The agreement will expire the later of 14 years following the effective date or after the completion of the planned maintenance. For the year ended December 31, 2002, \$2,416,178 was reported as a component of operations and maintenance expense in the accompanying statement of operations.

Tax Deposits

We have been assessed income tax on interest income against which we have filed an appeal with the ITAT and deposited the amount of tax assessed. This amount will be refunded to us if the ITAT decides in our favor. Our tax consultants are confident to have a favorable decision. The balance of these deposits at December 31, 2002 was \$885,275.

7. Concentration of Credit Risk

Financial instruments, which potentially subject us to credit risk, consist of cash and accounts receivable. Our cash accounts are held by major financial institutions. Our receivables are concentrated with WAPDA, as they are the sole purchaser of our electrical output under the terms of PPA.

8. Fair Value of Financial Instruments

As of December 31, 2002, the carrying value of financial instruments, including cash and cash equivalents, accounts receivable, and accounts payable, approximates fair value because of their short-term nature or the market-based nature of the instrument's interest rate. While there is no liquid market for our long-term debt, we believe that the carrying value of our long-term debt approximates its fair value at December 31, 2002.

Report of Independent Auditors

To the Board of Directors and Stockholders of
Empresa de Generación Eléctrica Fortuna, S.A.

We have audited the accompanying balance sheets of Empresa de Generación Eléctrica Fortuna, S.A. as of December 31, 2004 and 2003 and the related statements of income, comprehensive income and accumulated other comprehensive income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Empresa de Generación Eléctrica Fortuna, S.A. as of December 31, 2004 and 2003, and the results of its operations, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As fully disclosed in Notes 1 and 8, Empresa de Generación Eléctrica Fortuna, S.A. emerged as the result of the restructuring process of the Instituto de Recursos Hidráulicos y Electrificación (IRHE) and is part of a regulated group of companies engaged in the generation, transmission and distribution of electric energy in the Republic of Panama. As fully disclosed in the financial statements, the Company reports significant balances and transactions with related parties, the nature of which may not be the same if performed among non-related parties.

/s/ PricewaterhouseCoopers LLP

Panama, Republic of Panama
February 3, 2005

Empresa de Generación Eléctrica Fortuna, S.A.

**Balance Sheets
As of December 31,**

	<u>2004</u>	<u>2003</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 10,205,923	\$ 1,222,755
Non restricted investments	7,544,700	847,371
Accounts receivable — affiliates	14,830,126	12,501,293
Accounts receivable — other	924,666	548,303
Materials and supplies	5,270,727	5,070,495
Deferred tax asset	354,214	287,620
Other prepaid expenses and deposits	4,231,684	1,892,438
Total current assets	<u>43,362,040</u>	<u>22,370,275</u>
Note receivable — affiliate	12,000,000	12,000,000
Property, plant and equipment	687,899,413	683,401,151
Less — accumulated depreciation and amortization	<u>(244,370,129)</u>	<u>(229,696,178)</u>
Property plant and equipment, net	443,529,284	453,704,973
Other assets		
Restricted investments	13,965,312	13,828,718
Restricted cash	15,564	35,312
Deferred financing costs, net	3,571,354	3,999,836
Other	242,208	194,177
Assets from risk management activities	602,981	1,447,093
Total other assets	<u>18,397,419</u>	<u>19,505,136</u>
Total assets	<u><u>\$ 517,288,743</u></u>	<u><u>\$ 507,580,384</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable — affiliates	\$ 9,418,081	\$ 6,035,719
Accounts payable — other	1,093,374	1,419,210
Accrued liabilities	563,358	445,922
Current income taxes payable	7,137,769	30,753
Accrued interest	673,003	717,187
Current maturities of long-term debt	<u>11,560,578</u>	<u>10,473,309</u>
Total current liabilities	<u>30,446,163</u>	<u>19,122,100</u>
Long-term debt	145,683,596	157,228,692
Deferred income tax liability	2,023,885	2,113,692
Liabilities from risk management activities	2,354,039	2,675,717
Employee future benefit liability	808,444	617,716
Commitments and contingencies		
Stockholders' equity		
Common stock, no par value; authorized, issued and outstanding 100,000,000 shares	309,457,729	309,457,729
Retained earnings	28,133,546	18,270,580
Accounts receivable — employees	(1,817,806)	(1,910,722)
Accumulated other comprehensive income	199,147	4,880
Total stockholders' equity	<u>335,972,616</u>	<u>325,822,467</u>
Total liabilities and stockholders' equity	<u><u>\$ 517,288,743</u></u>	<u><u>\$ 507,580,384</u></u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.

**Statements of Income
For the years ended December 31,**

	<u>2004</u>	<u>2003</u>
Revenue		
Energy revenue — contracted	\$ 38,208,575	\$ 34,979,628
Energy revenue — spot	47,588,726	34,707,293
Capacity revenue	13,638,720	10,680,681
Auxiliary services and other	<u>1,534,902</u>	<u>3,077,923</u>
Total revenue	<u>100,970,923</u>	<u>83,445,525</u>
Operating Expenses		
Transmission fees	15,793,052	16,142,106
Depreciation and amortization	15,264,798	14,907,432
Energy purchases and associated costs	3,363,800	8,425,239
General and administrative	6,411,614	6,262,710
Operations and maintenance	2,526,856	2,735,131
Operating fees	<u>2,186,283</u>	<u>1,995,334</u>
Total operating expenses	<u>45,546,403</u>	<u>50,467,952</u>
Operating income	<u>55,424,520</u>	<u>32,977,573</u>
Other Income (Expense)		
Interest income	2,009,196	1,794,596
Interest and debt expense	(17,107,168)	(18,166,180)
Income (loss) from risk management activities	(442,098)	159,103
Other	<u>183,287</u>	<u>503,486</u>
	<u>(15,356,783)</u>	<u>(15,708,995)</u>
Income before income taxes	40,067,737	17,268,578
Income Tax Expense		
Current	(12,090,592)	(4,952,823)
Deferred	<u>156,401</u>	<u>78,472</u>
	<u>(11,934,191)</u>	<u>(4,874,351)</u>
Net income	<u>\$ 28,133,546</u>	<u>\$ 12,394,227</u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.
Statements of Changes in Stockholders' Equity
For the years ended December 31, 2004 and 2003

	<u>Common Stock</u>		<u>Retained</u>	<u>Accounts</u>	<u>Accumulated</u>	
	<u>Shares</u>	<u>Dollars</u>	<u>Earnings</u>	<u>Receivable</u>	<u>Other Comprehensive</u>	<u>Total</u>
				<u>Employees</u>	<u>Income</u>	
Balance as of						
December 31, 2002	100,000,000	\$309,457,729	\$ 31,801,353	\$ —	\$ 54,719	\$341,313,801
Dividends paid	—	—	(25,925,000)	—	—	(25,925,000)
Other comprehensive loss	—	—	—	—	(49,839)	(49,839)
Disbursement for the acquisition of common stocks	—	—	—	(1,988,750)	—	(1,988,750)
Payments received from employees	—	—	—	78,028	—	78,028
Net income	<u>—</u>	<u>—</u>	<u>12,394,227</u>	<u>—</u>	<u>—</u>	<u>12,394,227</u>
Balance as of						
December 31, 2003	100,000,000	309,457,729	18,270,580	(1,910,722)	4,880	325,822,467
Dividends paid	—	—	(18,270,580)	—	—	(18,270,580)
Other comprehensive income	—	—	—	—	194,267	194,267
Payments received from employees	—	—	—	92,916	—	92,916
Net income	<u>—</u>	<u>—</u>	<u>28,133,546</u>	<u>—</u>	<u>—</u>	<u>28,133,546</u>
Balance as of						
December 31, 2004	<u>100,000,000</u>	<u>\$309,457,729</u>	<u>\$ 28,133,546</u>	<u>\$(1,817,806)</u>	<u>\$199,147</u>	<u>\$335,972,616</u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.

**Statements of Cash Flows
For the years ended December 31,**

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities		
Net income	\$ 28,133,546	\$ 12,394,227
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	15,264,798	14,907,432
Amortization of discounts on long-term debt	95,818	95,818
Provision for obsolescence of materials and supplies	144,223	91,865
Deferred income taxes	(156,401)	(78,472)
Employee future benefits	190,728	189,883
Net effect of risk management activities	442,098	(159,103)
Changes in working capital:		
Accounts receivable — affiliates	(2,328,833)	5,401,821
Accounts receivable — other	(376,363)	(332,640)
Materials and supplies	(344,455)	62,412
Other prepaid expenses and deposits	(2,387,277)	(1,356,278)
Accounts payable — affiliates	3,382,362	1,785,291
Accounts payable — other	(325,836)	331,204
Accrued liabilities	117,436	(540,896)
Income tax payable	7,107,016	(3,672,525)
Accrued interest	(44,184)	—
Net cash provided by operating activities	<u>48,914,676</u>	<u>29,120,039</u>
Cash flows from investing activities		
Expenditures for equipment and work in process	(4,660,627)	(5,002,256)
Disposal of assets	—	14,935
Increase in restricted investments	(129,554)	(5,217,588)
Increase in restricted cash	19,748	(35,312)
Decrease (increase) in non restricted investments	<u>(6,510,102)</u>	<u>7,757,594</u>
Net cash used in investing activities	<u>(11,280,535)</u>	<u>(2,482,627)</u>
Cash flows from financing activities		
Payments on debt	(10,473,309)	—
Accounts receivable — employees	92,916	(1,910,722)
Deferred financing costs	—	(95,037)
Dividends paid	<u>(18,270,580)</u>	<u>(25,925,000)</u>
Net cash used in financing activities	<u>(28,650,973)</u>	<u>(27,930,759)</u>
Change in cash and cash equivalents	8,983,168	(1,293,347)
Cash and cash equivalents at beginning of period	<u>1,222,755</u>	<u>2,516,102</u>
Cash and cash equivalents at end of period	<u>\$ 10,205,923</u>	<u>\$ 1,222,755</u>
Supplemental disclosure of cash flow information		
Interest paid	<u>\$ 16,953,939</u>	<u>\$ 17,212,500</u>
Income taxes paid	<u>\$ 4,952,823</u>	<u>\$ 4,922,070</u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.
Statements of Comprehensive Income and Accumulated Other Comprehensive Income
For the years ended December 31,

	<u>2004</u>	<u>2003</u>
Comprehensive Income		
Net income	\$28,133,546	\$12,394,227
Unrealized gain on available for sale investments	199,147	4,880
Reclassification adjustment for realized gain on available for sale investments	<u>(4,880)</u>	<u>(54,719)</u>
Comprehensive income	<u>\$28,327,813</u>	<u>\$12,344,388</u>
Accumulated Other Comprehensive Income		
Unrealized gain on available for sale investments	<u>\$ 199,147</u>	<u>\$ 4,880</u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.

Notes to Financial Statements

1. Organization and Nature of Operations

We began operations under private management on January 8, 1999, as a Panamanian Corporation. On that date, the Government of Panama sold 49% of the common stock of the Company to Americas Generation Corporation (a consortium formed by affiliates of The Coastal Corporation (subsequently merged with El Paso Corporation) and Hydro-Quebec International, Inc.). The Government of Panama retained 49.9% of our stock, which includes 0.9% that is set aside for purchase by the former employees of IRHE, former owner of Empresa de Generación Eléctrica Fortuna, S.A. (Fortuna). Our employees own the remaining 1.1%.

Our main activity is the operation of a 300 megawatt hydroelectric generation plant located on the Chiriquí River, in Chiriquí Province, Republic of Panama.

We sell electricity and electrical generating capacity to distribution companies under the terms of power purchase agreements as well as through spot market sales within Panama and to other countries in Central America.

2. Summary of Significant Accounting Policies

Basis of presentation

Our financial statements are prepared on the accrual basis of accounting in accordance with principles generally accepted in the United States of America.

The financial statements for the year ended December 31, 2003 include reclassifications that were made to conform to the current year's presentation.

The most significant reclassifications applicable to the year 2003 relate to the presentation of information for risk management activities and the balance of the accounts receivable employees originated from the stock purchase program. These reclassifications are to conform to the recommended presentation under principles generally accepted in the United States of America and do not represent a restatement of the financial statements. The reclassification primarily is the recognition of the fair value of the swap designated as hedge on the balance sheet. The effect on 2003 balance sheet and other comprehensive income statements is the reclassification of the fair value of the swap designated as hedge for \$1,387,727 from the other comprehensive income to long term-debt on the liability side of the balance sheet. Additionally, as an effect, long-term debt was reduced in \$1,387,727 increasing liabilities from risk management activities account. The amount owed by employees under the stock purchase program for \$1,910,722 is presented as a component of the stockholders equity.

None of the reclassifications has a significant impact on the financial statements taken as a whole.

Use of estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities that exist as of the date of the financial statements. Actual results may differ from those estimates.

Functional currency

Our functional currency is the United States Dollar as it is the denomination of the majority of our activities and significant contracts. The monetary unit of the Republic of Panama is the Balboa. The Balboa is valued on par with the United States Dollar and is freely convertible.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Cash and cash equivalents

We consider short-term investments purchased with original maturities of three months or less to be cash equivalents.

Investments

Our investment securities, consists primarily of debt, have been categorized as available for sale and, as a result, are stated at fair value based on quoted market prices. Investment securities available for current operations are classified as current assets.

In accordance with Statement of Financial Accounting Standard (SFAS) No. 115 “Accounting for Certain Investments in Debt and Equity Securities”, we recorded an unrealized income of \$199,147 and \$4,880 at December 31, 2004 and 2003, respectively.

Allowance for doubtful accounts

We review collectibility of our accounts receivable using the specific identification method. At December 31, 2004 and 2003, no allowance for doubtful accounts was recorded.

Inventories

Inventories consist of spare parts, supplies and materials are valued at the lower of cost or market. The cost is determined by using the average cost method. We evaluate the need to record any adjustment for impairment of inventory each year. Inventories in excess of our estimated usage requirements are written down to their net realizable value.

Property, plant and equipment

Our property, plant and equipment is stated at transfer prices assigned to each group of assets established in the privatization process. Replacements or betterments of major property are capitalized, while replacements or additional minor units of property are expensed. Depreciation is calculated using the straight-line method, which in our opinion is adequate to allocate the costs of the assets over their estimated useful lives. The estimated useful lives are fifty years for the plant, thirty-five years for substation equipment and from four to ten years for other equipment. When these properties are retired due to abandonment or replacement, the cost less accumulated depreciation, plus retirement costs, less salvage value is charged as a gain or loss to earnings.

We evaluate the impairment of property, plant and equipment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with SFAS No. 144, “Accounting for the Impairment of Disposal of Long-Lived Assets”. Any impairment adjustment would be recorded in our income statement for the excess of the carrying amount over the fair value of the asset or group of assets that may be impaired.

Accounting for asset retirement obligations

Retirement and removal liabilities that meet the criteria specified in SFAS No. 143 “Accounting for Asset Retirement Obligations”, are accounted for in accordance with that standard. This statement requires companies to record a liability relating to the retirement and removal of assets used in their business. The liability is recorded at its present value, with a corresponding asset which is depreciated over the remaining useful life of the long-lived asset to which the liability relates. An on-going expense will also be recognized for changes in the value of the liability as a result of the passage of time. As of December 31, 2004 and 2003, we do not have asset retirement obligations.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Deferred costs

Deferred costs consist of certain financing fees on bonds issued by the Company. These costs have been deferred and will be amortized over the term of the bonds to which these costs relate.

Income taxes

We report income taxes based on income reported on our tax returns along with a provision for deferred income taxes. Deferred income taxes reflect the estimated future tax consequences of differences between the financial statement and tax bases of assets and liabilities and carryovers at each year end. We account for tax credits under the flow-through method, which reduces the provision for income taxes in the year the tax credits become available. We reduce deferred tax assets by a valuation allowance when, based on our estimates, it is more likely than not that a portion of those assets will not be realized in a future period. The estimates utilized in the recognition of deferred tax assets are subject to revision, either up or down, in future periods based on new facts and circumstances.

Revenue recognition

We recognize revenue in the period electricity is delivered and generating capacity is provided. Contracted prices are billed in accordance to provisions of applicable power sales agreements, while spot sales are in accordance to market prices prevailing at the transaction date.

Environmental costs

We may be exposed to environmental costs in the ordinary course of business. Expenditures for ongoing compliance with environmental regulations that relate to current operations are expensed or capitalized, as appropriate. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current and future revenue generation, are expensed. Liabilities are recorded when environmental assessments indicate that remediation efforts are probable and the costs can be reasonably estimated.

Estimates of the liability are based upon currently available facts, existing technology and presently enacted laws and regulations taking into consideration the likely effects of inflation and other societal and economic factors, and include estimates of associated legal costs.

These amounts also consider prior experience in remediating contaminated sites, other companies' clean-up experience and data released by governmental agencies. These estimated liabilities are subject to revision in future periods based on actual costs or new circumstances, and are included in the accompanying balance sheets at their undiscounted amounts. As of December 31, 2004 and 2003, no known environmental liabilities exist.

Risk management activities

We engage in risk management activities to manage risks associated with interest rates. These risk management activities involve the use of derivative financial instruments. We account for our derivative instruments under SFAS No. 133 "Accounting for Derivatives and Hedging Activities". Under SFAS No. 133, these derivatives are reflected in our balance sheet at their fair market value as assets and liabilities from risk management activities. We classify our derivatives as either current or non-current assets or liabilities based on our overall net position by counterparty and their anticipated settlement date.

