DYNEGY INC /IL/
Form 10-K/A
February 14, 2003

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

# FORM 10-K/A

AMENDMENT NO. 1

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

For the fiscal year ended December 31, 2001

[_] 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: 1-15659

DYNEGY INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Illinois | 74-2928353 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 1000 Louisiana, Suite 5800 Houston, Texas | 77002 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (713) 507-6400

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class: | Name of each exchange on which registered: |
|---|---|
| Class A common stock, no par value | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act:

| Title of each class: | Name of each exchange on which registered: |
|---|---|
| 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 the filing requirements for the past 90 days. Yes [X] 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. [_]

The aggregate market value of voting stock held by non-affiliates of the registrant as of March 4, 2002, computed by reference to the closing sale price of the registrant's common stock on the New York Stock Exchange on such date, was $7,724,959,720, using the definition of beneficial ownership contained in Rule 13d-3 under the Securities Exchange Act of 1934 and excluding shares held by directors and executive officers.

Number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Class A common stock, no par value per share, 268,881,299 shares outstanding as of March 4, 2002; Class B common stock, no par value per share, 96,891,014 shares outstanding as of March 4, 2002.

DOCUMENTS INCORPORATED BY REFERENCE. Part III (items 10, 11, 12 and 13) incorporates portions of the Notice and Proxy Statement for the 2002 Annual Meeting of Shareholders to be filed not later than 120 days after December 31, 2001.

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DYNEGY INC. FORM 10-K/A

INTRODUCTORY NOTE

Dynegy Inc. is filing this Amendment No. 1 on Form 10-K/A ("Amendment No. 1") to reflect the unaudited restatement of its 1999-2001 financial statements previously included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2001, which was originally filed on March 13, 2002 (the "Original Filing"), and to incorporate other revisions to the Original Filing. The financial information contained in the Original Filing has been revised to reflect the restatement items described in the Explanatory Note to the accompanying Consolidated Financial Statements. These restatement items include adjustments previously announced by Dynegy in its Current Reports on Form 8-K dated November 14, 2002 and January 31, 2003, which have been further adjusted as described in the Explanatory Note to the accompanying Consolidated Financial Statements. In this regard, Arthur Andersen LLP, our former independent public accountant, has advised us that its audit opinion relating to 2001 should no longer be relied upon and such audit opinion has been withdrawn. The revised financial statements have been prepared by management and reflect all currently known restatement items as of the date hereof. However, as a result of the re-audit currently being performed by PricewaterhouseCoopers LLP of our historical financial statements for the three-year period ended December 31, 2001, it is possible that additional adjustments to the unaudited financial statements contained herein may result, some of which could be material. Following completion of the re-audit, which the Company expects will occur in March 2003, further amendment of the Original Filing will be necessary in order to include the audit report of PricewaterhouseCoopers LLP as well as to reflect any other necessary changes. In addition, Dynegy's shelf registration statement filed on March 25, 2002 and the documents incorporated by reference therein, including this Form 10-K/A, remain subject to an ongoing review by the SEC Division of Corporation Finance.

The following Items of the Original Filing are amended by this Amendment No. 1:

Item 1. Business

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Item 6. Selected Financial Data

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Item 8. Financial Statements and Supplementary Data

Unaffected items have not been repeated in this Amendment No. 1.

PLEASE NOTE THAT THE INFORMATION CONTAINED IN THIS FORM 10-K/A, INCLUDING THE FINANCIAL STATEMENTS AND THE NOTES THERETO, DOES NOT REFLECT EVENTS OCCURRING AFTER THE DATE OF THE ORIGINAL FILING. FOR A DESCRIPTION OF THESE EVENTS, PLEASE READ THE COMPANY'S EXCHANGE ACT REPORTS FILED SINCE MARCH 13, 2002. SEE NOTE 19--SUBSEQUENT EVENTS FOR FURTHER DISCUSSION.



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DYNEGY INC.

PART I

PLEASE NOTE THAT THE INFORMATION CONTAINED IN THIS FORM 10-K/A, INCLUDING THE FINANCIAL STATEMENTS AND THE NOTES THERETO, DOES NOT REFLECT EVENTS OCCURRING AFTER MARCH 13, 2002 (THE DATE ON WHICH DYNEGY ORIGINALLY FILED ITS 2001 FORM 10-K) . FOR A DESCRIPTION OF THESE EVENTS, PLEASE READ THE COMPANY'S EXCHANGE ACT REPORTS FILED SINCE MARCH 13, 2002. SEE NOTE 19--SUBSEQUENT EVENTS FOR FURTHER DISCUSSION.

DEFINITIONS

As used in this Form 10-K, the abbreviations listed below are defined as follows:

Accord............. Accord Energy Limited.
Bcf................ Billions of cubic feet.
Bcf/d.............. Billions of cubic feet per day.
BGSL............... BG Storage Limited.
Btu................ British thermal unit--a measure of the amount of heat required to raise the temperature of one pound of water one degree Fahrenheit.
Catlin............. Catlin Associates, L.L.C.
Chevron............ Chevron U.S.A. Inc., now a subsidiary of ChevronTexaco.
ChevronTexaco...... ChevronTexaco Corporation
CERCLA or Superfund Comprehensive Environmental Response, Compensation and Liability Act.
DEC................ Dynegy Europe Communications.
Destec............. Destec Energy, Inc.
DGC................ Dynegy Global Communications, one of our four

reportable business segments.
DMG............... Dynegy Midwest Generation, Inc.
DMS............... Dynegy Midstream Services, one of our four reportable business segments.
DOT............... The U.S. Department of Transportation.
DWR............... The California Department of Water Resources.
Dynegy............ Dynegy Inc.
Enron............. Enron Corp.
EWGs.............. Exempt Wholesale Generators.
Extant............ Extant, Inc.
FASB.............. Financial Accounting Standards Board.
FERC.............. Federal Energy Regulatory Commission.
FPA............... The Federal Power Act.
HLPSA............. The Hazardous Liquid Pipeline Safety Act.
Holdings.......... Dynegy Holdings Inc., a wholly owned subsidiary of Dynegy Inc.
iaxis............. iaxis, Limited.
ICC............... Illinois Commerce Commission.
Illinova.......... Illinova Corporation, a wholly owned subsidiary of Dynegy Inc.
Investor.......... Black Thunder Investors LLC.
IP................ Illinois Power Company, a wholly owned subsidiary of Illinova.
ISO............... The California Independent System Operator.