Our income statement treatment of changes in fair value and settlements of derivatives depends on the nature of the derivative instrument and the type of hedging strategy used, if any. Cash flows associated with the settlement of our derivative instruments are recognized in operating cash flows.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

3. Investments

As of December 31, 2004 and 2003 our investments consisted of the following:

<u>Description</u>	<u>2004</u>			<u>2003</u>	
	<u>Amortized Cost</u>	<u>Unrealized Gain (Loss)</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Non restricted investments					
Government of Panama Notes	\$ 4,202,044	\$158,956	\$ 4,361,000	\$ —	\$ —
Government of Panama Zero Coupon	959,530	(5,630)	953,900	847,371	847,371
Corporate securities	<u>2,195,899</u>	<u>33,901</u>	<u>2,229,800</u>	<u>—</u>	<u>—</u>
Total non restricted investments	<u>7,357,473</u>	<u>187,227</u>	<u>7,544,700</u>	<u>847,371</u>	<u>847,371</u>
Restricted investments					
Cash and cash equivalents	4,878,878	—	4,878,878	4,844,215	4,844,215
Short-term corporate instruments	4,900,086	—	4,900,086	4,846,175	4,846,175
U.S. Government Fixed Income	<u>4,174,428</u>	<u>11,920</u>	<u>4,186,348</u>	<u>4,133,448</u>	<u>4,138,328</u>
Total restricted investments	<u>13,953,392</u>	<u>11,920</u>	<u>13,965,312</u>	<u>13,823,838</u>	<u>13,828,718</u>
Total investments . . .	<u>\$21,310,865</u>	<u>\$199,147</u>	<u>\$21,510,012</u>	<u>\$14,671,209</u>	<u>\$14,676,089</u>

We consider all of our investments to be available for sale.

Non restricted investments

The amortized cost and estimated fair value of our non restricted investments at December 31, 2004 and 2003, by contractual maturity is as follows:

	<u>2004</u>		<u>2003</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less	\$2,036,707	\$2,036,000	\$847,371	\$847,371
Due in 1-2 years	959,530	953,900	—	—
Due in 2-4 years	—	—	—	—
Due after 4 years	<u>4,361,236</u>	<u>4,554,800</u>	<u>—</u>	<u>—</u>
	<u>\$7,357,473</u>	<u>\$7,544,700</u>	<u>\$847,371</u>	<u>\$847,371</u>

As of December 31, 2004, the interest rates of our non restricted investments in Government of Panama Notes and corporate securities ranges from 6.300% to 9.375%. Our investment in Government of Panama Zero Coupon for 2004 and 2003 does not bear interest.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Restricted investments

The covenants associated with our bonds require us to maintain a cash balance in a debt service reserve fund in an amount equal to the next scheduled principal and interest payment. This fund is held in the name of the bond trustee on behalf of and for the benefit of our bond holders. As of December 31, 2004 and 2003 the debt service reserve account consisted of the restricted investments detailed above.

The amortized cost and estimated fair value of our restricted investments at December 31, 2004 and 2003, by contractual maturity is as follows:

	2004		2003	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less	<u>\$13,953,392</u>	<u>\$13,965,312</u>	<u>\$13,823,838</u>	<u>\$13,828,718</u>

As of December 31, 2004 and 2003, the interest rates of our restricted investments in cash and cash equivalents, and short-term corporate instruments range from 0.97% to 2.39% and 1.178% and 1.22%, respectively. Our investment in U.S. Government Fixed Income for 2004 and 2003 does not bear interest.

4. Property, Plant and Equipment

Property, plant and equipment consisted of the following as of December 31:

	<u>2004</u>	<u>2003</u>
Hydroelectric plant	\$639,834,009	\$635,939,332
Electrical equipment	23,489,588	23,214,588
Substation equipment	13,594,110	9,377,448
Other	<u>6,913,956</u>	<u>6,913,956</u>
	683,831,663	675,445,324
Less accumulated depreciation and amortization	<u>244,370,129</u>	<u>229,696,178</u>
	439,461,534	445,749,146
Construction in process	2,744,267	6,632,344
Land	<u>1,323,483</u>	<u>1,323,483</u>
	<u>\$443,529,284</u>	<u>\$453,704,973</u>

5. Employee Stock Purchase Program

In December 2002, our Board of Directors approved a plan to allow Fortuna's employees to purchase shares of our stock. The plan is designed to allow employees to acquire up to 1.8% of our shares. These shares were previously owned by the Government of Panama. Under the plan, we created a trust to provide loans to our employees to finance their purchase. The loans, which bear interest of 3%, are to be repaid with proceeds from dividends paid on the shares owned by the employees'. The repayment period is estimated to be 10 years. The loans are secured with the pledge of the stocks that are being acquired by our employees.

The purchases by our employees were completed in October 2003 and totaled \$1,988,750, this transaction included the purchase of 845,174 shares. The outstanding amount receivable from this transaction as of December 31, 2004 and 2003 is \$1,817,806 and \$1,910,722.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

6. Risk Management Activities

The following table summarizes the carrying value of the derivatives used in our risk management activities as of December 31:

	<u>2004</u>	<u>2003</u>
Assets from risk management activities		
Fair value of derivatives not designated as hedges	\$ 602,981	\$1,447,093
Liabilities from risk management activities		
Fair value of swap designated as hedge	\$1,468,063	\$1,387,727
Fair value of other derivatives not designated as hedges	885,976	1,287,990
	<u>\$2,354,039</u>	<u>\$2,675,717</u>

We currently use derivative financial instruments to hedge the impact of our market risk exposures on liabilities. We have engaged in an interest rate swap to hedge the variability of fair value related to our outstanding bonds. Changes in the derivative fair values that are effective as fair value hedges are deferred into the carrying value of the liability hedged to the extent they are effective and are not included in income until the hedged transaction occurs and is then recognized in earnings. The ineffective portion of a hedge's change in value is recognized immediately in earnings as a component of operating income.

We formally document all relationships between hedging instruments and hedged items, as well as our risk management objectives, strategies for undertaking various hedge transactions and our methods for assessing and testing effectiveness and measuring hedge ineffectiveness. All hedging instruments are linked to the hedged asset, liability, firm commitment or forecasted transaction. We also assess whether these derivatives are highly effective in offsetting changes in fair value of the hedged items. We discontinue hedge accounting prospectively if we determine that a derivative is no longer highly effective as a hedge or if we decide to discontinue the hedging relationship.

As of December 31, 2003, to manage interest rate risk, we were party of an Interest Rate Swap and Collar agreement to pay floating rates of interest on an initial notional value of \$51,000,000 (30% of the bonds outstanding) due to changes in the benchmark interest rate — not the overall change in fair value. As of December 31, 2004, the swap's notional amount is for \$47,858,010 of the outstanding bonds. During 2004 and 2003 we received \$722,406 and \$417,138, respectively, from this transaction and we recognized it as a reduction of interest expense. Under the terms of the swap, we receive a fixed rate from the counterparty and pay a variable rate based on six month LIBOR. This swap is designated as a hedging instrument. Under the collar agreement, we are protected by the counterparty when six month LIBOR exceeds 6%. On the other hand, we must make payments to the counterparty when six month LIBOR is below 1.5%. The notional amount of the collar agreement is identical to the notional amount of the swap. The cap and floor comprising the collar agreement are not designated as hedges and are accordingly recorded in our financial statements at fair market value with changes in fair value recorded in earnings under gains and losses from risk management activities.

7. Debt Obligation

Short-term borrowings

We maintain \$18.7 million in 2004 and \$32 million in 2003 in uncommitted revolving credit facilities with two local banks. There were no draws against these facilities as of December 31, 2004 and 2003.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Bonds

The National Commission of Securities of the Republic of Panama issued Resolution No. CNV-262-02 dated June 25, 2002, which authorized the registration of Corporate Bonds to its public offering.

On June 26, 2002 we issued bonds in an aggregate amount of \$170,000,000 at par. These bonds have an interest rate of 10 $\frac{1}{8}$ % and mature on December 16, 2013. The bonds are secured by a collateral guarantee, which contains a lien on substantially all real property, machinery and equipment owned by Fortuna that is not governed by the concession contracts with the Government of Panama. The collateral also includes a pledge of all of the shares of Fortuna owned by Americas Generation Corporation (AGC), and all amounts on deposit in the Debt Service Reserve Account. (See Note 3)

We agreed under the bond offering to exercise our best efforts to obtain the necessary regulatory approvals to grant security interests to our bondholders in the concession contracts (See Note 10) with the government of Panama, including the right to receive any payments from the government of Panama in the event of the termination of such concession contracts and in substantially all real property and machinery and equipment owned by Fortuna that is governed by the concession contracts with the government of Panama.

Since the closing of the bond offering in July 2002, we have requested these approvals. The National Economic Council (CENA) has notified Fortuna that it has recommended to the Cabinet Council that it approve the grant of a security interest for the benefit of the bondholders to the extent the security interest relates to the assignment of the right to receive any payments from the government of Panama in the event of a termination of the concession contracts.

The CENA has also notified Fortuna that it will not recommend the approval for the granting of a security interest for the benefit of the bondholders to the extent it relates to real property and machinery and equipment owned by Fortuna that is governed by the concession contracts.

These decisions by the CENA have no effect on our rights or obligations as they relate to the bonds.

We may redeem some or all of the bonds, at any time prior to maturity, upon not less than 30 nor more than 60 days notice to each holder of the bonds to be redeemed, at the redemption price equal to the outstanding principal amount of the notes being redeemed, together with accrued but unpaid interest, to the date of such redemption plus the make whole premium, if any.

The distribution of dividends to stockholders will be limited by the debt service coverage ratio for the period of the four consecutive fiscal quarters then ended, at least equal to a ratio of 1.50 to 1.0. We may not declare or pay any dividend, or make any distribution, of any kind or character in respect of any class of our capital stocks except on the date when interest or principal with respect to the notes is due and payable, provided that we will not declare or make any such distribution on any such date if and event of default shall have occurred and be continuing, our projected debt service coverage ratio expected for the next four consecutive fiscal quarters is expected to be less than 1.50 to 1.00 and that debt service reserve account does not contain the prescribed minimum balance.

Our Board of Directors approved on September 18, 2003 to establish the compromise of compensating AGC for the additional risk acquired by placing its shares in Fortuna, as guarantee for the issuance of corporate bonds in June 2002 for the totality of its shares in favor of the bondholders.

We are committed to make principal and interest payments semiannually, commencing on December 16, 2002, in the case of interest, and on June 16, 2004, in the case of principal.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Our long-term debt outstanding consisted of the following at December 31:

	<u>Maturity</u>	<u>Annual Interest Rate</u>	<u>Balance</u>	
			<u>2004</u>	<u>2003</u>
Bonds	Dec. 2013	10 ¹ / ₈ %	\$159,526,691	\$170,000,000
Fair value of swap designated as hedge			(1,468,063)	(1,387,727)
Subtotal			158,058,628	168,612,273
Less:				
Unamortized discount on long- term debt			814,454	910,272
Current maturities			11,560,578	10,473,309
Total long-term debt, less current maturities			<u>\$145,683,596</u>	<u>\$157,228,692</u>

The following are the aggregate amounts of maturities of our long-term debt, including current maturities, for the next five years and in total thereafter:

<u>Year</u>	<u>Principal Amount</u>
2005	\$ 11,560,578
2006	12,760,710
2007	14,085,435
2008	15,547,690
2009	17,161,738
Thereafter	88,410,540
Total	<u>\$159,526,691</u>

8. Related Party Transactions

Energy sales and purchases

As a result of the restructuring of the electricity sector of Panama, three distribution companies, four generating companies and one transmission company were formed. The Government of Panama retains an approximate forty-nine percent (49%) interest in the generating and distribution companies and a one hundred percent (100%) interest in the transmission company. In our case, The Government of Panama retained 49.9% of our stock, which includes 0.9% that is set aside for purchase by the former employees of IRHE, former owner of Fortuna. Our employees own the remaining 1.1%

Empresa de Generación Eléctrica Fortuna, S.A.

Notes to Financial Statements — (Continued)

In the normal course of business, we conduct purchases and sales of electricity and generating capacity from or to the other generating and distribution companies, as well as make payments to the transmission company and to one of the distribution companies for the usage of their lines to transmit electricity. These transactions are made under the terms and conditions of the power purchase agreements and the transmission fees discussed in Note 10 and via the Panamanian electricity spot market. A summary of the amounts derived from the purchase and sale of energy with related parties is as follows:

<u>Description</u>	<u>2004</u>		<u>2003</u>	
	<u>Amount</u>	<u>% of Total</u>	<u>Amount</u>	<u>% of Total</u>
Revenue	\$97,587,959	97	\$79,498,608	95
Purchases of energy	\$ 1,142,834	34	\$ 3,066,435	36
Transmission costs	\$15,793,052	100	\$16,102,695	99
Moratorium interest	\$ —	—	\$ 6,063	99
Moratorium expenses	\$ 276,375	100	\$ 1,799	100

Investments

Our non restricted investments include Hydro-Québec bonds for \$2,000,000 acquired in July 2004, with interest rate of 6.30% and maturity in May 11, 2011. The amounts derived from this transaction are as follows:

<u>Description</u>	<u>2004</u>	<u>2003</u>
Non restricted investment	\$2,000,000	\$ —
Interest receivable	\$ 18,106	\$ —
Interest income	\$ 81,106	\$ —

Collateral fee

Our Board of Directors established the compromise of compensating Americas Generation Corp. (AGC) for the additional risk acquired by placing their shares in Fortuna as guarantee for the issuance of Fortuna bond's during 2002 (see Note 7). The summary of the balances and amounts derived from this transaction are as follows:

<u>Description</u>	<u>2004</u>	<u>2003</u>
Accounts payable	\$824,000	\$1,275,000
Collateral fee expense	\$824,000	\$1,275,000

Management services

We have entered into a management agreement (the agreement) with AGC by which they were granted exclusive managerial, administrative and operational control until January 8, 2019. In exchange for the services rendered under this agreement, AGC is entitled to receive from us a fee equivalent to 4% of earnings before interest expense, income taxes, depreciation and amortization (EBITDA) from 1999 through 2003 and 3% of EBITDA thereafter, as defined in the agreement. The summary of the balances and amounts derived from fees charged by AGC under the terms of this contract are as follows:

<u>Description</u>	<u>2004</u>	<u>2003</u>
Other receivables	\$ 329,204	\$ 153,566
Accounts payable	\$ 618,758	\$ 440,106
Management fee	\$2,186,283	\$1,995,334

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Technical services

We have entered into a technical assistance contract with Hydro-Quebec International, Inc. and El Paso Power Company (an affiliate of El Paso Corporation), pursuant to which we have retained personnel of Hydro Quebec International, Inc. and El Paso Corporation for technical support in the implementation and development of our generation activities. The contract expired on December 31, 2001 and was renewed through December 31, 2008. The amounts paid to Hydro-Quebec International, Inc. and El Paso Corporation under these agreements are as follows:

<u>Description</u>	<u>2004</u>	<u>2003</u>
Capitalized as construction in progress	\$ 93,362	\$238,983
Charged to expenses	\$130,074	\$ 39,924
Accounts payable	\$ —	\$136,637
Accounts receivable	\$ 5,464	\$ 23,272

Note receivable

During 2002, we entered into a loan agreement with AGC for a \$12,000,000 loan with an interest rate of 11.125%. Interest is payable semi-annually on July and December of each year. The terms of the loan establish that repayments are made upon our request based on capital expenditure needs. The loan will mature at the latest date of Fortuna's bond maturity. If AGC fails to make any required loan repayments, we will apply any dividend payments to which AGC may become entitled to the loan balance until all outstanding repayments requests have been satisfied. The balance and amounts derived from this loan agreement are as follows:

<u>Description</u>	<u>2004</u>	<u>2003</u>
Loan receivable	\$12,000,000	\$12,000,000
Interest income	\$ 1,334,970	\$ 1,335,030

9. Income Taxes

The following table reflects the component of income tax expense (benefit) included in the statement of income for the years ended December 31:

	<u>2004</u>	<u>2003</u>
Pretax income from continuing operations:	<u>\$40,067,737</u>	<u>\$17,268,578</u>
Current income tax expense	\$12,090,592	\$ 4,952,823
Deferred income tax benefit	(156,401)	(78,472)
Total income tax expense	<u>\$11,934,191</u>	<u>\$ 4,874,351</u>

Our income tax expense included in the statements of income from operations differs from the amount computed by applying the statutory income tax rate of thirty percent (30%) for the following reasons at December 31:

	<u>2004</u>	<u>2003</u>
Tax expense at statutory rate	\$12,020,321	\$5,180,573
Decrease in non-taxable interest income and other	(86,130)	(306,222)
Income tax expense	<u>\$11,934,191</u>	<u>\$4,874,351</u>
Effective tax rate	<u>29.8%</u>	<u>28.2%</u>

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

The tax payable is detailed as follows:

	<u>2004</u>	<u>2003</u>
Current income taxes.....	\$12,090,592	\$4,952,823
Less prepaid income tax	<u>4,952,823</u>	<u>4,922,070</u>
Income tax payable	<u>\$ 7,137,769</u>	<u>\$ 30,753</u>

Deferred income tax assets and liabilities recognized on temporary differences that will be reversed in future periods are detailed as follows:

	<u>2004</u>	<u>2003</u>
Deferred tax asset:		
Provision for inventory obsolescence	\$ 171,188	\$ 150,000
Provision for fringe benefits	173,090	137,237
Provision for technical assistance and other	<u>9,936</u>	<u>383</u>
Total current portion of deferred tax asset	<u>\$ 354,214</u>	<u>\$ 287,620</u>
	<u>2004</u>	<u>2003</u>
Deferred tax liability:		
Property, plant and equipment	<u>\$2,023,885</u>	<u>\$2,113,692</u>

10. Commitments and Contingencies

Labor claims

In March of 1999, we began an administrative restructuring plan that resulted in the reduction of 32 employees. Some of these employees and the employees union filed claims against us under the Panamanian labor laws for an aggregate \$1,379,000. We and our lawyers believe that the final outcome of these cases will not have a material adverse effect on our financial statements.