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LNG............ Liquefied natural gas.
LPG............ Liquefied petroleum gas.
MBbls/d......... Thousands of barrels per day.
Mcf............ Thousands of cubic feet.
MMBtu.......... Millions of Btu.
MMcf/d......... Millions of cubic feet per day.
MGP............ Manufactured Gas Plant.
MW............. Megawatts.
NGA............ The Natural Gas Act of 1938, as amended.
NGLs........... Natural gas liquids.
NGPA........... The Natural Gas Policy Act of 1978, as amended.
NGPSA.......... Natural Gas Pipeline Safety Act.
Northern Natural Northern Natural Gas Company.
OSHA........... The Federal Occupational Safety and Health Act.
Project Alpha... A structured natural gas transaction entered into by Dynegy in April 2001.
PURPA.......... The Public Utilities Regulatory Policies Act of 1978.
PX............. The California Power Exchange.
RCRA........... The Resource Conversation and Recovery Act.
QFs............ "Qualifying facilities" are power generation facilities that typically sell power to a single purchaser and are generally exempt from FERC ratemaking regulation.
RTOs........... Regional transmission organizations established by the FERC to control electric transmissions facilities within a particular region.
T&D............ Transmission and Distribution, one of our four reportable business segments.

VaR............. Value at Risk.
VLGC............ Very Large Gas Carriers.
WEN............. Wholesale Energy Network, one of our four reportable business segments.

Item 1. BUSINESS

THE COMPANY

Dynegy Inc. (together with its subsidiaries, "Dynegy" or the "Company") is one of the world's leading energy merchants. Through our global energy delivery network and marketing, logistics and risk-management capabilities, we provide innovative solutions to customers in North America, the United Kingdom and Continental Europe. Our businesses include power generation and wholesale and direct commercial and industrial marketing of power, natural gas, coal and other similar products. We are also engaged in the transportation, gathering and processing of natural gas and natural gas liquids and the transmission and distribution of electricity and natural gas to retail consumers. Dynegy is also engaged in the telecommunications business through its global long-haul fiber optic and metropolitan network located in cities in the United States and Europe.

Dynegy began operations in 1985 and became incorporated in the State of Illinois in 1999 in connection with the acquisition of Illinova Corporation. The Company's principal executive office is located at 1000 Louisiana, Suite 5800, Houston, Texas 77002, and the telephone number of that office is (713) 507-6400. Dynegy and its affiliates maintain marketing or regional offices in Atlanta, Georgia; Aurora, Colorado; Boston, Massachusetts; Calgary, Canada; Chicago, Illinois; Dallas, Texas; Decatur, Illinois; Elida, Ohio; Hong Kong, China; Hyderabad, India; London, England; Lucerne, Switzerland; Manama, Bahrain; Midland, Texas; Milan, Italy; Montreal, Canada; Oakville, Canada; Oklahoma City, Oklahoma; Omaha, Nebraska; Paris, France; Pleasanton, California; Richmond, England; Tampa, Florida; and Washington, D.C.



SEGMENT DISCUSSION

[GRAPHIC DEPICTING SEGMENTS AND SUMMARY INFORMATION]

The Company is a holding company and has four reportable business segments: Wholesale Energy Network ("WEN"), Dynegy Midstream Services ("DMS"), Transmission and Distribution ("T&D") and Dynegy Global Communications ("DGC"). Financial information, including revenues from external customers by similar products or services and by geographic area, net income (loss) and total assets by geographic area are disclosed by segment as set forth in Note 17 to the consolidated financial statements.

Wholesale Energy Network Segment

WEN is engaged in the physical generation of electricity, the aggregation of natural gas supplies and the delivery of customer-focused products and services, such as risk-management services, around wholesale natural gas, power, coal and other similar products. This segment is focused on optimizing the Company's and its customers' global portfolio of assets and capacity contracts, as well as direct commercial and industrial sales and retail marketing alliances. The Company provides customer and risk-management activities to wholesale energy consumers in North America, the United Kingdom and Continental Europe and continues to assess local, regional and national markets, regulatory environments and other factors in order to support and direct future investment.

WEN is focused on the "Energy Value Chain," which is predicated on the notion that the economy consumes physical quantities of energy commodities, such as natural gas, electricity and coal and other similar products, and that consumers of energy expect reliability of supply as well as management of price. The logistics needed to move energy commodities from points of production to end-users requires substantial knowledge of energy infrastructure and the ability to access and utilize this infrastructure. The management of price risk requires knowledge of market factors impacting the economic realities of supply and demand. Dynegy's strength is its ability to capitalize on its extensive network of energy assets, contractual arrangements and market knowledge to provide its customers with reliable sources of physical energy, products and services. Dynegy combines physical delivery of energy through its extensive logistics infrastructure with its price risk-management capabilities and market expertise to provide our customers with customized products to meet their services needs.