Additionally, we maintain labor claims for a total of \$50,500 in the District Labor Courts of Panama and Chiriquí. In the first instances, we were condemned to pay former employees this amount but we are currently in the appeal process. The final outcomes of these cases are unpredictable at this stage, but will not have a material adverse effect on our financial statements.

Power sales agreements

We have signed contracts for the sales and purchases of long-term energy and firm capacity with distribution companies for a portion of the available capacity of our facility. We are paid for the amount of electricity delivered as well as for maintaining available generating capacity. Our contractual commitment for the supply of energy and capacity in MW's of the contracts signed as of December 31, 2004 are as follows:

<u>MW</u>	<u>Year</u>
284	2005
260	2006
185	2007
224	2008

These contracts give the purchaser the right to use of the facility contracted capacity and have a priority use of the associated energy related to the contracted capacity. During the period contracts are in effect, we are committed to deliver approximately 1,000 GWh for the period 2005 up to 2007 and 1,200 GWh for 2008.

Empresa de Generación Eléctrica Fortuna, S.A.

Notes to Financial Statements — (Continued)

By effects of the economic dispatch, we are required to purchase electricity on the spot market to fulfill our commitments. In the event we unable to fulfill our contractual commitments, we are liable for a penalty up to \$1,500/MWh of the energy not delivered.

Transmission fees

Transmission fees are formulated in accordance to a tariff regime, prepared and submitted by Empresa de Transmisión Eléctrica, S. A. (ETESA) to the regulatory agency, Ente Regulador de los Servicios Públicos (ERSP), in accordance to the Transmission Regime (*Régimen Tarifario de Transmisión*) that establishes the methodology to calculate the applicable payments. This methodology is not based on production volumes.

During 2004, ETESA initiated a sanctioning process against us for an alleged debt of the company related with transmission and connection charges. The purpose of this process is to request that the ERSP issue a resolution obligating us to pay approximately \$6,000,000 to ETESA including interest. We have strongly opposed and will vigorously defend ourselves from ETESA's request. We and our lawyers believe that the possibilities of success will depend on the interpretation of the ERSP on the facts of the case. We have accrued a provision for the amount billed by ETESA in the event that the final outcome of this process obligates us to pay the alleged debt.

Service fee

We are obligated to pay to the ERSP an annual charge for control and supervision services provided to utility companies. This rate will not exceed one percent (1%) of net sales of the providers in the electric energy sector of the immediately preceding year. Our share of this fee for 2004 and 2003 was \$577,005 and \$748,028 respectively.

Performance bonds

We maintain performance bonds to support related power purchase contracts and the concession agreements. The amount of the performance bonds issued as of December 31, 2004 and 2003 was \$34,425,865 and \$39,000,000, respectively.

Concession contract

We became a party to fifty-year concession contracts that grant certain rights including the generation and sale of electricity produced by the hydroelectric plant and the rights to use the waters of the Chiriquí River. We are obligated to administer, operate and maintain the plant during the term of the contract. Such terms may be renewed for an additional fifty years subject to the ERSP approval.

11. Fair Value of Financial Instruments

Carrying value of financial instruments, including cash and cash equivalents, accounts receivable, investments, accounts payable and accrued expenses, approximates to fair value because of their short-term nature or the market-based nature of the instrument's interest rate. The fair value of our long-term debt has been estimated based on quoted market price for the same available locally. The carrying amount of the long-term debt, including current maturities, does not exceed the estimated fair value.

Empresa de Generación Eléctrica Fortuna, S.A.

**Balance Sheet
(Unaudited)**

**As of
December 31,
2002**

ASSETS

Current assets:

Cash and cash equivalents	\$ 2,516,102
Non restricted investments	8,646,287
Accounts receivable — affiliates	17,903,114
Accounts receivable — other	215,663
Materials and supplies	5,224,772
Deferred tax asset	290,727
Other prepaid expenses and deposits	<u>730,337</u>
Total current assets	<u>35,527,002</u>

Note receivable — affiliate	12,000,000
Property, plant and equipment	678,555,350
Less — accumulated depreciation and amortization	<u>(215,360,847)</u>
Property, plant and equipment, net	463,194,503

Other assets

Restricted investments	8,619,647
Deferred financing costs, net	<u>5,341,470</u>
Total other assets	<u>13,961,117</u>

Total assets	<u><u>\$ 524,682,622</u></u>
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LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities

Accounts payable — affiliates	\$ 4,250,428
Accounts payable — other	1,088,006
Accrued liabilities	1,414,651
Current income taxes payable	3,703,278
Current portion of deferred income taxes	100,000
Accrued interest	<u>717,187</u>
Total current liabilities	<u>11,273,550</u>

Long-term debt	170,000,000
Deferred income tax liability	2,095,271

Commitments and contingencies

Stockholders' equity

Common stock, no par value; authorized, issued and outstanding 100,000,000 shares ...	309,457,729
Accumulated other comprehensive income	54,719
Retained earnings	<u>31,801,353</u>
Total stockholders' equity	<u>341,313,801</u>
Total liabilities and stockholders' equity	<u><u>\$ 524,682,622</u></u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.

**Statement of Income
(Unaudited)**

	For the Year Ended December 31, 2002
Revenue	
Energy revenue — contracted	\$ 55,988,954
Energy revenue — spot	26,470,437
Capacity revenue	17,551,200
Auxiliary services and other	<u>838,750</u>
Total revenue	<u>100,849,341</u>
Operating expenses	
Energy purchases and associated costs	6,357,911
Transmission fees	13,490,258
Operations and maintenance	2,450,780
Operating fees	2,900,757
General and administrative	6,483,521
Depreciation and amortization	<u>14,711,202</u>
Total operating expenses	<u>46,394,429</u>
Operating income	<u>54,454,912</u>
Other income (expense)	
Interest income	1,326,491
Interest and debt expense	(12,146,124)
Other	<u>418,581</u>
	<u>(10,401,052)</u>
Income before income taxes	44,053,860
Income tax expense	
Current	(13,291,795)
Deferred	<u>114,288</u>
	<u>(13,177,507)</u>
Net income	<u><u>\$ 30,876,353</u></u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.
Statement of Changes in Stockholders' Equity
(Unaudited)

	Common Stock		Retained Earnings		Accumulated Other Comprehensive Income	Total
	Shares	Dollars	Unrestricted	Internally Designated		
Balance as of December 31, 2001	100,000,000	\$309,457,729	\$ 22,707,513	\$ 4,000,000	\$ —	\$336,165,242
Transfer to unrestricted retained earnings	—	—	4,000,000	(4,000,000)	—	—
Dividends paid	—	—	(25,782,513)	—	—	(25,782,513)
Other comprehensive income	—	—	—	—	54,719	54,719
Net income	—	—	30,876,353	—	—	30,876,353
Balance as of December 31, 2002	<u>100,000,000</u>	<u>\$309,457,729</u>	<u>\$ 31,801,353</u>	<u>\$ —</u>	<u>\$54,719</u>	<u>\$341,313,801</u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.

**Statement of Cash Flows
(Unaudited)**

	For the Years Ended December 31, 2002
Cash flows from operating activities	
Net income	\$ 30,876,353
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	14,711,202
Deferred income taxes	(114,288)
Changes in working capital:	
Accounts receivable — affiliates	(4,898,419)
Accounts receivable — other	(28,748)
Materials and supplies	(150,191)
Prepaid taxes	812,547
Other prepaid expenses and deposits	(225,103)
Accounts payable — affiliates	508,105
Accounts payable — other	(5,889,067)
Accrued liabilities	794,310
Income tax payable	3,703,278
Accrued interest	(2,198,871)
Net cash provided by operating activities	<u>37,901,108</u>
Cash flows from investing activities	
Expenditures for equipment and work in process	(3,948,288)
Note receivable — affiliate	(12,000,000)
Increase in restricted investments	(8,606,250)
Decrease in non restricted investments	<u>(8,604,965)</u>
Net cash used in investing activities	<u>(33,159,503)</u>
Cash flows from financing activities	
Proceeds from bond issuance	170,000,000
Payments on debt	(141,319,949)
Deferred financing costs	(5,580,589)
Dividends paid	<u>(25,782,513)</u>
Net cash used in financing activities	<u>(2,683,051)</u>
Change in cash and cash equivalents	2,058,554
Cash and cash equivalents at beginning of period	<u>457,548</u>
Cash and cash equivalents at end of period	<u>\$ 2,516,102</u>
Supplemental disclosure of cash flow information	
Interest paid	<u>\$ 14,344,995</u>
Income taxes paid	<u>\$ 8,775,968</u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.
Statement of Comprehensive Income and Changes in Accumulated Other Comprehensive Income
(Unaudited)

	For the Years Ended December 31, 2002
Comprehensive Income	
Net income	\$30,876,353
Unrealized gain on investments	<u>54,719</u>
Other comprehensive income	<u>54,719</u>
Comprehensive income	<u><u>\$30,931,072</u></u>
Changes in Accumulated Other Comprehensive Income	
Balance, January 1	\$ —
Other comprehensive income	<u>54,719</u>
Balance, December 31	<u><u>\$ 54,719</u></u>

See accompanying notes.

Empresa de Generación Eléctrica Fortuna, S.A.

**Notes to Financial Statements
(Unaudited)**

1. Organization and Nature of Operations

We began operations under private management on January 8, 1999, as a Panamanian Corporation. On that date, the Government of Panama sold 49% of the common stock of the Company to Americas Generation Corporation (a consortium formed by affiliates of The Coastal Corporation (subsequently merged with El Paso Corporation) and Hydro-Quebec International, Inc.). The Government of Panama retained 50.8% of our stock, which includes 1.8% that is set aside for purchase by our employees. Our employees own the remaining 0.2%.

Our main activity is the operation of a 300 megawatt hydroelectric generation plant located on the Chiriquí River, in Chiriquí Province, Republic of Panama.

We sell electricity and electrical generating capacity to distribution companies under the terms of power purchase agreements as well as through spot market sales within Panama and to other countries in Central America.

2. Summary of Significant Accounting Policies

Basis of Presentation

Our financial statements are prepared on the accrual basis of accounting in accordance with principles generally accepted in the United States of America.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities that exist as of the date of the financial statements. Actual results may differ from those estimates.

Functional Currency

Our functional currency is the United States Dollar as it is the denomination of the majority of our activities and significant contracts. The monetary unit of the Republic of Panama is the Balboa. The Balboa is valued on par with the United States Dollar and is freely convertible.

Cash and Cash Equivalents

We consider short-term investments purchased with original maturities of three months or less to be cash equivalents.

Investments

Our investment securities, consists primarily of debt, have been categorized as available for sale and, as a result, are stated at fair value based on quoted market prices. Investment securities available for current operations are classified as current assets.

In accordance with Statement of Financial Accounting Standard (SFAS) No. 115 "Accounting for Certain Investments in Debt and Equity Securities", we recorded an unrealized income of \$54,719 at December 31, 2002.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Revenue Recognition and Receivables

We recognize revenue in the period electricity is delivered and generating capacity is provided.

Allowance for Doubtful Accounts

We review collectibility of our accounts receivable using the specific identification method. At December 31, 2002, no allowance for doubtful accounts was recorded.

Inventories

Inventories consist of spare parts, supplies and materials are valued at the lower of cost or market. The cost is determined by using the average cost method. We evaluate the need to record any adjustment for impairment of inventory each year. Inventories in excess of our estimated usage requirements are written down to their net realizable value.

Property, Plant and Equipment

Our property, plant and equipment is stated at transfer prices assigned to each group of assets established in the privatization process. Replacements or betterments of major property are capitalized, while replacements or additional minor units of property are expensed. Depreciation is calculated using the straight-line method, which in our opinion is adequate to allocate the costs of the assets over their estimated useful lives. The estimated useful lives are fifty years for the plant, thirty-five years for substation equipment and from four to ten years for other equipment. When these properties are retired due to abandonment or replacement, the cost less accumulated depreciation, plus retirement costs, less salvage value is charged as a gain or loss to earnings. Beginning in 2003, retirement and removal liabilities that meet the criteria specified in SFAS No. 143, *Accounting for Asset Retirement Obligations*, will be accounted for in accordance with that standard. See *Recent Accounting Pronouncements* below.

We evaluate the impairment of property, plant and equipment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with SFAS No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets*.

Deferred Costs

Deferred costs consist of certain financing fees and discounts on bonds issued by the Company. These costs have been deferred and will be amortized over the term of the bonds to which these costs relate.

Income Taxes

We report income taxes based on income reported on our tax returns along with a provision for deferred income taxes. Deferred income taxes reflect the estimated future tax consequences of differences between the financial statement and tax bases of assets and liabilities and carryovers at each year end. We account for tax credits under the flow-through method, which reduces the provision for income taxes in the year the tax credits become available. We reduce deferred tax assets by a valuation allowance when, based on our estimates, it is more likely than not that a portion of those assets will not be realized in a future period. The estimates utilized in the recognition of deferred tax assets are subject to revision, either up or down, in future periods based on new facts and circumstances.

Environmental Costs

We may be exposed to environmental costs in the ordinary course of business. Expenditures for ongoing compliance with environmental regulations that relate to current operations are expensed or capitalized, as

Empresa de Generación Eléctrica Fortuna, S.A.

Notes to Financial Statements — (Continued)

appropriate. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current and future revenue generation, are expensed. Liabilities are recorded when environmental assessments indicate that remediation efforts are probable and the costs can be reasonably estimated.

Estimates of the liability are based upon currently available facts, existing technology and presently enacted laws and regulations taking into consideration the likely effects of inflation and other societal and economic factors, and include estimates of associated legal costs.

These amounts also consider prior experience in remediating contaminated sites, other companies' clean-up experience and data released by governmental agencies. These estimated liabilities are subject to revision in future periods based on actual costs or new circumstances, and are included in the accompanying balance sheet at their undiscounted amounts. As of December 31, 2002, no known environmental liabilities exist. We plan on spending approximately \$1,000,000 over the next five years on environmental matters.

Recent Accounting Pronouncements

Accounting for Asset Retirement Obligations

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. This statement requires companies to record a liability relating to the retirement and removal of assets used in their business. The liability is recorded at its present value, with a corresponding asset which is depreciated over the remaining useful life of the long-lived asset to which the liability relates. An on-going expense will also be recognized for changes in the value of the liability as a result of the passage of time. The provisions of this Statement are effective for fiscal years beginning after June 15, 2002. The adoption of this statement did not have any impact on our financial statements.

Accounting for Costs Associated with Exit or Disposal Activities

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This statement will require us to recognize costs associated with exit or disposal activities when they are incurred rather than when we commit to an exit or disposal plan. Examples of costs covered by this guidance include lease termination costs, employee severance costs that are associated with restructurings, discontinued operations, plant closings or other exit or disposal activities. The provisions of this statement are effective for fiscal years beginning after December 31, 2002 and will impact any exit or disposal activities we initiate after January 1, 2003.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

3. Investments

As of December 31, 2002 our investments consisted of the following:

<u>Description</u>	<u>Amortized Cost</u>	<u>Unrealized Gain (Loss)</u>	<u>Estimated Fair Value</u>
Non restricted investments			
Government of Panama Notes	\$ 2,415,334	\$17,666	\$ 2,433,000
Government of Panama Zero Coupon	3,337,109	(3,236)	3,333,873
Corporate securities	2,852,522	26,892	2,879,414
Total non restricted investments	<u>8,604,965</u>	<u>41,322</u>	<u>8,646,287</u>
Restricted investments			
Cash and cash equivalents	3,271,823	—	3,271,823
Short-term corporate instruments	3,269,500	5,937	3,275,437
U.S. Government Fixed Income	2,064,927	7,460	2,072,387
Total restricted investments	<u>8,606,250</u>	<u>13,397</u>	<u>8,619,647</u>
Total investments	<u>\$17,211,215</u>	<u>\$54,719</u>	<u>\$17,265,934</u>

Non Restricted Investments

We consider all of our non restricted investments to be available for sale.

The amortized cost and estimated fair value of our non restricted investments at December 31, 2002, by contractual maturity is as follows:

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less	\$3,337,109	\$3,333,873
Due in 1-2 years	—	—
Due in 2-4 years	—	—
Due after 4 years	5,267,856	5,312,414
	<u>\$8,604,965</u>	<u>\$8,646,287</u>

Restricted Investments

The covenants associated with our bonds require us to maintain a cash balance in a debt service reserve fund in an amount equal to the next scheduled principal and interest payment. This fund is held in the name of the bond trustee on behalf of and for the benefit of our bondholders. As of December 2002, the debt service reserve account consisted of the restricted investments detailed above.