[GRAPHIC DEPICTING ENERGY VALUE CHAIN]

Dynegy views its gas and power marketing and power generation businesses as an integrated unit. Control of merchant generation, when coupled with the Company's national wholesale gas and power marketing franchise, creates a wide range of value-creation opportunities benefiting both the Company and its customers. Dynegy's wholesale marketing franchise adds value to its generation assets by providing national market access, market infrastructure and intelligence, risk-management and arbitrage opportunities, fuel management and procurement expertise and transmission expertise for inputs (gas, coal and fuel oil) and outputs (power). Generation capacity, in turn, adds value to the Company's wholesale marketing franchise by providing an outlet/market for gas and coal supplies, a source of reliable power supply and an enhanced ability to structure innovative new products and services for customers.

Natural Gas Purchases. As part of our wholesale energy business, Dynegy purchases natural gas from a wide variety of suppliers. Dynegy also purchases at various index prices and markets substantially all of the natural gas produced or controlled by Chevron U.S.A. Inc. in the United States (except Alaska). In addition, the Company and ChevronTexaco Corp., ("ChevronTexaco") have agreed pursuant to a term sheet dated December 12, 2001 to expand this commercial relationship to include the volumes historically produced by Texaco. On March 1, 2002, a subsidiary of the Company began buying the historical Texaco volumes on an interim basis and is in the late stages of negotiations with ChevronTexaco to finalize a long term commercial agreement to cover



these volumes. This relationship provides the Company with a significant, stable supply of natural gas which, when combined with gas supplies available from our network of other supply sources, allows us to effectively manage gas supplies and reduces the risk of short-term supply shortages during periods of peak demand. In 2001, approximately 22 percent of WEN's natural gas purchases were made from Chevron U.S.A. Inc.

The Company's expanded relationship with ChevronTexaco will increase the volume of natural gas we purchase from Chevron U.S.A. Inc. and ChevronTexaco from approximately 2.0 Bcf/d to approximately 3.0 Bcf/d. We also expect to provide supply and service for in excess of 2.0 Bcf/d of natural gas for the former Texaco's facilities and third-party term markets.

Transportation. The Company arranges for transportation of the natural gas it markets from the supplier's receipt point to the purchaser's requested delivery point. The Company generally retains title to this natural gas from the receipt point to the delivery point and obtains pipeline transportation. The Company believes that its understanding of the United States' pipeline network, along with the scale and geographic reach of its gas marketing efforts, are important to the Company's success as a physical supplier of energy. The Company uses a variety of transportation arrangements to move its customers' volumes, including short-term and long-term firm and interruptible agreements with pipelines and brokered firm contracts with its customers.

Natural Gas Sales. The Company sells natural gas under sales agreements that have varying terms and conditions intended to match seasonal and other changes in demand. The Company's wholesale customer base consists primarily of gas and electric utilities and industrial and commercial end-users and marketers of natural gas. For the year ended December 31, 2001, the Company sold an aggregate average of 12.6 Bcf/d of natural gas. As described above, Dynegy expects future average physical natural gas sales to increase significantly as a result of additional supply volumes to be provided by ChevronTexaco.

Natural Gas Storage. Natural gas storage capacity plays an important role in the Company's ability to act as a full-service natural gas marketer by allowing us to manage relatively constant gas supply volumes with uneven demand levels. Through the use of our storage capabilities, we offer peak delivery services to satisfy winter heating and summer electric-generating demands. Storage inventories also provide performance security or "backup" service to our customers. The Company at various times leases short-term and long-term firm and interruptible storage. Our recent acquisitions of Northern Natural Gas Company ("Northern Natural") and BG Storage Limited should enable us to expand storage services in the U.S. and U.K. markets.

Power. Dynegy markets electricity and power products and services, providing a 24-hour-a-day resource for the sale and purchase of power through access to wholesale markets throughout North America and Europe. The Company helps generation customers manage and optimize their fuel supplies, optimize generation assets and capacity utilization and maximize energy conversion and tolling opportunities. In addition, the Company provides market aggregation and sales assistance and risk-management services and strategies. The Company will at times contract for transmission capacity over regulated transmission lines in order to facilitate regional movements of power. In 2001, Dynegy sold 317 million megawatt-hours of electricity.

At December 31, 2001, Dynegy had interests in 41 power projects in operation, under construction or in development, having gross capacity of 18,833 MW (13,738 MW net) of electricity. Approximately 66 percent of these facilities were solely gas-fired plants, with the remaining facilities fueled by coal, heavy fuel oil or some combination of coal, fuel oil and natural gas. The combined gross capacity of owned facilities in operation at December 31, 2001 approximated 15,856 MW (10,761 MW net) of electricity and 2.7 million pounds per hour of steam available for sale to customers. Approximately 68 percent of the gross capacity (55 percent net) in operation at December 31, 2001 was under long-term power purchase agreements.

Domestically, our power plants are located in California, Georgia, Illinois, Kentucky, Louisiana, Michigan, Nevada, New York, North Carolina, Ohio, Texas, Virginia and Washington. In addition, in connection with our 2000 acquisition of Illinova Corporation, we acquired a total of seven operating power projects in China, Costa



Rica, Honduras, Jamaica, Pakistan and Panama having an aggregate gross capacity of 918 MW (228 MW net) of electricity.

In addition to ownership and operation of generation facilities, the Company provides services to affiliated ventures in the areas of project development, engineering, regulatory and environmental affairs, operating and maintenance services, business and energy management and fuel supply.

Commercial and Industrial. Deregulation of the gas and power markets is evolving to encourage greater competition and access to markets. As a result, Dynegy is pursuing opportunities to provide energy solutions to regional and national commercial and industrial customers who need customized energy solutions for their natural gas and electricity requirements. Dynegy's services include full requirements energy management, supply delivery or asset management and price risk-management services. Dynegy believes that its energy network and physical logistics capability positions the Company to provide mutually beneficial energy solutions to our customers.