The amortized cost and estimated fair value of our restricted investments at December 31, 2002, by contractual maturity is as follows:

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less	\$8,606,250	\$8,619,647

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

4. Property, Plant and Equipment

Property, plant and equipment consisted of the following as of December 31, 2002:

Hydroelectric plant	\$634,768,265
Electrical equipment	22,326,436
Substation equipment	9,377,448
Other	6,147,213
	<u>672,619,362</u>
Less accumulated depreciation and amortization	215,360,847
	457,258,515
Construction in process	4,612,505
Land	1,323,483
	<u><u>\$463,194,503</u></u>

5. Debt Obligation

Short-Term Borrowings

We maintain \$18 million in 2002 in uncommitted revolving credit facilities with two local banks. There were no draws against these facilities as of December 31, 2002.

Long-Term Debt

As the result of the privatization process, we, along with, the Instituto de Recursos Hidráulicos y Electrificación (IRHE) and the Panamanian Government signed a Debt Assignment and Assumption Contract in which IRHE and the Panamanian Government assigned and we agreed to assume certain long-term debts of IRHE. We agreed to and were obliged to comply with all conditions of the original debt contracts.

We emerged as the principal debtor with Impregilo, S.p.A. and make all related payments directly to the creditor. For the remaining debts, the Republic of Panama remained as principal debtor, and we reimbursed the government for all related payments.

Under the terms of our debt agreement, we were required to pay the Republic of Panama an annual guarantee fee equal to ½ of 1% of the total remaining outstanding assumed debt on the anniversary date of the contract.

Our debt agreement also required us to either prepay or refinance all of the assumed debt on or by January 1, 2003. On July 3, 2002, all of the debt and related obligations assumed through the privatization process were repaid in full with the proceeds of the bond issuance.

Bonds

On June 26, 2002 we issued bonds in an aggregate amount of \$170,000,000 at par. These bonds have an interest rate of 10½% and mature on December 16, 2013. The bonds are secured by collateral guarantee, which contains a lien on substantially all real property, machinery and equipment owned by Fortuna that is not governed by the concession contracts with the Government of Panama. The collateral also includes a pledge of all of the shares of Fortuna owned by Americas Generation Corporation (AGC), and all amounts on deposit in the Debt Service Reserve Account. (See Note 3)

We agreed under the bond offering to exercise our best efforts to obtain the necessary regulatory approvals to grant security interests to our bondholders in the concession contracts (See Note 9) with the

Empresa de Generación Eléctrica Fortuna, S.A.

Notes to Financial Statements — (Continued)

government of Panama, including the right to receive any payments from the government of Panama in the event of the termination of such concession contracts and in substantially all real property and machinery and equipment owned by Fortuna that is governed by the concession contracts with the government of Panama.

Since the closing of the bond offering in July 2002, we have requested these approvals. The National Economic Council (CENA) has notified Fortuna that it has recommended to the Cabinet Council that it approve the grant of a security interest for the benefit of the bondholders to the extent the security interest relates to the assignment of the right to receive any payments from the government of Panama in the event of a termination of the concession contracts.

The CENA has also notified Fortuna that it will not recommend the approval for the granting of a security interest for the benefit of the bondholders to the extent it relates to real property and machinery and equipment owned by Fortuna that is governed by the concession contracts.

These decisions by the CENA have no effect on our rights or obligations as they relate to the bonds.

We may redeem some or all of the bonds, at any time prior to maturity, upon not less than 30 nor more than 60 days notice to each holder of the bonds to be redeemed, at the redemption price equal to the outstanding principal amount of the notes being redeemed, together with accrued but unpaid interest, to the date of such redemption plus the make whole premium, if any.

The distribution of dividends to stockholders will be limited by the debt service coverage ratio for the period of the four consecutive fiscal quarters then ended, at least equal to a ratio of 1.50 to 1.0. We may not declare or pay any dividend, or make any distribution, of any kind or character in respect of any class of our capital stocks except on the date when interest or principal with respect to the notes is due and payable, provided that we will not declare or make any such distribution on any such date if an event of default shall have occurred and be continuing, our projected debt service coverage ratio expected for the next four consecutive fiscal quarters is expected to be less than 1.50 to 1.00 and that debt service reserve account does not contain the prescribed minimum balance.

We are committed to make principal and interest payments semiannually, commencing on December 16, 2002, in the case of interest, and on June 16, 2004, in the case of principal.

Our long-term debt outstanding consisted of the following at December 31, 2002:

	<u>Maturity</u>	<u>Annual Interest Rate</u>	<u>Balance 2002</u>
Bonds	Dec. 2013	10⅞%	<u>\$170,000,000</u>

The following are the aggregate amounts of maturities of our long-term debt, including current maturities, for the next five years and in total thereafter:

<u>Year</u>	<u>Principal Amount</u>
2003	\$ —
2004	10,473,309
2005	11,560,578
2006	12,760,710
2007	14,085,435
Thereafter	<u>121,119,968</u>
Total	<u>\$170,000,000</u>

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

6. Related Party Transactions

Energy Sales and Purchases

As a result of the restructuring of the electricity sector of Panama, three distribution companies, four generating companies and one transmission company were formed. The Government of Panama retains an approximate forty-nine percent (49%) interest in the generating and distribution companies and a one hundred percent (100%) interest in the transmission company. In our case, The Government of Panama retained 50.8% of our stock, which includes 1.8% set aside for purchase by employees. Our employees own the remaining 0.2%.

In the normal course of business, we conduct purchases and sales of electricity and generating capacity from or to the other generating and distribution companies, as well as make payments to the transmission company and to one of the distribution companies for the usage of their lines to transmit electricity. These transactions are made under the terms and conditions of the power purchase agreements and the transmission fees discussed in Note 9, and via the Panamanian electricity spot market. A summary of the amounts derived from the purchase and sale of energy with related parties as of December 31, 2002 is as follows:

<u>Description</u>	<u>Amount</u>	<u>% of Total</u>
Revenue	\$100,388,878	99
Purchases of energy	3,435,250	54
Transmission costs	13,413,075	99

Debt Assignment and Assumption Agreement

As a result of the privatization, and pursuant to an assignment and assumption agreement with the Panamanian Government and IRHE, we were assigned certain debt obligations. A portion of this debt was owed to the Government of Panama. (See Note 5). During 2002 there was no interest expense based on this agreement. The amount of the annual guarantee fee recorded according to the debt agreement during 2002 was \$352,473.

Management Services

We have entered into a management agreement with Americas Generation Corp. (AGC) by which they were granted exclusive managerial, administrative and operational control until January 8, 2019. In exchange for the services rendered under this agreement, AGC is entitled to receive from us a fee equivalent to 4% of earnings before interest expense, income taxes, depreciation and amortization (EBITDA) from 1999 through 2003 and 3% of EBITDA thereafter. The summary of the balances and amounts derived from fees charged by AGC under the terms of this contract as of December 31, 2002 are as follows:

<u>Description</u>	
Accounts payable	\$ 764,924
Management fee	\$2,900,757

Technical Services

We have entered into a technical assistance contract with Hyrdo-Quebec International, Inc. and El Paso Power Company (an affiliate of El Paso Corporation), pursuant to which we have retained personnel of Hydro-Quebec International, Inc. and El Paso Corporation for technical support in the implementation and development of our generation activities. The contract expired on December 31, 2001 and was renewed through December 31, 2008. The amounts paid to Hydro-Quebec International, Inc. and El Paso Corporation under these agreements as of December 31, 2002 are as follows:

Empresa de Generación Eléctrica Fortuna, S.A.

Notes to Financial Statements — (Continued)

<u>Description</u>	
Capitalized as construction in progress	\$269,376
Charged to expenses	\$ 43,359
Accounts payable	\$475,791
Accounts receivable	\$ 303

Note Receivable

During 2002, we entered into a loan agreement with AGC for a \$12,000,000 loan with an interest rate of 11.125%. Interest is payable semi-annually on July and December of each year. The terms of the loan establish that repayments are made upon our request based on capital expenditure needs. The loan will mature at the latest date of Fortuna's bond maturity. If AGC fails to make any required loan repayments, we will apply any dividend payments to which AGC may become entitled to the loan balance until all outstanding repayments requests have been satisfied. The balance and amounts derived from this loan agreement as of December 31, 2002 are as follows:

<u>Description</u>	
Loan receivable	\$12,000,000
Interest income	\$ 665,671

7. Retained Earnings

Our Board of Directors, in its June 2, 1999 meeting, determined to draw from our accumulated retained earnings as of January 8, 1999, \$10,000,000 to establish an internally designated reserve restricted for any unpaid obligations, future claims or contingencies that were in existence at the time of the privatization. On October 21, 1999, our Board determined to reverse \$6,000,000 of the reserve and pay the same amount as dividends to the Panamanian Government. This amount related to earnings of the company from the period prior to the privatization.

On December 10, 2002 our Board of Directors determined that the only remaining obligation from the pre-privatization period was for \$925,000 for certain repairs to the access roads in the vicinity of the Plant. At this time, our Board voted to transfer \$3,075,000 from internally designated retained earnings to unrestricted retained earnings. The Board of Directors also approved the payment of \$3,075,000 as dividends to the Panamanian Government and the remaining \$925,000 withheld in retained earnings destined to be used for repairing the access roads to the Plant.

8. Income Taxes

The following table reflects the component of income tax expense (benefit) included in the statement of income for the year ended December 31, 2002:

Pretax income from continuing operations	\$44,053,860
Current income tax expense	\$13,291,795
Deferred income tax benefit	<u>(114,288)</u>
Total income tax expense	<u>\$13,177,507</u>

Empresa de Generación Eléctrica Fortuna, S.A.

Notes to Financial Statements — (Continued)

Our income tax expense included in the statement of income from operations differs from the amount computed by applying the statutory income tax rate of thirty percent (30%) for the following reasons at December 31, 2002:

Tax expense at statutory rate	\$13,216,158
Decrease in non-taxable interest income and other	<u>(38,651)</u>
Income tax expense	<u>\$13,177,507</u>
Effective tax rate	<u>29.9%</u>

The tax payable is detailed as follows:

Current income taxes	\$13,291,795
Less prepaid income tax	<u>9,588,517</u>
Income tax payable	<u>\$ 3,703,278</u>

At December 31, 2002 deferred income tax assets and liabilities recognized on temporary differences that will be reversed in future periods are detailed as follows:

Deferred tax asset:

Provision for inventory obsolescence	\$180,000
Provision for fringe benefits	97,704
Provision for technical assistance and other	<u>13,023</u>
Total current portion of deferred tax asset	<u>\$290,727</u>

Deferred tax liability:

Depreciation expense applicable to future periods	\$ 2,195,271
Less current portion of depreciation expense	<u>100,000</u>
Total non-current portion of deferred tax liability	<u>\$ 2,095,271</u>

9 Commitments and Contingencies

Labor Claims

In March of 1999, we began an administrative restructuring plan that resulted in the reduction of 32 employees. Some of these employees filed claims against us under the Panamanian labor laws for an aggregate \$379,000. Additionally, we are awaiting the outcome of the claims announced by the former IRHE Union members in a labor related case for \$175,000, in which the first court decision was in our favor. A second court reaffirmed this decision. We believe that the final outcome of this case will not have a material adverse effect on our financial statements.

Power Purchase Agreements

We are a party to long-term firm capacity and required associated energy contracts with the distribution companies for a portion of the available capacity of our facility. We are paid for the amount of electricity

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

delivered as well as for maintaining available generating capacity. The size and expiration dates of the contracts are as follows:

<u>MW</u>	<u>Expiration</u>
140	December 31, 2003
24	December 31, 2004

These contracts give the purchaser the right of use of the contracted firm capacity of our facility and a priority use of the associated energy related to the firm capacity. During the period that both contracts are in effect, we are committed to deliver approximately 1,000 GWh in 2004 and 900 GWh in 2005 of electricity. By effects of the national economic dispatch, we will be required to purchase electricity on the spot market to meet our commitments. Any differential in cost between the amount paid on the spot market and the sales price per our contracts is recognized in our income statement in the period the energy is delivered. In the event that we are unable to fulfill our obligations under the contracts, we are liable for a penalty of five times the sales price of the energy not delivered.

Transmission Fees

Transmission fees are set according to the rates established by the ERSP, a regulatory agency, and are not based on production volumes. According to law, the ERSP reviews the rates every four years. The last review of the rates was completed on July 1, 2001.

Service Fee

We are obligated to pay to the ERSP an annual charge for control and supervision services provided to utility companies. This rate will not exceed one percent (1%) of net sales of the providers in the electric energy sector of the immediately preceding year. Our share of this fee for 2002 was \$629,322.

We have requested the ERSP to declare non-applicable for the generating companies the obligation of paying the control and supervision charge, based on Law 6 of 1997. The ERSP has refused the request. We have appealed their decision and are waiting for the resolution of the appeal from the Supreme Court.

Discharge Tunnel Repairs

We are carrying out a program for an integral improvement of the discharge tunnel, which constitutes a long-term project of major importance for the continuity and efficiency of plant operations. We have estimated that total disbursements required to cover the cost of permanent improvements to the tunnel is approximately \$12,000,000. As of December 31, 2002, we had accumulated costs, primarily related to a major improvement to the discharge tunnel, of \$10,354,038.

During 2002, we capitalized as fixed assets \$5,077,952 out of the total accumulated costs of the project.

Performance Bonds

We maintain performance bonds to support related power purchase contracts and the concession agreements. The amount of the performance bonds issued as of December 31, 2002 was \$49,000,000.

Concession Contract

We became a party to fifty-year concession contracts that grant certain rights including the generation and sale of electricity produced by the hydroelectric plant and the rights to use the waters of the Chiriquí River. We are obligated to administer, operate and maintain the plant during the term of the contract. Such terms may be renewed for an additional fifty years subject to the ERSP approval.

Empresa de Generación Eléctrica Fortuna, S.A.
Notes to Financial Statements — (Continued)

Substation Expansion

During 2002 we entered into a contract for \$1,639,876 for the expansion of the 230KV substation. It is anticipated that the work will be completed by May 2003.

Employees stock acquisition plan

On December 10, 2002, our board of directors approved the plan for the purchase of Fortuna's stock by employees. The purchase plan includes the creation of a trust fund as mechanism for the stock acquisition. The plan is designed to allow employees to acquire up to 1.8% set aside for them that is currently included in the total ownership of the Government of Panama.

10. Fair Value of Financial Instruments

Carrying value of financial instruments, including cash and cash equivalents, accounts receivable, investments, accounts payable and accrued expenses, approximates to fair value because of their short-term nature or the market-based nature of the instrument's interest rate. The fair value of our long-term debt has been estimated based on quoted market price for the same available locally. The carrying amount of the long-term debt, including current maturities, does not exceed the estimated fair value.

Report of Independent Auditors

To the Stockholders of Saba
Power Company (Private) Limited:

In our opinion, the accompanying balance sheets and the related statements of operations, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Saba Power Company (Private) Limited (the "Company") at December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the Company has restated its financial statements as of January 1, 2003.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has suffered events of default on its debt facilities and the lenders have notified the Company of their intent to exercise their default remedies available which include accelerating the payment of all outstanding principal, interest and penalties and which raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ PricewaterhouseCoopers LLP

Houston, Texas
August 26, 2005

Saba Power Company (Private) Limited

Balance Sheets

	<u>December 31, 2004</u>	<u>December 31, 2003</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 45,117,839	\$ 36,896,657
Accounts receivable	9,361,751	7,759,415
Inventory		
Supplies	3,824,518	3,868,498
Fuel	3,639,558	3,655,151
Advance for fuel purchases	2,436,822	1,407,772
Prepaid and other current assets	<u>246,614</u>	<u>299,649</u>
Total Current Assets	<u>64,627,102</u>	<u>53,887,142</u>
Property, plant, and equipment:		
Equipment	141,115,237	141,068,588
Land	<u>422,783</u>	<u>422,783</u>
Subtotal	141,538,020	141,491,371
Less: accumulated depreciation	<u>(24,611,573)</u>	<u>(19,829,413)</u>
Property, Plant, and Equipment, net	<u>116,926,447</u>	<u>121,661,958</u>
Other assets:		
Deferred financing costs, net	3,427,410	4,144,891
Other deferred costs, net	<u>—</u>	<u>988</u>
Total Other Assets	<u>3,427,410</u>	<u>4,145,879</u>
Total assets	<u><u>\$184,980,959</u></u>	<u><u>\$179,694,979</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Interest payable	\$ 20,160,116	\$ 14,280,447
Accounts payable		
Trade	4,787,352	4,942,223
Affiliates	2,830,452	2,929,697
Retainage payable	—	1,658,179
Notes payable	<u>88,601,955</u>	<u>87,944,437</u>
Total Current Liabilities	<u>116,379,875</u>	<u>111,754,983</u>
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Common stock, (10 Rupee par value); 240,000,000 ordinary shares authorized and 234,279,683 shares issued and outstanding	54,842,706	54,842,706
Additional paid-in capital	7,442,445	7,442,445
Retained earnings	<u>6,315,933</u>	<u>5,654,845</u>
Total Stockholders' Equity	<u>68,601,084</u>	<u>67,939,996</u>
Total liabilities and stockholders' equity	<u><u>\$184,980,959</u></u>	<u><u>\$179,694,979</u></u>

See the accompanying notes to these financial statements.