In addition, Dynegy's retail gas and electric strategy is to strengthen key customer relationships by forming regional retail gas and power alliances, which require less capital investment and fewer financial risks relative to other national retail marketing strategies. The combination of Dynegy's low-cost energy supply with a regional utility's large, installed customer base and local name recognition positions each alliance to capture a significant portion of the local gas and power market when those markets fully open to competition.

Dynegy Midstream Services Segment

General. DMS consists primarily of the Company's North American midstream liquids operations, NGL marketing and global LPG transportation and marketing operations, located principally along the Gulf Coast and in London. North American midstream liquids operations are actively engaged in gathering and processing natural gas and fractionating, storing, terminalling, transporting, distributing and marketing NGLs. This vertically integrated NGL infrastructure permits the Company to generate revenues throughout all facets of the NGL business, from inlet natural gas volumes gathered from producing horizons to distributing and marketing NGLs to end-users throughout the world. This business provides the Company with broad-based, real-time market information that allows the Company to capture capacity, demand and distribution inefficiencies that exist from time to time in the market.

[GRAPHIC DEPICTING LIQUIDS VALUE CHAIN]

DMS attempts to maximize earnings from its vertically integrated core gas gathering, processing and downstream assets. Similar to WEN's convergence strategy, ownership and control of upstream processing and downstream fractionation, storage, terminalling and transportation assets provides opportunities to DMS' NGL distribution and marketing business. DMS' human and capital resources are aligned and focused on capturing growth opportunities in all core areas, including the Gulf of Mexico region and areas outside North America.

The Company is among the industry leaders in substantially all midstream component businesses, ranging from natural gas processing to distributing and marketing NGLs to end-users. Our position as a natural gas processor is expected to grow as the Company is in the final stages of negotiations with ChevronTexaco to



expand its relationship to include the historical Texaco volumes. In December 2001, the Company expanded its commercial agreement with ChevronTexaco to purchase the undedicated liquid production associated with the processing of Texaco's natural gas. In January 2002, the Company also purchased Texaco's wholesale propane marketing business and integrated it into Dynegy's existing wholesale business.

Natural Gas Gathering and Processing. The natural gas processing industry is a major oil and gas industry segment, providing the necessary service of refining raw natural gas into marketable pipeline quality natural gas and NGLs. We own interests in 23 gas processing plants, including 13 plants we operate, as well as associated and stand-alone natural gas gathering pipeline systems. These assets are located in key producing areas of Louisiana, New Mexico and Texas. During 2001, we processed on average 1.9 Bcf/d of natural gas and produced on average 84 thousand gross barrels per day of NGLs. We have the right to process substantially all of Chevron U.S.A. Inc.'s processable natural gas in those geographic areas where it is economically feasible for us to do so. We are also in the final stages of negotiations with ChevronTexaco to process the historical Texaco volumes. In 2002, we estimate that approximately 60 percent of the volume processed will be under percentage of proceeds contracts, 29 percent will be under processor economic election contracts (either keep whole or fee based) and the remaining 11 percent will be under keep whole processing arrangements.

Under percentage of proceeds contracts, we sell the natural gas and NGLs, return to the producer their share of the proceeds derived from such sale and keep a portion of the proceeds as our processing fee. If a producer has negotiated the right to take its share of natural gas and NGLs in kind, the producer gives to us a percentage of the natural gas and NGLs as our fee and takes the remaining percentage in kind at the tailgate of the plant. Under processor economic election contracts, the producer has the election to either process on a keep whole basis or pay us a fee for processing the natural gas.

This fee could be in the form of a percentage of the natural gas and/or NGLs processed or a cash payment for providing the processing services. Under keep whole processing arrangements, the natural gas is processed to remove the NGLs and other impurities to make the natural gas merchantable. We keep the NGLs and then return to the producer merchantable natural gas containing the same Btu content as was delivered to us prior to processing. We are allowed to keep the NGLs as our fee for processing but must purchase and return to the producer a volume of merchantable natural gas to replace the Btus that were removed through processing so that the producer is kept whole on the Btus it delivered to the plant.

Our natural gas processing services are provided at two types of plants, referred to as field and straddle plants. Field plants aggregate volumes from multiple producing wells into quantities that can be economically processed to extract NGLs and to remove water vapor, solids and other contaminants. Straddle plants are situated on mainline natural gas pipelines and allow operators to extract NGLs from a natural gas stream and replace the equivalent Btus with pipeline quality gas when the market value of NGLs separated from the natural gas stream is higher than the market value of the same unprocessed natural gas.

Fractionation. Liquids removed from natural gas at processing plants are generally in the form of a commingled stream of light liquid hydrocarbons (raw product). The commingled NGLs are separated at fractionation facilities into component products of ethane, propane, normal butane, isobutane and natural gasoline. Fractionation contracts typically include a base fee per gallon subject to adjustment for certain variable costs, such as energy consumed in operation. The Company has ownership interests in three stand-alone fractionation facilities: two in Mont Belvieu, Texas and one in Lake Charles, Louisiana. We operate the Louisiana facility and one of the Mont Belvieu facilities. During 2001, these facilities fractionated an aggregate average of 226 thousand gross barrels per day.

Transportation Operations. The Company has developed a NGL transportation and logistics infrastructure that is comprised of a wide range of transportation and distribution assets designed to satisfy the various delivery requirements of our distribution and marketing services business. In the United States, the Company owns over 9,700 miles of gas gathering and gas liquids pipelines, primarily in the North Texas, Gulf Coast and Permian Basin regions. We also have access to approximately 2,000 railcars through a services agreement with ChevronTexaco. We own and operate 88 tank trucks and 21 pressurized barges. These assets are



deployed to serve our wholesale distribution terminals, Texas Gulf Coast fractionators, underground storage facilities, pipeline injection terminals and many of the nation's crude oil refineries. The Company's large-scale marine terminals are located in Mississippi, Texas, Florida, Tennessee and Louisiana, offering importers and wholesalers a variety of methods for transporting products to the marketplace. We control over 108 million barrels of underground liquids storage capacity in Texas, Louisiana, and Mississippi, providing customers with the ability to store, buy and sell specification products.