Saba Power Company (Private) Limited
Statements of Operations

	For the Year Ended December 31, 2004	For the Year Ended December 31, 2003
Revenue		
Electricity capacity	\$22,111,894	\$23,195,512
Electricity energy	<u>31,686,139</u>	<u>23,526,025</u>
Total revenue	<u>53,798,033</u>	<u>46,721,537</u>
Operating expenses		
Fuel	35,527,134	26,875,639
Administrative	2,844,077	5,715,161
Operating	1,752,043	1,741,573
Depreciation	<u>4,782,160</u>	<u>4,799,699</u>
Total operating expenses	<u>44,905,414</u>	<u>39,132,072</u>
Operating income	<u>8,892,619</u>	<u>7,589,465</u>
Other (income) expense		
Interest income	(200,799)	(544,342)
Interest expense	6,597,149	6,115,750
Foreign exchange loss (gain)	<u>1,835,181</u>	<u>(520,567)</u>
Total other expense	<u>8,231,531</u>	<u>5,050,841</u>
Net income	<u><u>\$ 661,088</u></u>	<u><u>\$ 2,538,624</u></u>

See the accompanying notes to these financial statements.

Saba Power Company (Private) Limited
Statements of Changes in Stockholders' Equity

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Paid in Capital</u>	<u>Earnings</u>	<u>Total</u>
Balance, January 1, 2003, as previously reported	234,279,683	\$54,842,706	\$7,442,445	\$ 6,613,719	\$68,898,870
Adjustment (Note 2)	<u>—</u>	<u>—</u>	<u>—</u>	<u>(3,497,498)</u>	<u>(3,497,498)</u>
Balance, January 1, 2003, as restated	234,279,683	54,842,706	7,442,445	3,116,221	65,401,372
Net income	<u>—</u>	<u>—</u>	<u>—</u>	<u>2,538,624</u>	<u>2,538,624</u>
Balance, December 31, 2003 . .	234,279,683	54,842,706	7,442,445	5,654,845	67,939,996
Net income	<u>—</u>	<u>—</u>	<u>—</u>	<u>661,088</u>	<u>661,088</u>
Balance, December 31, 2004 . .	<u>234,279,683</u>	<u>\$54,842,706</u>	<u>\$7,442,445</u>	<u>\$ 6,315,933</u>	<u>\$68,601,084</u>

See the accompanying notes to these financial statements.

Saba Power Company (Private) Limited
Statements of Cash Flows

	For the Year Ended December 31, 2004	For the Year Ended December 31, 2003
Cash flows from operating activities:		
Net income	\$ 661,088	\$ 2,538,624
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,500,629	5,516,977
Foreign currency exchange (gains)/losses	1,561,747	(322,077)
Other non-cash income adjustments	657,518	1,219,347
Working capital changes:		
Accounts receivable	(1,602,336)	4,686,489
Advance for fuel purchases	(1,029,050)	1,647,837
Fuel inventory	15,593	(1,732,143)
Supplies inventory	43,980	(145,034)
Prepaid and other current assets	53,035	(70,484)
Interest payable	5,879,670	5,398,269
Accounts payable	(154,872)	(870,297)
Accounts payable, affiliates	(99,245)	253,891
Retainage payable	(1,658,179)	—
Net cash provided by operating activities	<u>9,829,578</u>	<u>18,121,399</u>
Cash flows from investing activities:		
Equipment purchases	(46,649)	(166,030)
Net cash used in investing activities	<u>(46,649)</u>	<u>(166,030)</u>
Effect of exchange rate changes on cash	(1,561,747)	322,077
Net increase in cash and cash equivalents	8,221,182	18,277,446
Cash and cash equivalents at beginning of period	<u>\$36,896,657</u>	<u>\$18,619,211</u>
Cash and cash equivalents at end of period	<u>\$45,117,839</u>	<u>\$36,896,657</u>

See the accompanying notes to these financial statements.

Saba Power Company (Private) Limited

Notes to Financial Statements

1. Organization and Background

We were organized on December 7, 1994, as a Pakistani public limited company under the Pakistani Companies Ordinance, 1984. By subsequent amendment of its Memorandum of Association, our legal structure was converted to a private limited company, effective November 18, 1996. Our primary purpose is the ownership and operation of a residual fuel oil fired 125.55 net megawatt ("MW") power plant near Farouqabad, Pakistan (the "Facility"). The construction of the plant was completed and we began operations in December 1999.

The successful operation of our facility is dependent upon future events, including the completion of permanent financing arrangements and the execution of amendments to various operating agreements. Failure to obtain permanent financing arrangements or to execute certain amendments to our operating agreements could have a material adverse effect on our financial position, results of operations and cash flows. As discussed further in Note 3, we are in default on certain of our debt agreements and one of the lenders has delivered to us a notice of its intent to exercise the default remedies available which include immediate payment of all outstanding principal, interest and penalties. Accordingly, the related amounts outstanding have been classified as current liabilities in the accompanying balance sheets. See Note 5 for additional information.

Pursuant to a Purchase and Sale Agreement, dated November 26, 1996, Coastal Saba Power Ltd. ("Coastal SP"), an indirect wholly owned subsidiary of El Paso CGP Company ("El Paso CGP") (formerly the Coastal Corporation prior to its merger with El Paso in January 2001), agreed to acquire a 72% interest in our capital stock. This percentage interest was subsequently modified pursuant to the Shareholders' Agreement dated February 25, 1997. As of December 31, 2004, Coastal SP, Cogen Technologies Saba Capital Company L.L.C. ("Cogen") and Capco Resources Inc. ("Capco") own 94.14%, 4.71% and 1.15%, respectively, of our outstanding shares, except for eight shares held by directors. Net income is allocated to our shareholders based on their respective ownership interests.

2. Summary of Significant Accounting Policies

Basis of Presentation

Our financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Restatement

During the completion of the financial statements for the years ended December 31, 2003 and 2004, we identified that we had not appropriately recorded interest expense and associated charges, primarily related to penalty interest, from June 2000 through 2002 due to our lenders as provided for in the contractual terms of our borrowing agreements. As a result, we have restated our retained earnings and stockholders' equity balances as of January 1, 2003, in our statement of changes in stockholders' equity to appropriately reflect the cumulative amount of these charges that should have been recorded in prior periods. The effect of this restatement was to decrease retained earnings and stockholders' equity as of January 1, 2003 by approximately \$3.5 million from the \$6.6 million and \$68.9 million previously reported to \$3.1 million and \$65.4 million as restated. Such interest and associated charges have been appropriately reflected in the 2004 and 2003 financial statements.

Use of Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities that exist at the date of the financial statements. Actual results could differ from those estimates.

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

Functional Currency

Our functional currency is the U.S. dollar since the majority of our activities and significant contractual agreements are denominated in or indexed to U.S. dollars and based on the Government of Pakistan's ("GOP") commitment to guarantee our conversion of Pakistan rupees into U.S. dollars under the terms of our Implementation Agreement ("IA") (See Note 5 for additional information). All monetary assets and liabilities denominated in the Pakistan rupee have been remeasured into the U.S. dollar using the current exchange rates as of December 31, 2004 and 2003. All nonmonetary balance sheet items, income and related expenses denominated in the Pakistan rupee are remeasured into the U.S. dollar using historic exchange rates. Foreign exchange gains and losses resulting from remeasurement are recorded during the period and are recognized in the accompanying statements of operations.

Revenue Recognition

We recognize revenue when we deliver electric energy and provide electric capacity. Revenue is based on the quantity of electric energy delivered and electric capacity provided at the rates specified in our Power Purchase Agreement ("PPA").

Cash and Cash Equivalents

We consider all highly liquid investments with original maturities of three months or less to be cash and cash equivalents.

Accounts Receivable

Accounts receivable include all trade accounts receivable owed to us for capacity revenue and sales of energy. Periodically, we review the collectability of our accounts receivable using the specific identification method and establish an allowance for amounts that are not expected to be collected. As of December 31, 2004 and 2003, there was no allowance for doubtful accounts recorded.

Advance for Fuel Purchases

We make advances to our fuel supplier for the purchase of one month of fuel. Upon delivery, an amount representing the cost of the fuel is reclassified to fuel inventory.

Inventory

Inventory, which consists of fuel, spare parts, materials and supplies, is recorded at the lower of cost or market. Cost is determined on a first-in, first-out ("FIFO") basis for fuel inventory and a weighted average basis for spare parts, materials and supplies.

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

Property, Plant and Equipment

Property, plant, and equipment are stated at cost. Betterments of major units of property are capitalized, while repairs, maintenance and replacements or additions of minor units of property are expensed. Depreciation is calculated using the straight-line method based on an estimated useful life and an estimated salvage value. The estimated useful lives of our assets are 30 years for the generating plant, 10 years for office equipment, furniture and fixtures, and telecommunication equipment, and 5 years for vehicles. Net investment in property, plant and equipment as of December 31, 2004 and 2003, consisted of the following:

	<u>December 31, 2004</u>	<u>December 31, 2003</u>
Generating plant.....	\$140,318,258	\$140,272,137
Land	422,783	422,783
Office equipment	52,176	52,176
Furniture and fixtures	98,768	98,240
Telecommunication equipment.....	614,990	614,990
Vehicles.....	31,045	31,045
Less: Accumulated depreciation.....	<u>(24,611,573)</u>	<u>(19,829,413)</u>
Property, plant, & equipment, net	<u>\$116,926,447</u>	<u>\$121,661,958</u>

We evaluate the impairment of our long-lived assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires that long-lived assets be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When such events or changes in circumstances occur, an impairment loss is recognized if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. We did not record any asset impairments in 2004 and 2003.

Deferred Financing Costs

Deferred financing costs consist of certain fees paid to obtain and continue the loan facility of the Eurocurrency Facility and the Eximbank Credit Facility (See Note 3 for additional information). These costs have been deferred and are being amortized on a straight-line basis over the term of the related debt facility. The ABN Amro (Eximbank Credit Facility) financing costs are being amortized over 12 years and the Sanwa (Eurocurrency Facility) financing costs are being amortized over 7 years. Total amortization expense for the year ended December 31, 2004 and 2003, amounted to \$717,481 in each year, and was reported as a component of interest expense in the accompanying statements of operations.

Taxation

We are not subject to income tax in Pakistan due to the exemption granted by the IA (See Note 5 for additional information). Accordingly, no current or deferred income taxes have been provided in the accompanying financial statements.

3. Debt Agreements

We entered into loan agreements with three separate lenders to provide construction and term financing for our Facility. Under the terms of our loan agreement with ABN AMRO Bank (“ABN”), ABN provided construction financing with a loan of approximately \$81.5 million, bearing interest at LIBOR + 1.75% (the “Construction Facility”), that contains an Eximbank Guarantee Agreement Against Political Risks (“Eximbank Guarantee”) and Sanwa Bank provided a \$25.0 million loan, bearing interest at

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

LIBOR + 3.625% (the “Eurocurrency Facility”). After completion and acceptance of the Facility, the Construction Facility was scheduled to be repaid with the proceeds of a direct loan (the “Eximbank Credit Facility”) from Eximbank. As collateral for the Construction Facility and Eurocurrency Facility, we have pledged substantially all of our assets and our shareholders have additionally pledged their shares in us.

Under the Eurocurrency Facility, there was to be fourteen semi-annual principal and interest payments beginning March 15, 2000. We have incurred events of default under the Eurocurrency Facility for the failure to pay principal and interest due per the terms of the loan agreement. We have failed to make any principal payments since the initial contractual payment date of March 15, 2000 and we have not made any interest payments since June 2002. Under the terms of the Eurocurrency Facility, if an event of default occurs and is ongoing, the Eurocurrency Facility Agent has the right, among other rights, to declare all outstanding amounts to be immediately due and payable. The Eurocurrency Facility Agent has not delivered to us any notices of its intent to exercise the default remedies available. As a result of the uncured event of default as of December 31, 2004 and 2003, the \$25.0 million Eurocurrency Facility balance outstanding has been reflected as a current liability in the accompanying balance sheets. Total interest payable at December 31, 2004 and 2003 related to the Eurocurrency Facility was approximately \$6.4 million and \$4.6 million, respectively. There have been no payments of principal or interest subsequent to December 31, 2004.

The Construction Facility was to mature on December 31, 1999, and was to be repaid with funds from the Eximbank Credit Facility. As a result of Eximbank’s re-examination of the project, Eximbank determined that it would not provide funding under the Eximbank Credit Facility. In addition, as the result of Eximbank’s failure to provide financing, the State Bank of Pakistan has not accepted the registration of the Construction Facility and therefore we have not been able to make any principal or interest payments related to the Construction Facility. Interest payments have not been made since June 2002 under the Construction Facility. We incurred events of default under the Construction Facility as a result of nonpayment of principal at December 31, 1999 and the termination of the Eximbank Credit Facility. Accordingly, the Construction Facility Agent has the right, among other rights, to declare all outstanding amounts to be immediately due and payable. Of the \$81.5 million originally available under the Construction Facility, a total of \$63.6 million had been drawn and remains outstanding as of December 31, 2004. The total amount outstanding under the Construction Facility has been reflected as a current liability in the accompanying balance sheets as of December 31, 2004 and 2003. We incur commitment fees on the Construction Facility of .5% per annum on the unused portion of the Construction Facility and we also incur agency fees on the Construction Facility of \$150,000 per year, plus expenses.

We previously entered into a Standstill Agreement with Eximbank, ABN and the Eximbank lenders syndicate. The Standstill Agreement provided, among other things, that the outstanding balance of the Construction Facility would not be accelerated because of the occurrence and continuation of any event of default or potential event of default related generally to the nonpayment of amounts due under the loan agreements. The initial Standstill Agreement was executed as of December 22, 1999, and was subsequently extended and restated through September 2001. In September 2001, the Standstill Agreement expired and was not extended. The Eximbank Facility Agent (ABN) delivered to us a notice of its intent to exercise the default remedies available which include immediate payment of all outstanding principal, interest and penalties in February 2002.

We, ABN, the syndicate Eximbank lenders, Eximbank and Sanwa continue to negotiate the terms and provisions of a restructuring of the term financing for the project and executed a term sheet in December 2004 in an attempt to restructure our debt. We have been incurring penalty interest of 2% on all outstanding balances since June 2000 though a portion of this penalty interest may be forgiven if the refinancing is completed by August 31, 2005. As of December 31, 2004 and 2003, we have included approximately \$6.3 million and \$4.8 million, respectively, of penalty interest in interest payable.

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

As previously discussed, we are in default on our debt agreements due to non-payment (and due to the fact that we have not funded the required debt service reserve balances and other required reserve accounts) and, in one case, the lender has delivered to us a notice of their intent to exercise their default remedies one of which could result in the lenders accelerating amounts owed under the debt agreements and their subsequent foreclosure on the shares owned by our shareholders. Accordingly, the related amounts outstanding have been classified as a current liability in the accompanying balance sheets. We do not have the working capital availability or alternative means of financing in place to meet our obligations. There can be no assurance that the outcome of these negotiations will result in our favor or will not have a material adverse effect on our financial position, results of operations or cash flows. As a result of the default, our lenders have final approval of our operating expenditures and we are not able to make dividend distributions to our shareholders.

Our financial statements have been prepared assuming that we will continue as a going concern. There can be no assurance that we will be able to restructure our indebtedness successfully or that our liquidity and capital resources will be sufficient to maintain normal operations. These financial statements do not include any adjustments relating to the recoverability and classification of assets carrying amounts or the amount and classification of liabilities that might result should we be unable to continue as a going concern.

4. Related Party Transactions

Management Services Agreement

We entered into a management services agreement (the “MSA Agreement”) with El Paso Technology Pakistan (Private) Limited (“EPTP”), an indirect wholly-owned subsidiary of El Paso CGP. The agreement provides for EPTP to have general responsibility for managing our affairs. As consideration for services rendered, EPTP is reimbursed on a monthly basis for its actual costs incurred plus a fixed annual fee of \$10,000. The agreement was executed on February 25, 1997, and will terminate on December 31, 2016, subject to early termination by either party in accordance with the terms of the agreement. During the years ended December 31, 2004 and 2003, we incurred \$446,455 and \$426,282, respectively, of expenses related to the MSA agreement.

Operations and Maintenance Agreement

We entered into an operations and maintenance agreement (the “O&M Agreement”) with EPTP, which provides for an annual operations and maintenance fee of \$100,000, indexed annually for inflation, and reimbursements of certain expenses including payroll costs. During the years ended December 31, 2004 and 2003, we incurred \$995,598 and \$1,053,300, respectively, of expenses related to the O&M agreement. The O&M Agreement is set to expire on December 31, 2005, however Saba and EPTP may decide to extend the agreement on mutually beneficial terms.

Accounts Receivable and Payable — Affiliates

Coastal Saba Investor II (“CSI II”), a wholly owned subsidiary of El Paso CGP, incurred expenditures on our behalf for the development of the Facility. As of December 31, 2004 and 2003, accounts payable to CSI II amounted to \$1,520,284. These accounts payable are non interest bearing. Due to the loan defaults discussed in Note 3, no payments have been made on this liability.

Other affiliate payables of \$1,310,168 and \$1,409,414 were due to EPTP as of December 31, 2004 and 2003, respectively. These payables relate to costs incurred related to our MSA Agreement and the O&M Agreement with EPTP. These accounts payable are also non interest bearing.

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

5. Commitments and Contingencies

Legal Proceedings

Engineering Procurement and Construction Procurement Contracts

During our development stage, we entered into an Engineering and Procurement Contract (“EP Contract”) with the Babcock & Wilcox Company (“B&W”), a subsidiary of McDermott International, Inc., to perform the design, engineering and procurement services necessary to complete the Facility. The EP Contract provided for bonuses and liquidated damages, as appropriate, depending on completion dates and certain output performance levels. We also entered into a Construction and Procurement Contract (“CP Contract”) with B&W Construction Company, Inc. (a subsidiary of B&W) to perform the local procurement, construction, installation, commissioning, and demonstration services necessary to complete the Facility.