Distribution and Marketing Services. Dynegy's distribution and marketing services include: (1) refinery services, (2) wholesale propane marketing and (3) purchasing mixed NGLs and NGL products from NGL producers and other sources and selling such NGL products to petrochemical manufacturers, refineries and other marketing companies.

In connection with our refinery services operations, we purchase NGL products from refinery customers, such as Chevron U.S.A. Inc, and sell NGL products to various customers. The Company generally earns a margin in these operations by retaining a portion of the resale price or a fixed minimum fee per gallon. Approximately 15 percent of DMS' NGL purchases in 2001 were from Chevron U.S.A. Inc and approximately 12 percent were from another supplier. In 2001, the Company sold an average of 41 thousand barrels per day through this refinery services business.

Wholesale propane marketing operations include the sale of propane and related logistical services to major multi-state retailers, independent retailers and other end users. Our propane supply comes from our refinery services operations and from our other distribution and marketing operations. We generally sell propane at a fixed price based on the current market price established at Mont Belvieu or for the posted price at the time of delivery. In 2001, the Company sold an average of approximately 51 thousand barrels of propane per day.

We market our own NGL production and also purchase NGLs from other NGL producers and marketers for resale. Our distribution and marketing services business sold an average of 366 thousand barrels per day of NGLs in North America in 2001. The Company generally purchases NGL products from producers at a monthly pricing index less applicable fractionation, transportation and marketing fees and resells these products to petrochemical manufacturers, refineries and other marketing companies. In addition to margins that the Company earns from purchasing NGL products from producers pursuant to contract, we also earn a margin by purchasing and selling NGL products in the spot market and in the forward market.

Dynegy also markets LPG worldwide via use of chartered large-hull ships. In 2001, 100 thousand barrels per day of LPG were marketed by this business. These operations acquire and market product from producing areas in the North Sea, West Africa, Algeria and the Arabian Gulf as well as from the U.S. Gulf Coast region. Dynegy plans continued expansion of this international business including developing facilities in producing areas and growing downstream markets. We charter four VLGC (Very Large Gas Carriers) totaling more than 176,000 tons of capacity supporting our worldwide marketing activities. One newly built VLGC is committed to charter and is scheduled for September 2002 delivery.

In total, we sold approximately 557 thousand barrels per day of NGLs to approximately 770 customers (amounts are aggregate totals for marketing, wholesale and global operations). In 2001, approximately 23 percent of our NGL sales were made with ChevronTexaco or one of its affiliates and approximately 11 percent were to another customer.

Transmission & Distribution Segment

Our transmission and distribution segment consists of IP's operations acquired in the Illinova Corporation ("Illinova") acquisition in early 2000. IP is based in Decatur, Illinois and provides retail electric and natural gas service to residential, commercial and industrial consumers in substantial portions of northern, central and southern Illinois. Electric transmission service also is supplied to numerous utilities, municipalities and power marketing entities.

IP supplies retail electric service to an estimated population of 1.4 million. Retail natural gas service is supplied by IP to a population of approximately 1 million people. IP holds franchises in all of the incorporated municipalities that it services. As of January 3, 2002, based on the number of billable meters, IP served over 588,000 active electric customers and over 412,000 active gas customers.

IP has seven underground gas storage fields having a total capacity of approximately 11.6 Bcf and a total deliverability on a peak day of approximately 289,000 Mcf. IP also has contracts with various natural gas pipelines for 5.1 Bcf of underground storage capacity, having total deliverability on a peak day of approximately 93,000 Mcf. Operation of underground storage permits IP to increase deliverability to its customers during peak load periods by extracting gas that was previously put into storage during the off-peak months.

IP owns an interconnected electric transmission system of approximately 2,600 circuit miles and a distribution system that includes approximately 37,000 circuit miles of overhead and underground lines. Additionally, IP owns 755 miles of gas transmission pipe and 7,543 miles of gas distribution pipe. All of these properties are located in Illinois.

Dynegy Global Communications Segment

DGC was established during the fourth quarter of 2000 to pursue and capture opportunities in the communications marketplace through opportunistic asset acquisitions and strategic partnerships. DGC has refined its strategic business model to include voice services, storage and government sales and is focused on controlling costs and capital expenditures until the recovery of the overall communications industry.

Dynegyconnect, L.P., DGC's North American subsidiary, completed one of the first optically switched mesh networks in the world in the fourth quarter of 2001. The network spans more than 16,000 route miles and reaches 45 of the largest cities in the United States.

In May 2001, DGC established its metro strategy with the announcement of a network services agreement with Telseon, Inc. to develop an 18 city all-optical network, capable of producing significant, scalable, high-bandwidth solutions among multiple points of presence ("POPs") in tier 1 metro markets. The metro strategy is complementary to Dynegyconnect's network and will provide DGC with access to approximately 80 POPs in select U.S. metro areas.

Dynegy Europe Communications ("DEC") was formed following the acquisition of iaxis, Limited, a privately held, London-based communications company, in March 2001. As a result of this acquisition, DEC acquired a fiber optic network that now reaches more than 26 cities in 11 countries. The European network is linked to the U.S. via a transatlantic connection between New York and London, providing seamless connectivity to DGC's customers throughout the U.S., the U.K. and Continental Europe.

DGC believes its network and metro strategy have unique cost advantages and capability compared to its competitors. As a result, as the telecommunications industry rebounds, DGC believes it will be able to compete very effectively.

COMPETITION

Dynegy faces strong competition in the development of new electric generating plants, the acquisition of existing generating facilities and the marketing and transportation of energy commodities. The Company's primary competition is with merchant energy companies as well as entities vying for market share in the deregulating domestic electricity generating and marketing industries. The Company believes its primary competitors in this business consist of approximately 25 companies.