Pursuant to the terms of our EP Contract and CP Contract, B&W pledged to complete the Facility to a certain level of readiness (known as “MPA”) by April 4, 1999. The Facility did not reach MPA until October 29, 2000, which is the official date certified by the lenders’ engineer pursuant to the contract. After MPA was reached on October 29, 2000, we issued a demand to B&W for delay liquidated damages as set forth in the contracts. B&W responded by asserting that its delays were excused by events of force majeure and in November 2001 we filed a Demand for Arbitration with the American Arbitration Association (“AAA”) pursuant to the contracts, seeking approximately \$24 million in damages. In January 2002, B&W filed an answer and counterclaim, asserting approximately \$15 million in damages including a demand for payment of approximately \$9 million in retainage. In January 2004, the AAA issued a final resolution on these claims and awarded to B&W \$1,575,207 in settlement of both of these claims. The impact of this resolution resulted in a non-cash reduction of approximately \$7.5 million in retainage payable and property, plant, and equipment in the accompanying 2003 balance sheet.

On February 25, 2004, B&W filed a motion to modify the award, requesting that the AAA enter additional monetary awards in their favor of approximately \$1.3 million. We filed a response to this motion on March 5, 2004, in which we opposed all of these additional claims. On April 1, 2004, the arbitrators granted this motion to modify the award and awarded B&W an additional \$82,972. Shortly thereafter, B&W filed suit in the federal court in New York City seeking to confirm its total arbitration award (\$1,575,207 plus \$82,972 plus post award interest), and on June 29, 2004, the court confirmed the total award and entered judgment in favor of B&W and against us. In July 2004, B&W served notice of the judgment on us and served a Restraining Notice and Execution of Notice to Garnishee on ABN AMRO. On December 17, 2004, the balance of \$1,658,179 was paid to B&W.

Withholding Tax

We received an assessment in August 1998 from the Pakistan Central Board of Revenue (“CBR”) alleging that we failed to comply with certain Pakistan withholding tax requirements. The amount of the assessment was approximately \$1.8 million and we were required to deposit \$625,000 in order to appeal the assessment. In 1999, the Commissioner of Income Tax (Appeals) ordered the assessment “set aside,” effectively ruling in our favor. We received a refund of the deposit from the CBR on August 13, 1999. We, along with the CBR, filed appeals before the Pakistan Income Tax Appellate Tribunal (“ITAT”), who decided to hear both appeals simultaneously. To date, the ITAT has not heard the case. We do not believe that any liability that we might incur as a result of this litigation would have a material adverse effect on our financial condition, results of operations, or cash flows.

Cogen Suit

In June 2005, Cogen and Nadeem Babar (“Claimants”) filed a petition against us, ABN, Coastal SP, Coastal Saba Investor, Coastal Saba Investor II, and the El Paso Corporation (“Respondents”). The petition

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

was for recovery of approximately \$10 million and a permanent injunction against the transfer of our assets, operation of our bank accounts maintained with ABN, and the restriction of the sale of our stock held by Coastal SP as a result of certain “enhancement events” which Claimants allege have occurred. In July 2005, Claimants obtained a court order restraining Respondents from transferring any shares held by Coastal SP. Further hearings are scheduled for September 2005. Respondents deny that any “enhancement events” have occurred and do not agree that payment is due. We do not believe that any liability that we might incur as a result of this litigation would have a material adverse effect on our financial condition, results of operations, or cash flows.

Power Purchase Agreement

We entered into a 30-year term PPA with the Pakistan Water and Power Development Authority (“WAPDA”) whereby WAPDA agreed to purchase up to 105% of the Facility’s dependable capacity of 108.57 net megawatts pursuant to the PPA. Subsequently, we entered into a Memorandum of Understanding (“MOU”) with WAPDA in July 1999, which resulted in a slight reduction in the power tariff and increased the amount of estimated dependable capacity to 119.57 net megawatts. We are in the process of incorporating the terms of the MOU into an amendment to the PPA. Under the terms of the MOU, the PPA amendment, if executed, will (1) limit our liquidated damages payable to WAPDA to the \$2.8 million for the period from August 1998 through June 1999, which is recorded in trade payables at December 31, 2004 and 2003; (2) eliminate certain financial and operations and maintenance reserve requirements required by the PPA which are described below; and (3) extend the required commercial operations date. We believe the PPA amendment will ultimately be approved and executed and the resulting changes will not have a material adverse effect on our operations. We are currently operating according to the terms of the MOU agreement with the exception of a dispute related to the level of dependable capacity. In December 2002, we demonstrated and tested dependable capacity above 125.55 MW. However, we declared dependable capacity at 125.55 megawatts, which is 105% of 119.57 megawatts. WAPDA has only recognized dependable capacity of 116 megawatts and is only paying capacity payments based on this level of capacity. We and WAPDA have agreed to non-binding mediation related to this capacity issue, as well other issues, pursuant to the dispute resolution process provided for in the PPA. We have not recognized any revenue related to the incremental dependable capacity to which we believe we are entitled. During the years 2004 and 2003, we did not recognize approximately \$1.8 million and \$1.6 million of revenue related to this dispute.

Under the terms of the PPA and the MOU, we deliver electricity only as instructed by WAPDA. The price paid by WAPDA for electricity consists of a non-escalable capacity payment, an escalable capacity payment and an energy payment. The non-escalable capacity payment is structured to cover our debt service requirements, including payments of principal and interest, and is indexed for changes in the Pakistan Rupee exchange rate in order to provide for a fixed payment in U.S. dollars. The escalable component is structured to cover our operating, administrative and general expenses, as well as provide a return on and of equity to the stockholders and is also indexed for changes in inflation and Pakistan Rupee exchange rates. The energy payment is based on net electrical output of the Facility and contains a fuel cost component and an operations and maintenance cost component indexed for changes in inflation and changes in the Pakistan Rupee exchange rate. If, through a change in law or a political force majeure event (as defined in the PPA), we are required to repair or make changes to the Facility, we will be allowed to pass those charges through to WAPDA via a supplemental tariff.

Under the terms of the PPA, we are charged penalties related to outages incurred above a certain level. The penalty charged is based on a multiple of the average capacity purchase price for outages above a certain allowable limit each year. We did not incur any penalties related to outages in 2003 or 2004. We are also subject to a penalty of 0.30 Rupees per kilowatt-hour, escalated annually for changes in Pakistan inflation and exchange rates, if we do not meet the dispatch requests of WAPDA within established levels. During the years

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

ended December 31, 2004 and 2003, we incurred \$57,456 and \$31,338, respectively, of penalties related to this provision, which are included in our operating expenses.

The PPA also required us to maintain a letter of credit for the benefit of WAPDA equal to \$25 per kilowatt of estimated dependable capacity. We are also required to maintain a reserve fund at a level mutually agreed to by us and WAPDA, which was to be initially funded at an amount equal to approximately three months of the annual operating and maintenance budget. Money in the reserve fund could be used by us for major maintenance items in the event that we lacked other available funds for operation and maintenance of the plant. As of December 31, 2004, we have not funded these reserves based on the PPA renegotiation and the fact that the MOU eliminated this requirement.

We would be considered to be in default of the PPA and the PPA would terminate if, among other things, we incurred cumulative operating losses greater than 50% of the equity contributed by our shareholders commensurate with the funding of the construction financing plus any additional equity committed after the funding of the construction financing. The PPA also imposes penalties on WAPDA if certain contractual conditions are not met such as amounts charged to us as penalties under the FSA for changes in the Facility's anticipated fuel usage due to changes in WAPDA's dispatch level requirements. These provisions of the PPA were not changed with the MOU.

We receive a bonus of 0.08 Rupee for each kWh of net electrical output above certain minimums during the months of January through June of each year. The amount of the bonus payable is indexed over the initial term of the PPA for changes in Pakistan inflation and Pakistan Rupee exchange rates.

Fuel Supply Agreement

We entered into a 30-year term Fuel Supply Agreement ("FSA") with Pakistan State Oil Company Ltd. ("PSO") where PSO is the exclusive supplier of fuel, diesel oil, greases, lubricants and additives for the Facility. The prices for fuel and diesel oil are established by the GOP Petroleum Products (Development Surcharge) Ordinance 1961, subject to the condition that no price shall exceed the price charged for like quality by PSO to all other thermal generating plants in the same geographic area. Prices for greases, lubricants and additives must be mutually agreed to by us and PSO, based on PSO's current trade price lists and the price charged for like quality and specification by PSO to other thermal generating plants.

The FSA requires us to maintain a 30 day supply of fuel at full load operations basis. The FSA recognizes that the Facility may be shutdown for 30 days every year and for 60 days every 5th year for scheduled outages. The FSA requires 60 days advance notice of the beginning and duration of the scheduled outages.

As a result of executing the MOU related to the PPA, we have negotiated an amendment to the FSA to reflect the increase in the dependable capacity and the related fuel supply requirements. We believe the amendments will ultimately be approved and executed and the resulting changes will not have a material adverse impact on our operations. Currently, we are operating and paying according to the terms of the negotiated amendment.

Implementation Agreement

We entered into the IA under which the GOP agrees to use its best efforts to support our exclusive right to design, finance, insure, construct, complete, own, operate and maintain our Facility throughout the initial term of our PPA, including any extension caused by the occurrence of a "force majeure" event. The IA may be extended by mutual agreement. Through the IA, the GOP agrees to use all reasonable efforts to assist us in obtaining all necessary consents, and grants our exemption from taxation of income during the term of the PPA, including exemption prior to commercial operations from customs duties on the import of materials and equipment. The IA allows us to register anywhere in Pakistan and to change our registration from time to time, in order to allow us to obtain favorable stamp tax and registration fee rates for registration of the

Saba Power Company (Private) Limited
Notes to Financial Statements — (Continued)

financing documents and other documents or instruments in connection with the project. Under the IA and with appropriate consent and/or approval from the State Bank of Pakistan, we may freely transfer funds to banks or other parties outside of Pakistan without foreign exchange restrictions.

The IA imposes certain deadlines and other requirements, the violation of which can be considered an event of default and may require us to transfer the Facility to the GOP. If the Facility is transferred to the GOP in the event of such a default, we will be reimbursed by the GOP for our outstanding debt. Upon default, the IA will terminate and the GOP will have no further interest in or obligations under the IA. Some of the more significant events of default include the following: (a) cumulative operating losses (as determined under the IA) of at least 50% of the combined equity contributions; and (b) any material breach by us of the PPA or the FSA which is not remedied within 30 days after notice of the breach. There has been no event of default under the terms of the IA.

In 2002, we amended the IA to extend the original required commercial operations date, and to reflect the terms of the negotiated amendments to the PPA and FSA discussed above.

6. Concentration of Credit and Business Risk

Financial instruments, which potentially subject us to credit risk, consist of cash and accounts receivable. Our cash accounts are held by major financial institutions. Our receivables are concentrated with WAPDA, as they are the sole purchaser of our electrical output under the terms of PPA. Our fuel purchases are concentrated with PSO as they are the sole provider of our fuel supply and their performance has been guaranteed by the GOP under the IA. Our customer, industry, and geographic concentrations have the potential to impact our overall exposure to credit risk, either positively or negatively, in that the customer base may be similarly affected by changes in economic, industry, weather or other conditions.

7. Fair Value of Financial Instruments

As of December 31, 2004 and 2003, the carrying value of financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and debt, approximates fair value because of their short-term nature, the market-based nature of the debt's interest rate, and other factors. While there is no liquid market for our notes payable, we believe that the carrying value approximates its fair value at December 31, 2004 and 2003.

Saba Power Company (Private) Limited

**Balance Sheets
(Unaudited)**

	<u>December 31, 2002</u>	<u>June 30, 2002</u>
	<u>(Restated)</u>	<u>(Restated)</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 18,619,211	\$ 3,673,823
Accounts receivable	12,445,904	17,593,238
Inventory:		
Supplies	3,723,464	3,668,051
Fuel	1,923,008	2,964,764
Advance for fuel purchases	3,055,609	2,005,497
Prepaid and other current assets	229,165	741,434
Total Current Assets	<u>39,996,361</u>	<u>30,646,807</u>
Property, Plant, and Equipment:		
Equipment	140,902,558	148,371,202
Land	422,783	422,783
Subtotal	141,325,341	148,793,985
Less: accumulated depreciation	<u>(15,029,714)</u>	<u>(12,520,439)</u>
Property, Plant, and Equipment, net	<u>126,295,627</u>	<u>136,273,546</u>
Other Assets:		
Deferred financing costs, net	4,862,372	5,221,112
Other deferred costs, net	785	1,279
Total Other Assets	<u>4,863,157</u>	<u>5,222,391</u>
Total Assets	<u><u>\$171,155,145</u></u>	<u><u>\$172,142,744</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Interest payable	\$ 8,882,178	\$ 5,918,857
Accounts payable:		
Trade	5,812,520	5,155,152
Affiliates	2,675,806	2,581,498
Retainage payable	1,658,179	9,126,989
Notes payable	86,725,090	86,725,090
Total Current Liabilities	<u>105,753,773</u>	<u>109,507,586</u>
Stockholders' Equity:		
Common stock, (10 Rupee par value); 240,000,000 ordinary shares authorized and 234,279,683 shares issued and outstanding	54,842,706	54,842,706
Additional paid-in capital	7,442,445	7,265,331
Retained earnings	3,116,221	527,121
Total Stockholders' Equity	<u>65,401,372</u>	<u>62,635,158</u>
Total Liabilities and Stockholders' Equity	<u><u>\$171,155,145</u></u>	<u><u>\$172,142,744</u></u>

See the accompanying notes to these financial statements.

Saba Power Company (Private) Limited
Statements of Operations
(Unaudited)

	For the Six Months Ended December 31, 2002 <u>(Restated)</u>	For the Year Ended June 30, 2002 <u>(Restated)</u>
Revenue		
Electricity capacity	\$11,939,635	\$23,982,568
Electricity energy	<u>9,707,905</u>	<u>22,828,912</u>
Total revenue	<u>21,647,540</u>	<u>46,811,480</u>
Operating expenses		
Fuel	11,110,337	24,792,823
Administrative	2,259,092	3,662,357
Operating	932,166	4,272,972
Depreciation	<u>2,509,275</u>	<u>5,019,152</u>
Total operating expenses	<u>16,810,870</u>	<u>37,747,304</u>
Operating income	<u>4,836,670</u>	<u>9,064,176</u>
Other (income) expense		
Interest income	(427,491)	(1,171,451)
Interest expense	3,322,061	7,069,922
Foreign exchange gain	<u>(647,000)</u>	<u>(907,338)</u>
Total other expense	<u>2,247,570</u>	<u>4,991,133</u>
Net income	<u><u>\$ 2,589,100</u></u>	<u><u>\$ 4,073,043</u></u>

See the accompanying notes to these financial statements.

Saba Power Company (Private) Limited
Statements of Changes in Stockholders' Equity
(Unaudited)

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Paid in Capital</u>	<u>Earnings</u>	<u>Total</u>
				<u>(Deficit)</u>	
				<u>(Restated)</u>	
Balance, July 1, 2001, as previously reported	175,054,683	\$43,342,706	\$18,765,331	\$(2,409,307)	\$59,698,730
Adjustment (Note 2)	—	—	—	(1,136,615)	(1,136,615)
Balance, July 1, 2001, as restated	175,054,683	\$43,342,706	\$18,765,331	\$(3,545,922)	\$58,562,115
Issuance of shares	59,225,000	11,500,000	(11,500,000)	—	—
Net income	—	—	—	4,073,043	4,073,043
Balance, June 30, 2002	234,279,683	54,842,706	7,265,331	527,121	62,635,158
Paid in capital	—	—	177,114	—	177,114
Net income	—	—	—	2,589,100	2,589,100
Balance, December 31, 2002 . .	<u>234,279,683</u>	<u>\$54,842,706</u>	<u>\$ 7,442,445</u>	<u>\$ 3,116,221</u>	<u>\$65,401,372</u>

See the accompanying notes to these financial statements.

Saba Power Company (Private) Limited
Statements of Cash Flows
(Unaudited)

	<u>For the Six Months Ended December 31, 2002</u> (Restated)	<u>For the Year Ended June 30, 2002</u> (Restated)
Cash Flows From Operating Activities		
Net income	\$ 2,589,100	\$ 4,073,043
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,868,509	5,738,813
Foreign currency exchange gains	(470,480)	(406,949)
Gain on sale of equipment	—	(6,095)
Working capital changes:		
Accounts receivable	5,147,334	(6,250,166)
Advance for fuel purchases	(1,050,112)	(630,747)
Fuel inventory	1,041,756	(1,157,169)
Supplies inventory	(55,413)	(526,207)
Prepaid and other current assets	512,269	(723,426)
Interest payable	2,963,321	(797,532)
Accounts payable	657,368	2,730,952
Accounts payable, affiliates	94,308	(2,697,096)
Net cash provided by (used in) operating activities	<u>14,297,960</u>	<u>(652,579)</u>
Cash Flows From Investing Activities:		
Equipment purchases	(166)	(211,345)
Proceeds from sale of equipment	<u>—</u>	<u>4,406</u>
Net cash used in investing activities	<u>(166)</u>	<u>(206,939)</u>
Cash Flows From Financing Activities:		
Proceeds from additional paid in capital	<u>177,114</u>	<u>—</u>
Net cash provided by financing activities	<u>177,114</u>	<u>—</u>
Effect of Exchange Rate Changes on Cash	470,480	406,949
Net Increase (Decrease) in Cash and Cash Equivalents	14,945,388	(452,569)
Cash and Cash Equivalents at Beginning of Period	<u>3,673,823</u>	<u>4,126,392</u>
Cash and Cash Equivalents at End of Period	<u><u>\$18,619,211</u></u>	<u><u>\$ 3,673,823</u></u>
Supplemental Cash Flow Disclosure:		
Non-cash reduction in retainage payable	\$ 7,468,810	—
Interest paid	—	\$ 7,150,074

See the accompanying notes to these financial statements.