Dynegy's wholesale energy network competes with international, national and regional full-service energy providers, merchants, producers and pipelines for sales based on its ability to aggregate competitively priced



supplies from a variety of sources and locations and to utilize efficient transportation. Dynegy believes that technological advances in executing transactions will differentiate the competition in the near term. Operationally, Dynegy believes its ability to remain a low-cost merchant and to effectively combine value-added services, competitively priced supplies and price risk-management services will determine its level of success through its wholesale energy network.

Demand for power may be met by generation capacity based on several competing technologies, such as gas-fired or coal-fired generation and power generating facilities fueled by alternative energy sources including hydro power, synthetic fuels, solar, wind, wood, geothermal, waste heat, solid waste and nuclear sources. The Company's power generation business competes with other non-utility generators, regulated utilities, unregulated subsidiaries of regulated utilities and other energy service companies in the development and operation of energy-producing projects. The trend towards deregulation in the U.S. electric power industry has resulted in a highly competitive market for acquisition or development of domestic power generating facilities. As the nation's regulated utilities seek non-regulated investments and to the extent states continue to move toward retail electric competition, these trends can be expected to continue for the foreseeable future. However, recent events in the marketplace, including the California electricity crisis in late 2000 and the alleged manipulation of electricity prices by Enron and other wholesale electricity merchants, have caused some states to publicly reconsider their approach to deregulation, or to retreat from deregulation altogether.

The Company's NGL marketing businesses face significant and varied competitors, including major integrated oil companies, major pipeline companies and their marketing affiliates and national and local gas gatherers, processors, brokers, marketers and distributors of varying sizes and experience. The principal areas of competition include obtaining gas supplies for gathering and processing operations, obtaining supplies of raw product for fractionation, the marketing of NGLs, crude oil, residue gas, condensate and sulfur, and the transportation and storage of natural gas, NGLs and crude oil. Competition typically is based on location and operating efficiency of facilities, reliability of services, delivery capabilities and price.

Competition has become a dominant issue for the electric utility industry in which IP operates. The Public Utilities Regulatory Policies Act of 1978 ("PURPA") facilitated development of co-generators and independent power producers. Promotion of competition continued with the enactment of the Energy Policy Act of 1992, which authorized the FERC to mandate wholesale wheeling of electricity by utilities at the request of certain authorized generating entities and electric service providers. Competition arises not only from co-generation or independent power production, but also from municipalities seeking to extend their service boundaries to include customers being served by utilities. Further competition may be facilitated by the adoption of state utility deregulation legislation, as has occurred in Illinois, or by federal regulatory action. The Company believes its primary competitors in this business consist of approximately 8 companies.

Dynegy's entrance into the communications industry also subjects Dynegy to competition with industry participants having substantial financial resources and significant industry expertise. Dynegy competes with a substantial number of communications companies, many of which have greater resources and/or focus only on one industry or a niche within a single industry.

REGULATION

The Company is subject to regulation by various federal, state, local and foreign agencies, including the regulations described below.

Natural Gas Regulation. The transportation (including storage) and sale for resale of natural gas in interstate commerce is subject to regulation by the FERC under the Natural Gas Act of 1938, as amended ("NGA"), and, to a lesser extent, the Natural Gas Policy Act of 1978, as amended ("NGPA"). The rates charged by interstate pipelines for interstate transportation and storage services, and the terms and conditions for



provision of such services, are regulated by the FERC, which generally also must approve any changes to these rates or terms and conditions prior to their implementation. The FERC also has jurisdiction over, among other things, the construction and operation of pipeline and related facilities used in the transportation and storage of natural gas in interstate commerce, including the extension, expansion, acquisition, disposition, or abandonment of such facilities; maintenance of accounts and records; depreciation and amortization policies; and transactions with and conduct of interstate pipelines relating to affiliates. Venice Gathering System is a regulated interstate pipeline.

Commencing in 1992, the FERC issued Order No. 636 and subsequent orders (collectively, "Order No. 636"), which require interstate pipelines to provide transportation separate, or "unbundled," from the pipelines' sales of gas. Also, Order No. 636 requires pipelines to provide open-access transportation on a basis that is equal for all shippers. The FERC intends for Order No. 636 to foster increased competition within all phases of the natural gas industry. Prior to its acquisition of Venice Gathering System, Order No. 636 did not directly regulate any of Dynegy's activities; however, like other interstate pipelines, Venice Gathering System must comply with FERC's open-access transportation regulations. The implementation of these orders has not had a material adverse effect on Dynegy's results of operations. The courts have largely affirmed the significant features of Order No. 636 and numerous related orders pertaining to the individual pipelines, although certain appeals remain pending and the FERC continues to review and modify its open-access regulations.

In 2000, the FERC issued Order No. 637 and subsequent orders (collectively, "Order No. 637"), which imposed a number of additional reforms designed to enhance competition in natural gas markets. Among other things, Order No. 637 revised the FERC pricing policy by waiving price ceilings for short-term released interstate pipeline transportation capacity for a two-year period, and effected changes in FERC regulations relating to interstate transportation scheduling procedures, capacity segmentation, pipeline penalties, rights of first refusal and information reporting. Most major aspects of Order No. 637 are pending judicial review. It is uncertain whether and to what extent FERC's market reforms will survive judicial review and, if so, whether the FERC's actions will achieve the goal of further increasing competition in natural gas markets.

The FERC recently proposed to expand its existing rules governing the conduct of interstate pipelines and their marketing affiliates to include all energy affiliates. If adopted, the proposed rule would, among other things, preclude the exchange of transportation related information among an interstate pipeline and any of its energy affiliates. The FERC has stated that one purpose of the proposal is to allow pipeline affiliates and non-affiliates to compete in energy markets on an even basis. It is uncertain whether or when the FERC may adopt the proposed rule, or the extent to which it may affect the cost or other aspects of Dynegy's operations; however, Dynegy does not anticipate that its regulated transmission providers and their energy affiliates will be impacted any differently than other similar industry participants.

Pursuant to the NGPA and the Wellhead Decontrol Act of 1989, most sales of natural gas are no longer subject to price controls. However, the FERC retains jurisdiction over certain sales made by interstate pipelines or their affiliates, such as Dynegy has become with its recent acquisitions. The FERC has authorized such sales to be made at unregulated prices, terms and conditions. While sales of natural gas can be made at market prices, and upon unregulated terms and conditions, there is no assurance that such regulatory treatment will continue indefinitely in the future. Congress or, as to sales remaining subject to its jurisdiction, the FERC, could re-enact price controls or other regulation in the future.

Certain federal and provincial regulatory authorities require parties to transactions involving natural gas exports to hold export or removal permits. The Company's indirect wholly owned Canadian subsidiary, Dynegy Canada Inc., holds various Canadian and U.S. permits for such purposes. In the United Kingdom, the natural gas business is subject to regulation by the Office of Gas Supply.

Gas Processing. Dynegy's gas processing operations could become subject to FERC regulation. The FERC has traditionally maintained that a processing plant used primarily for removal of NGLs for economic purposes is not a facility for transportation or sale for resale of natural gas in interstate commerce, and therefore, is not subject to jurisdiction under the NGA. However, the FERC considers a processing plant used primarily for purposes related to transportation safety and efficiency to be subject to such regulation. Dynegy believes its gas processing plants are primarily involved in removing NGLs for economic purposes and, therefore, are exempt from FERC jurisdiction. Nevertheless, the FERC has made no specific finding as to Dynegy's gas processing plants. In addition, certain facilities downstream of processing plants are being considered for use in transporting gas between pipelines, which may invoke FERC's jurisdiction. Such jurisdiction likely would apply to the downstream facility as a pipeline, however, and not to the plants themselves.

Liquified Natural Gas (LNG) Terminals. LNG terminals operating in interstate commerce are subject to FERC jurisdiction and regulation of rates, terms and conditions of service such as is described above concerning interstate natural gas transportation and storage. Dynegy is in the process of securing approvals to construct such a facility in Louisiana.

Gas Gathering. The NGA exempts gas gathering facilities from the jurisdiction of the FERC, while interstate transmission facilities remain subject to FERC jurisdiction, as described above. Dynegy believes its gathering facilities and operations meet the tests used by the FERC to determine nonjurisdictional gathering facility status, although the FERC's articulation and application of such tests have varied over time. Nevertheless, the FERC has made no specific findings as to the exempt status of any of Dynegy's facilities. No assurance can be given that all of Dynegy's gas gathering facilities will remain classified as such and, therefore, remain exempt from FERC regulation. Some states regulate gathering facilities to varying degrees; generally rates are not regulated.

Electricity Marketing Regulation. The Company's electricity marketing operations are regulated by the Federal Power Act ("FPA") and the FERC with respect to rates, terms and conditions of services and various reporting requirements. FERC policies permit trading and marketing entities to market electricity at market-based rates. While FERC has affirmed its desire to move toward competitive markets with market-based pricing, it is reviewing the specifics of implementing this policy. For further discussion, please see "Power Generation Regulation" below.

In December 1999, the FERC issued Order No. 2000, which addressed a number of issues relating to the regional transmission of electricity. In particular, Order No. 2000 provided for regional transmission organizations ("RTOs") to control the transmission facilities within a particular region. After a period of progress toward voluntary creation of RTOs as envisioned by the FERC, activity has slowed due to uncertainty concerning required standards and structures for such entities. Recently, the FERC commenced proceedings designed to result in the adoption of generally standardized market terms and conditions governing interstate transmission and RTO operation, including generic standards and procedures for the interconnection of generation to the transmission grid. The FERC plans to propose new rules respecting these matters this year and has directed electric industry participants to establish a single organization to assist with the development of business practices and protocols that will be needed to implement such standardized terms and conditions. It is uncertain what rules the FERC may adopt as the result of these proceedings. The impact of these RTOs on the Company's electricity marketing operations cannot be predicted. (For further discussion, please see "Illinois Power Company" below.)

Power Generation Regulation. The Company's generation assets include projects that are Exempt Wholesale Generators ("EWGs") or qualifying facilities ("QFs"). One form of EWG is a merchant plant, which operates independently from designated power purchasers and as a result will generate and sell power to market when electricity sales prices exceed the cost of production. A QF typically sells the power it generates to a single power purchaser.

The FPA grants the FERC exclusive ratemaking jurisdiction over wholesale sales of electricity in interstate commerce. The Company's power generation operations also are subject to regulation by the FERC under



PURPA with respect to rates, the procurement and provision of certain services and operating standards. Although facilities deemed QFs under PURPA are exempt from ratemaking and other provisions of the FPA, non-QF independent power projects and certain power marketing activities are subject to the FPA and the FERC's ratemaking jurisdiction, as well as the Public Utilities Holding Company Act of 1935 ("PUHCA") and the Energy Policy Act of 1992. All of the projects owned or operated by Dynegy as QFs are qualifying facilities and, as such, under PURPA are exempt from the ratemaking and other provisions of the FPA. Dynegy's EWGs, which are not QFs, have been granted market-based rate authority and comply with the FPA requirements governing approval of wholesale rates and subsequent transfers of ownership interests in such projects.