SABA POWER COMPANY (PRIVATE) LIMITED

NOTES TO FINANCIAL STATEMENTS

1. Organization and Background

We were organized on December 7, 1994, as a Pakistani public limited company under the Pakistani Companies Ordinance, 1984. By subsequent amendment of its Memorandum of Association, our legal structure was converted to a private limited company, effective November 18, 1996. Our primary purpose is the ownership and operation of a residual fuel oil fired 124.7 net megawatt ("MW") power plant near Farouqabad, Pakistan (the "Facility"). The construction of the plant was completed and we began operations in December 1999.

The successful operation of our facility is dependent upon future events, including the completion of permanent financing arrangements and the execution of amendments to various operating agreements. Failure to obtain permanent financing arrangements or to execute certain amendments to our operating agreements could have a material adverse effect on our financial position, results of operations and cash flows. As discussed further in Note 4, we are in default on certain of our debt agreements and one of the lenders has delivered to us a notice of the intent to exercise the default remedies available which include immediate payment of all outstanding principal, interest, and penalties. Accordingly, the related amounts outstanding have been classified as current liabilities in the accompanying balance sheets. See Note 6 for a discussion regarding amendments to the Implementation Agreement ("IA").

Pursuant to a Purchase and Sale Agreement, dated November 26, 1996, Coastal Saba Power Ltd. ("Coastal SP"), an indirect wholly owned subsidiary of El Paso CGP Company ("El Paso CGP") (formerly the Coastal Corporation prior to its merger with El Paso in January 2001), agreed to acquire a 72% interest in our capital stock. This percentage interest was subsequently modified pursuant to the Shareholders' Agreement dated February 25, 1997. As of December 31, 2002, Coastal SP, Cogen Technologies Saba Capital Company L.L.C. ("Cogen") and Capco Resources Inc. ("Capco") own 92.15%, 6.31% and 1.54%, respectively, of our outstanding shares, except for eight shares held by directors (For further information on the Shareholders' Agreement, see Note 3).

2. Summary of Significant Accounting Policies

Basis of Presentation

Our financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Certain reclassifications have been made to prior year in order to conform to the current presentation. Such reclassifications had no impact on operating income, net income, or stockholders' equity. In 2002, we changed our accounting year end from June 30 to December 31. Accordingly we have presented our financial statements as of and for the six months ended December 31, 2002, and as of and for the year ended June 30, 2002.

Restatement

During the completion of the financial statements for the years ended December 31, 2003 and 2004, we identified that we had not appropriately recorded interest expense and associated charges, primarily related to penalty interest from June 2000 through 2002 due to our lenders as provided for in the contractual terms of our borrowing agreements. As a result, we have restated these 2002 financial statements to appropriately reflect this interest expense and associated charges in prior periods. The effects of this restatement on our financial statements are shown below:

	For the Six Months Ended December 31, 2002		For the Year Ended June 30, 2002	
	As Reported	As Restated	As Reported	As Restated
Income Statement:				
Administrative Expense	\$2,142,879	\$2,259,092	N/A	N/A
Interest Expense	2,505,531	3,322,061	5,641,782	7,069,922
Net income	3,521,843	2,589,100	5,501,183	4,073,043

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

	As of December 31, 2002		As of June 30, 2002	
	As Reported	As Restated	As Reported	As Restated
Balance Sheet:				
Interest Payable	\$ 5,555,135	\$ 8,882,178	\$ 3,408,344	\$ 5,918,857
Accounts Payable — Trade	5,642,065	5,812,520	5,100,910	5,155,152
Retained Earnings	6,613,719	3,116,221	3,091,876	527,121
Total Stockholder's Equity	68,898,870	65,401,372	65,199,913	62,635,158

In our statements of cash flows for both periods, our total cash flows from operating, investing and financing activities were unaffected by these restatements; however, individual line items within these statements have been restated.

Use of Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities that exist at the date of the financial statements. Actual results could differ from those estimates.

Functional Currency

Our functional currency is the U.S. dollar since the majority of our activities and significant contractual agreements are denominated in or indexed to U.S. dollars and based on the Government of Pakistan's ("GOP") commitment to guarantee our conversion of Pakistan rupees into U.S. dollars under the terms our IA (See Note 6). All monetary assets and liabilities denominated in the Pakistan rupee have been remeasured into the U.S. dollar using the current exchange rates at the end of the period. All nonmonetary balance sheet items, income and related expenses denominated in the Pakistan rupee are remeasured into the U.S. dollar using historic exchange rates. Foreign exchange gains and losses resulting from remeasurement are recorded during the period and are recognized in the accompanying statements of operations.

Revenue Recognition

We recognize revenue when we deliver electric energy and provide electric capacity. Revenue is based on the quantity of electric energy delivered and electric capacity provided at the rates specified in our Power Purchase Agreement ("PPA").

Cash and Cash Equivalents

We consider all highly liquid investments with original maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable include all trade accounts receivable owed to us for capacity revenue and sales of energy. Periodically, we review the collectability of our accounts receivable using the specific identification method and establish an allowance for amounts that are not expected to be collected. As of December 31, 2002 and June 30, 2002, there was no allowance for doubtful accounts recorded.

Advance Fuel Purchases

We make advances to our fuel supplier for the purchase of one month of fuel. Upon delivery, an amount representing the cost of the fuel is reclassified to fuel inventory.

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

Inventory

Inventory, which consists of fuel, spare parts, materials, and supplies, is recorded at the lower of cost or market. Cost is determined on a first-in, first-out (“FIFO”) basis for fuel inventory and weighted average for spare parts, materials, and supplies.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Betterments of major units of property are capitalized, while repairs, maintenance and replacements or additions of minor units of property are expensed. Depreciation is calculated using the straight-line method based on an estimated useful life and an estimated salvage value. The estimated useful lives of our assets are 30 years for the generating plant, 10 years for office equipment, furniture and fixtures, and telecommunication equipment, and 5 years for vehicles. Net investment in property, plant, and equipment as of December 31, 2002, and June 30, 2002 consisted of the following:

	<u>December 31, 2002</u>	<u>June 30, 2002</u>
Generating plant	\$140,106,107	\$147,574,917
Land	422,783	422,783
Office equipment	52,176	52,010
Furniture and fixtures	98,240	98,240
Telecommunication equipment	614,990	614,990
Vehicles	31,045	31,045
Less: Accumulated depreciation	<u>(15,029,714)</u>	<u>(12,520,439)</u>
Property, plant, & equipment, net	<u>\$126,295,627</u>	<u>\$136,273,546</u>

We evaluate the impairment of our long-lived assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires that long-lived assets be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When such events or changes in circumstances occur, an impairment loss is recognized if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. We did not record any asset impairments in 2002.

Deferred Financing Costs

Deferred financing costs consist of certain fees paid to obtain and continue the loan facility of the Eurocurrency Facility and the Eximbank Credit Facility (See Note 4). These costs have been deferred and are being amortized on a straight-line basis over the term of the related debt facility. The ABN Amro (Eximbank Credit Facility) financing costs are being amortized over 12 years and the Sanwa (Eurocurrency Facility) financing costs are being amortized over 7 years. Total amortization expense for the six months ended December 31, 2002, and for the year ended June 30, 2002, amounted to \$358,740 and \$717,480, respectively, and was reported as a component of interest expense in the accompanying statements of operations.

Taxation

We are not subject to income tax in Pakistan due to the exemption granted by the IA (See Note 6). Accordingly, no current or deferred income taxes have been provided in the accompanying financial statements.

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

Recent Accounting Pronouncements

Accounting for Asset Retirement Obligations

In August 2001, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 143, Accounting for Asset Retirement Obligations. This statement requires companies to record a liability relating to the retirement and removal of assets used in their businesses. The liability is discounted to its present value, and the related asset value is increased by the amount of the resulting liability. Over the life of the asset, the liability will be accreted to its future value and eventually extinguished when the asset is taken out of service. The provisions of this statement are effective for fiscal years beginning after June 15, 2002. We adopted this standard on July 1, 2002, and did not recognize any asset or related liability for the cost of removing or retiring long-lived assets in our business as we have no legal obligation to do so.

3. Shareholders’ Agreement

Under the provisions of the Amended and Restated Shareholders’ Agreement (the “Shareholders’ Agreement”) dated February 25, 1997, Coastal SP and Cogen (“Sponsors”) were obligated to contribute 92.75% and 7.25%, respectively, of the total base equity capital required for the project (“Base Equity”) in the amount of approximately \$43 million, which included \$15.3 million of development cost reimbursements as share capital. The occurrence of certain enhancement events (as defined in the Shareholders’ Agreement) may result in Cogen and Capco receiving payment of up to \$9.2 million in reimbursement of the \$15.3 million of development costs. These enhancement events include the increase of saleable capacity under the PPA, a shift in a portion of the tariff subject to currency devaluation, and avoidance of liquidated damages resulting from our failure to timely meet the required commercial operations date. In addition to the Base Equity, the Shareholders’ Agreement and our Amended and Restated Common Debt Agreement required Coastal SP to provide \$11.5 million in additional financing availability during the construction period in excess of our debt financings (see Note 4) through a Cost Overrun Letter of Credit (“LOC”), upon which we could draw funds. As of December 31, 2002, the Cost Overrun LOC proceeds had been fully drawn. These amounts were contributed as additional construction financing and subsequently exchanged for 59,225,000 shares of our stock. At the completion of construction, the Sponsors were obligated to apply any unused portion of the Cost Overrun LOC to fund a Debt Service Reserve. To the extent such reserve was not fully funded, the Sponsors were required to provide up to one-half of such under funding with additional equity in the form of an LOC or cash, and direct all available cash flows from operations to fund the reserve up to the required level. As of December 31, 2002, no funding of the Debt Service Reserve or establishment of a Debt Service Reserve LOC on our behalf had taken place. See Note 4 for discussion regarding the renegotiation of our debt agreements.

The shareholders were obligated to pay for their shares to ensure that the ratio of debt to Base Equity is at all times equal to or less than 76 percent. As of December 31, 2002, the ratio of debt to Base Equity (including both debt and equity capitalization) was 58 percent.

Additionally, pursuant to the terms of the Shareholders’ Agreement and our Amended and Restated Common Debt Agreement, the Sponsors were required to provide for a Restoration Reserve, as defined, through an additional \$4.5 million in equity contributions upon the completion of construction and an additional \$4.5 million by the end of the first year of operations. The Restoration Reserve can be utilized for capital expenditures required following a restoration event (i.e., change in law, political force majeure), as defined in the IA (See Note 6). The \$9 million amount reduces in year five and year ten to \$6.75 million and \$4.5 million, respectively, as the threshold amounts drop in the IA. As of December 31, 2002, no funding of the Restoration Reserve or establishment of a Restoration Reserve LOC had taken place. See Note 4 for discussion regarding the renegotiation of our debt agreements.

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

4. Debt Agreements

We entered into loan agreements with three separate lenders to provide the required non-equity construction and term financing for our Facility. Under the terms of our loan agreement with ABN AMRO Bank (“ABN”), ABN provided construction financing via an approximate \$81 million loan, bearing interest at LIBOR + 1.75% (the “Construction Facility”) that contains an Eximbank Guarantee Agreement Against Political Risks (“Eximbank Guarantee”) and Sanwa Bank provided a \$25 million loan, bearing interest at LIBOR + 3.625% (the “Eurocurrency Facility”). After completion and acceptance of the Facility, the Construction Facility was scheduled to be repaid with the proceeds of a direct loan (the “Eximbank Credit Facility”) from Eximbank. Funds provided during the construction period in excess of those from our loan agreements were provided by our shareholders as further discussed in Note 3. As collateral for the Construction Facility and Eurocurrency facility, we have pledged substantially all of our assets and our shareholders have additionally pledged their shares in us.

Under the Eurocurrency facility, there was to be fourteen semi-annual principal and interest payments beginning March 15, 2000. We have incurred events of default under the Eurocurrency Facility for the failure to pay semi-annual interest payments due February 15, 2000, and interest and principal amounts due on March 15, 2000, September 15, 2000, March 15, 2001, September 15, 2001, March 15, 2002, September 15, 2002, March 15, 2003, September 15, 2003, March 15, 2004, and September 15, 2004. Beginning in December 2000, we made total payments of approximately \$5.1 million through December 31, 2002, related to past interest amounts due. Total interest payable at December 31, 2002, that has not been paid related to the Eurocurrency Facility was approximately \$2.9 million. There have been no payments subsequent to December 31, 2002. Under the terms of the Eurocurrency Facility, if an event of default occurs and is ongoing, the Eurocurrency Facility Agent has the right, among other rights, to declare all outstanding amounts to be immediately due and payable. The Eurocurrency Facility Agent has not delivered to us any notices of its intent to exercise the default remedies available. As a result of the uncured event of default during the six months ended December 31, 2002 and the year ended June 30, 2002, the \$25,000,000 Eurocurrency Facility balance outstanding has been reflected as a current liability in the accompanying balance sheets.

The Construction Facility matured on December 31, 1999, and was to be repaid with funds under the Eximbank Credit Facility. As a result of Eximbank’s re-examination of the project, Eximbank determined that it would not provide funding under the Eximbank Credit Facility. We incurred an event of default as a result of nonpayment of the Construction Facility at December 31, 1999. As defined in the Construction Facility, the termination or cancellation of the Eximbank Credit Facility is an event of default, for which the Construction Facility Agent has the right, among other rights, to declare all outstanding amounts to be immediately due and payable. Funding under the Construction Facility has not been available since December 1999 because of Eximbank’s failure to provide funding for the repayment of the Construction Facility. Of the \$81,495,000 originally available under the Construction Facility, a total of \$61,725,090 had been drawn and remains outstanding as of December 31, 2002. The total amount outstanding under the Construction Facility has been reflected as a current liability in the accompanying balance sheets as of December 31, 2002 and June 30, 2002. We incur commitment fees on the Construction Facility of .5% per annum on the unused portion. We also incur agency fees on the Construction Facility of \$150,000 per annum, plus expenses.

We negotiated a Standstill Agreement with Eximbank, ABN and the Eximbank lenders syndicate. The Standstill Agreement provided, among other things, that the outstanding balance of the Construction Facility will not be accelerated because of the occurrence and continuation of any event of default or potential event of default related generally to the nonpayment of amounts due under the loan agreements. The initial Standstill Agreement was executed as of December 22, 1999, and was subsequently extended and restated through September 2001. In September 2001, the Standstill Agreement expired and was not extended. The Eximbank Facility Agent (ABN) delivered to us in February 2002 a notice of its intent to exercise the default remedies available which include immediate payment of all outstanding principal, interest, and penalties. We, ABN, the

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

syndicate Eximbank lenders, Eximbank and Sanwa continue to negotiate the terms and provisions of a restructuring of the term financing for the project.

As previously discussed, we are in default on certain of our debt agreements and, in one case, the lender has delivered to us a notice of its intent to exercise its default remedies. Accordingly, the related amounts outstanding have been classified as a current liability in the accompanying balance sheets. We do not have the working capital availability or alternative means of financing in place to meet our obligations. We are in negotiations with our lenders regarding the establishment of term re-financing. There can be no assurance that the outcome of these negotiations will result in our favor or will not have a material adverse effect on our financial position, results of operations, or cash flows. As a result of the default, our lenders have final approval of our operating expenditures and we are not able to make dividend distributions to our shareholders.

Our financial statements have been prepared assuming that we will continue as a going concern. As discussed above and as shown in the accompanying balance financial statements, we are currently in default of our Construction Facility and the lenders have exercised the default remedies available, which raises substantial doubt about our ability to continue as a going concern and our ability to realize our assets and to discharge our liabilities in the normal course of business. There can be no assurance that we will be able to restructure successfully our indebtedness or that our liquidity and capital resources will be sufficient to maintain normal operations. These financial statements do not include any adjustments relating to the recoverability and classification of assets carrying amounts or the amount and classification of liabilities that might result should we be unable to continue as a going concern.

5. Related Party Transactions

Management Services Agreement

We entered into a management services agreement (the “MSA Agreement”) with El Paso Technology Pakistan (Private) Limited (“EPTP”), an indirect wholly-owned subsidiary of El Paso CGP. The agreement provides for EPTP to have general responsibility for managing our affairs. As consideration for services rendered, EPTP is reimbursed on a monthly basis for its actual costs incurred plus a fixed annual fee of \$10,000. The agreement was executed on February 25, 1997, and will terminate on December 31, 2016, subject to early termination by either party in accordance with the terms of the agreement. During the six months ended December 31, 2002, and the year ended June 30, 2002, we incurred approximately \$202,633 and \$375,865, respectively, of expenses related to the MSA agreement.

Operations and Maintenance Agreement

We entered into an operations and maintenance agreement (the “O&M Agreement”) with EPTP, which provides for an annual operations and maintenance fee of \$100,000, indexed annually for inflation, and reimbursements of certain expenses including payroll costs. During the six months ended December 31, 2002, and the year ended June 30, 2002, we incurred approximately \$420,255 and \$1,040,846, respectively, of expenses related to the O&M agreement.

Accounts Payable — Affiliates

Coastal Saba Investor II (“CSI II”), a wholly owned subsidiary of El Paso CGP, incurred expenditures on our behalf for the development of the Facility. As of December 31, 2002, and June 30, 2002, accounts payable to CSI II amounted to \$1,520,284. These accounts payable are non-interest bearing. Due to the loan defaults discussed in Note 4, no payments have been made on this liability.

Other affiliate payables of \$1,155,522 and \$1,061,214, were due to EPTP as of December 31, 2002 and June 30, 2002, respectively. These payables relate to costs incurred related to our MSA Agreement and the O&M Agreement with EPTP. These accounts payable are non-interest bearing.

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

6. Commitments and Contingencies

Legal Proceedings

Engineering Procurement and Construction Procurement Contracts

During our development stage, we entered into an Engineering and Procurement Contract (“EP contract”) with the Babcock & Wilcox Company (“B&W”), a subsidiary of McDermott International, Inc., to perform the design, engineering and procurement services necessary to complete the Facility. The EP contract provided for bonuses and liquidated damages, as appropriate, depending on completion dates and certain output performance levels. We also entered into a Construction and Procurement Contract (“CP contract”) with B&W Construction Company, Inc. (a subsidiary of B&W) to perform the local procurement, construction, installation, commissioning, and demonstration services necessary to complete the Facility.

Pursuant to the terms of our contracts, B&W pledged to complete the Facility to a certain level of readiness (known as “MPA”) by April 4, 1999. The Facility did not reach MPA until October 29, 2000, which is the official date certified by the lenders’ engineer pursuant to the contract. After MPA was reached on October 29, 2000, we issued a demand to B&W for delay liquidated damages as set forth in the contracts. B&W responded by asserting that its delays were excused by events of force majeure and in November 2001 we filed a Demand for Arbitration with the American Arbitration Association (“AAA”) pursuant to the contracts, seeking approximately \$24 million in damages. In January 2002, B&W filed an answer and counterclaim, asserting approximately \$15 million in damages including a demand for payment of approximately \$9 million in retainage. In January 2004, the AAA issued a final resolution on these claims and awarded to B&W \$1,575,207 in settlement of both of these claims. The impact of this resolution resulted in a non-cash reduction of approximately \$7.5 million in retainage payable and property, plant, and equipment in the accompanying balance sheet.

On February 25, 2004, B&W filed a motion to modify the award, requesting that the AAA enter additional monetary awards in their favor of approximately \$1.3 million. We filed a response to this motion on March 5, 2004, in which we opposed all of these additional claims. On April 1, 2004, the arbitrators granted this motion to modify in part and awarded B&W an additional \$82,972. Shortly thereafter, B&W filed suit in the federal court in New York City seeking to confirm its total arbitration award (\$1,575,207 plus \$82,972 plus post award interest), and on June 29, 2004, the court confirmed the total award and entered judgment in favor of B&W and against our company. In July 2004, B&W served notice of the judgment on our company and served a Restraining Notice and Execution of Notice to Garnishee on ABN AMRO.

Withholding Tax

We received an assessment in August 1998 from the Pakistan Central Board of Revenue (“CBR”) alleging that we failed to comply with certain Pakistan withholding tax requirements. The amount of the assessment was approximately \$1.8 million and we were required to deposit \$625,000 in order to appeal the assessment. In 1999, the Commissioner of Income Tax (Appeals) ordered the assessment “set aside,” effectively ruling in our favor. We received a refund of the deposit from the CBR on August 13, 1999. We, along with the CBR, filed appeals before the Pakistan Income Tax Appellate Tribunal (“ITAT”), who decided to hear both appeals simultaneously. To date, the ITAT has not heard the case.

Implementation Agreement

We entered into an IA under which the GOP agrees to use its best efforts to support our exclusive right to design, finance, insure, construct, complete, own, operate and maintain our Facility throughout the initial term of our PPA, including any extension caused by the occurrence of a “force majeure” event. The IA may be extended by mutual agreement. Through the IA, the GOP agrees to use all reasonable efforts to assist us in obtaining all necessary consents, and grants our exemption from taxation of income during the term of the

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

PPA, including exemption prior to commercial operations from customs duties on the import of materials and equipment. The IA allows us to register anywhere in Pakistan and to change our registration from time to time, in order to avail ourselves of favorable stamp tax and/or registration fee rates for registration of the financing documents and other documents or instruments in connection with the project. Under the IA and with appropriate consent and/or approval from the State Bank of Pakistan, we may freely transfer funds to banks or other parties outside of Pakistan without foreign exchange restrictions.

The IA imposes certain deadlines and other requirements, the violation of which can be considered an event of default and may require us to transfer the Facility to the GOP. If the Facility is transferred to the GOP in the event of such a default, we will be reimbursed by the GOP for our outstanding debt. Upon default, the IA will terminate and the GOP will have no further interest in or obligations under the IA. Some of the more significant events of default include the following: (a) cumulative operating losses (as determined under the IA) of at least 50% of the combined equity contributions; and (b) any material breach of the PPA or the Fuel Supply Agreement (“FSA”) by us (see below) not remedied within 30 days after notice of the breach.

We are currently in the process of negotiating an amendment to the IA to extend the original required commercial operations date, as discussed at the end of Note 6.

Power Purchase Agreement

We entered into a 30-year term PPA with the Pakistan Water and Power Development Authority (“WAPDA”) whereby WAPDA agrees to purchase up to 105% of the Facility’s dependable capacity of 108.57 net megawatts pursuant to the PPA.

We deliver electricity only as ordered by WAPDA. The price paid by WAPDA for electricity consists of a non-escalable capacity payment, an escalable capacity payment and an energy payment. The non-escalable capacity payment is structured to cover our debt service requirements, including payments of principal and interest, and is indexed for changes in the Pakistan Rupee exchange rate in order to provide for a fixed payment in U.S. dollars. The escalable component is structured to cover our operating, administrative and general expenses, as well as provide a return on and of equity to the stockholders and is also indexed for changes in inflation and Pakistan Rupee exchange rates. The energy payment is based on net electrical output of the Facility and contains a fuel cost component and an operations and maintenance cost component indexed for changes in inflation and changes in the Pakistan Rupee exchange rate. If, through a change in law or a political force majeure event (as defined in the PPA), we are required to repair or make changes to the Facility, we will be allowed to pass those charges through to WAPDA via a supplemental tariff.

The PPA imposes liquidated damages and/or penalties on us if certain contractual conditions are not met. The liquidated damages and/or penalties imposed by the PPA include the following:

- Payment of a penalty based on a multiple of the average capacity purchase price for outages above a certain allowable limit each year. During the six months ended December 31, 2002, and the year ended June 30, 2002, we incurred \$90,912 and \$2,281,553, respectively, of liquidated damages related to this provision, which is included in our operating expenses.
- Payment of a penalty of 0.30 Rupees per kilowatt-hour (“kWh”) for not meeting the dispatch requests of WAPDA within acceptable tolerance levels.

The PPA requires us to maintain the following:

- A letter of credit for the benefit of WAPDA equal to \$25 per kilowatt of estimated dependable capacity.
- A reserve fund at a level mutually agreed to by us and WAPDA, to be initially funded at an amount equal to approximately three months of the annual operating and maintenance budget. Money in the

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

reserve fund may be drawn by us and used for major maintenance items in the event that we lack other available funds for operation and maintenance of the plant.

As of December 31, 2002, we have not established these amounts based on the tariff renegotiation as discussed below.

We will be considered to be in default of the PPA and the PPA will terminate if, among other things, we incur cumulative operating losses greater than 50% of the equity contributed by our shareholders commensurate with the funding of the construction financing plus any additional equity committed after the funding of the construction financing. The PPA imposes liquidating damages and/or penalties on WAPDA if certain contractual conditions are not met such as amounts charged to us as penalties under the FSA for changes in the Facility's anticipated fuel usage due to changes in WAPDA's dispatch levels.

We will receive a bonus of 0.08 Rupee for each kWh of net electrical output above certain minimums during the months of January through June of each year. The amount of the bonus payable shall be indexed over the initial term of the PPA on the basis of changes in inflation and Pakistan Rupee exchange rates.

Fuel Supply Agreement

We entered into a 30-year term Fuel Supply Agreement ("FSA") with Pakistan State Oil Company Ltd. ("PSO") whereby PSO is the exclusive supplier of fuel, diesel oil, greases, lubricants and additives for the Facility. The prices for fuel and diesel oil are established by the GOP Petroleum Products (Development Surcharge) Ordinance 1961, subject to the condition that no price shall exceed the price charged for like quality by PSO to all other thermal generating plants in the same geographic area. Prices for greases, lubricants and additives must be mutually agreed to by us and PSO, based on PSO's then current trade price lists and the price charged for like quality and specification by PSO to other thermal generating plants.

The FSA requires us to maintain a 30 day supply of fuel and prohibits us from shutting the Facility down for more than 30 days in the aggregate per year and not more than 60 days in any fifth year.

Tariff Renegotiation of IA, PPA, and FSA

We have been in discussions with WAPDA concerning the tariff and other PPA provisions since 1998. We entered into a Memorandum of Understanding ("MOU") with WAPDA in July 1999, which will effect an adjustment in our tariff. We are in the process of documenting the MOU by appropriate amendments to the PPA, IA, and FSA. Under the terms of the MOU, the PPA amendment, when executed, will limit our liquidated damages payable to WAPDA to for the period from August 1998 through June 1999. We had accrued \$2.8 million and \$2.7 million as of December 31, 2002 and June 30, 2002 in trade payables on our balance sheet for these damages. The amendment will also eliminate certain financial and operations and maintenance reserve requirements required by the PPA and extend the required commercial operations date.

The MOU terms have been incorporated into amendments to the PPA, IA, and FSA, and the PPA amendment is the subject of ongoing discussions between us and WAPDA. Formal approval by all parties of the amended PPA, IA, and FSA is ongoing. We believe the amendments will be approved and executed and the resulting changes will not have a material adverse effect on our operations. Currently, we are operating and billing according to the terms of the MOU agreement.

7. Concentration of Credit and Business Risk

Financial instruments, which potentially subject us to credit risk, consist of cash and accounts receivable. Our cash accounts are held by major financial institutions. Our receivables are concentrated with WAPDA, as they are the sole purchaser of our electrical output under the terms of PPA. Our fuel purchases are concentrated with the GOP, as they are the sole provider of our fuel supply. Our facilities are located in

SABA POWER COMPANY (PRIVATE) LIMITED
NOTES TO FINANCIAL STATEMENTS — (Continued)

Pakistan. Our customer, industry, and geographic concentrations have the potential to impact our overall exposure to credit risk, either positively or negatively, in that the customer base may be similarly affected by changes in economic, industry, weather, or other conditions.

8. Fair Value of Financial Instruments

As of December 31, 2002 and June 30, 2002, the carrying value of financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and debt instruments, approximates fair value because of their short-term nature, the market-based nature of the instrument's interest rate, or other factors. While there is no liquid market for our notes payable, we believe that the carrying value approximates its fair value at December 31, 2002.

EXHIBIT LIST
December 31, 2004

Exhibits not incorporated by reference to a prior filing are designated by an “*”; all exhibits not so designated are incorporated herein by reference to a prior filing as indicated.

<u>Exhibit Number</u>	<u>Description</u>
3.A	Amended and Restated Certificate of Incorporation dated March 7, 2002 (Exhibit 3.A to our 2001 Form 10-K).
3.B	By-laws dated June 24, 2002 (Exhibit 3.B to our 2002 Form 10-K).
4.A	Indenture dated as of February 15, 1994 and First Supplemental Indenture dated as of February 15, 1994.
4.B	Indenture dated as of March 5, 2003 between ANR Pipeline Company and The Bank of New York Trust Company, N.A., successor to The Bank of New York, as Trustee (Exhibit 4.1 to our Form 8-K filed March 5, 2003).
10.A	Amended and Restated Credit Agreement dated as of November 23, 2004, among El Paso Corporation, ANR Pipeline Company, Colorado Interstate Gas Company, El Paso Natural Gas Company, Tennessee Gas Pipeline Company, the several banks and other financial institutions from time to time parties thereto and JPMorgan Chase Bank, N.A., as administrative agent and as collateral agent (Exhibit 10.A to our Form 8-K filed November 29, 2004).
10.B	Amended and Restated Security Agreement dated as of November 23, 2004, made by among El Paso Corporation, ANR Pipeline Company, Colorado Interstate Gas Company, El Paso Natural Gas Company, Tennessee Gas Pipeline Company, the Subsidiary Grantors and certain other credit parties thereto and JPMorgan Chase Bank, N.A., not in its individual capacity, but solely as collateral agent for the Secured Parties and as the depository bank (Exhibit 10.B to our Form 8-K filed November 29, 2004).
10.C	\$3,000,000,000 Revolving Credit Agreement dated as of April 16, 2003 among El Paso Corporation, El Paso Natural Gas Company, Tennessee Gas Pipeline Company and ANR Pipeline Company, as Borrowers, the Lenders Party thereto, and JPMorgan Chase Bank, as Administrative Agent, ABN Amro Bank N.V. and Citicorp North America, Inc., as Co-Document Agents, Bank of America, N.A. and Credit Suisse First Boston, as Co-Syndication Agents, J.P. Morgan Securities Inc. and Citigroup Global Markets Inc., as Joint Bookrunners and Co-Lead Arrangers. (Exhibit 99.1 to El Paso Corporation’s Form 8-K filed April 18, 2003); First Amendment to the \$3,000,000,000 Revolving Credit Agreement and Waiver dated as of March 15, 2004 among El Paso Corporation, El Paso Natural Gas Company, Tennessee Gas Pipeline Company, ANR Pipeline Company and Colorado Interstate Gas Company, as Borrowers, the Lenders party thereto and JPMorgan Chase Bank, as Administrative Agent, ABN AMRO Bank N.V. and Citicorp North America, Inc., as Co-Documentation Agents, Bank of America, N.A. and Credit Suisse First Boston, as Co-Syndication Agents (Exhibit 10.A.1 to our 2003 First Quarter Form 10-Q); Second Waiver to the \$3,000,000,000 Revolving Credit Agreement dated as of June 15, 2004 among El Paso Corporation, El Paso Natural Gas Company, Tennessee Gas Pipeline Company, ANR Pipeline Company and Colorado Interstate Gas Company, as Borrowers, the Lenders party thereto and JPMorgan Chase Bank, as Administrative Agent, ABN AMRO Bank N.V. and Citicorp North America, Inc., as Co-Documentation Agents, Bank of America, N.A. and Credit Suisse First Boston, as Co-Syndication Agents (Exhibit 10.A.2 to our 2003 Second Quarter Form 10-Q); Second Amendment to the \$3,000,000,000 Revolving Credit Agreement and Third

<u>Exhibit Number</u>	<u>Description</u>
	Waiver dated as of August 6, 2004 among El Paso Corporation, El Paso Natural Gas Company, Tennessee Gas Pipeline Company, ANR Pipeline Company and Colorado Interstate Gas Company, as Borrowers, the Lenders party thereto and JPMorgan Chase Bank, as Administrative Agent, ABN AMRO Bank N.V. and Citicorp North America, Inc., as Co-Documentation Agents, Bank of America, N.A. and Credit Suisse First Boston, as Co-Syndication Agents. (Exhibit 99.B to our Form 8-K filed August 10, 2004).
21	Omitted pursuant to the reduced disclosure format permitted by General Instruction I to Form 10-K.
*31.A	Certification of Chief Executive Officer pursuant to sec. 302 of the Sarbanes-Oxley Act of 2002.
*31.B	Certification of Chief Financial Officer pursuant to sec. 302 of the Sarbanes-Oxley Act of 2002.
*32.A	Certification of Chief Executive Officer pursuant to 18 U.S.C. sec. 1350 as adopted pursuant to sec. 906 of the Sarbanes-Oxley Act of 2002.
*32.B	Certification of Chief Financial Officer pursuant to 18 U.S.C. sec. 1350 as adopted pursuant to sec. 906 of the Sarbanes-Oxley Act of 2002.

Undertaking

We hereby undertake, pursuant to Regulation S-K, Item 601(b), paragraph (4)(iii), to furnish to the Securities and Exchange Commission upon request all constituent instruments defining the rights of holders of our long-term debt and consolidated subsidiaries not filed herewith for the reason that the total amount of securities authorized under any of such instruments does not exceed 10 percent of our total consolidated assets.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, El Paso CGP Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 29th day of November 2005.

EL PASO CGP COMPANY

/s/ DOUGLAS L. FOSHEE

Douglas L. Foshee
Chairman of the Board,
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of El Paso CGP Company and in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ DOUGLAS L. FOSHEE</u> (Douglas L. Foshee)	Chairman of the Board and Director, President and Chief Executive Officer (Pincipal Executive Officer)	November 29, 2005
<u>/s/ D. MARK LELAND</u> (D. Mark Leland)	Executive Vice President, Chief Financial Officer and Director (Pincipal Financial Officer)	November 29, 2005
<u>/s/ ROBERT W. BAKER</u> (Robert W. Baker)	Executive Vice President, General Counsel and Director	November 29, 2005