In some markets where Dynegy owns generation facilities, specifically California and New York, the FERC has from time to time approved and subsequently extended temporary price caps on wholesale power sales, or other market mitigation measures. Due to concerns over potential short supply and high prices in the summer of 2001, the New York Independent System Operator, Inc. ("NYISO"), the FERC-approved operator of electric transmission facilities and centralized electric markets in New York, filed an Automated Mitigation Procedure ("AMP") proposal with the FERC. The AMP caps bid prices based on the cost characteristics of generating facilities in New York, such as those owned or operated by the Company. In an order issued on June 28, 2001, the FERC accepted the AMP proposal for the summer of 2001. In a subsequent order issued on November 27, 2001, the FERC extended the AMP through April 30, 2002. The AMP may be further extended in the future.

Price volatility and other market dislocations in the California market have precipitated a number of FERC actions related to the California market, in addition to price caps and market mitigation measures. These include an investigation of gas pipeline marketing affiliate abuse in the region, proceedings regarding whether, and to what extent, price refunds are owed by wholesale electricity suppliers serving the state, and complaints requesting the FERC to reform or void various long-term power sales contracts. Recently, as a prelude to possible initiation of a new complaint proceeding, the FERC began investigating whether any entity has manipulated prices for electricity or natural gas in the West, since January 1, 2000, possibly resulting in unjust and unreasonable prices under long-term power sales contracts entered into since that time. Additional matters in California are discussed below under "Management's Discussion and Analysis of Financial Condition and Results of Operations--California Market/West Coast Power."

On November 20, 2001, the FERC issued an order that would subject the sales of all entities with market-based rate tariffs to "refunds or other remedies" in the event the seller engages in "anticompetitive behavior or the exercise of market power." The FERC has postponed the effectiveness of this refund condition pending its consideration of comments submitted by interested parties. Dynegy and other similarly-situated generators and power marketers have submitted comments in opposition to the proposed refund condition. It is uncertain how the FERC will act respecting this matter. If the FERC were to establish the broad refund condition proposed, it would increase the risk inherent in electric marketing activities for all wholesale sellers of electricity, including Dynegy. Establishment of the proposed refund condition, together with a finding that Dynegy engaged in any of the specified activities, also could require Dynegy to refund some of the electricity payments it has collected or reduce the amount it is owed for electricity.

State Regulatory Reforms. The Company's domestic gas and power marketing and power generation businesses are subject to various regulations from the states in which they operate. Proposed reforms to these regulations are proceeding in several states, including California, the results of which could affect the Company's operations.

Illinois Power Company. IP is an electric utility as defined in PUHCA. Its direct parent company, Illinova, and Dynegy are holding companies as defined in PUHCA. However, each of Illinova and Dynegy generally are exempt from regulation under section 3(a)(1) of PUHCA. They remain subject to regulation under PUHCA with respect to the acquisition of certain voting securities of other domestic public utility companies and utility holding companies.



IP also is subject to regulation by the FERC under the FPA as to transmission rates, terms and conditions of service, the acquisition and disposition of transmission facilities and other matters. The FERC has declared IP exempt from the NGA and related FERC orders, rules and regulations.

IP is further subject to regulation by the State of Illinois and the Illinois Commerce Commission ("ICC"). The Illinois Public Utilities Act was significantly modified in December 1997 by the Electric Service Customer Choice and Rate Relief Law of 1997, or P.A. 90-561, but the ICC still has broad powers of supervision and regulation with respect to rates and charges and various other matters. Under P.A. 90-561, IP must continue to provide bundled retail electric services to all who choose to continue to take service at tariff rates and must provide unbundled electric distribution services to all eligible customers as defined by P.A. 90-561 at rates determined by the ICC.

In January 1998, IP, in conjunction with eight other transmission-owning entities, filed with the FERC for all approvals necessary to create and to implement the Midwest Independent System Operator ("MISO"). IP subsequently withdrew from the MISO to join several transmission owners (the "Alliance Companies") proposing to form the Alliance RTO. As proposed, the Alliance RTO would function as an RTO with National Grid, USA ("National Grid") as the managing member for a period of seven years.

In an order issued on December 20, 2001, the FERC reversed its previous findings, stated that it would not approve the Alliance RTO, and directed the

Alliance Companies to explore how their business plan could be accommodated with the MISO or another RTO. Discussions continue with both MISO and another party, but no agreement has been reached. The Alliance Companies, including IP, continue to consider other opportunities for participation in an RTO. Any RTO in which IP ultimately participates will be subject to the outcome of the FERC's proceedings on standardized market terms and conditions.

IP's retail natural gas sales also are regulated by the ICC. Such sales are priced under a purchased gas adjustment mechanism under which IP's gas purchase costs are passed through to its customers if such costs are determined prudent.

Pending Legislation. The U.S. Congress has before it a number of bills that could impact regulations applied to Dynegy and its subsidiaries. These include bills that would repeal PUHCA and portions of PURPA and that would affect FERC's regulatory authority over energy marketing, generation and trading. Recent market events, including the California electricity crisis in late 2000 and the alleged manipulation of electricity prices by wholesale electricity merchants, have prompted questions about the wisdom of PUHCA repeal and whether more stringent regulation may be needed. The outcome of these bills and the effects that they might have cannot be predicted with certainty.

Foreign Regulation. Dynegy Europe Limited acquired BG Storage Limited in the fourth quarter of 2001 and, as a result, now owns and operates the Rough and Hornsea gas storage facilities in the U.K. In connection with that acquisition, Dynegy Europe Limited gave statutory undertakings to the Secretary of State for Trade and Industry in the U.K. under the Fair Trading Act of 1973. The key aspects of these legislatively required undertakings, which relate to the operation of the storage assets acquired and expire on April 30, 2004, are as follows:

(1) Dynegy Storage Limited, the Dynegy Europe Limited subsidiary that operates the assets, will ensure that the maximum physical capacity of the facilities is made available to the market on non-discriminatory terms and that 20% of the capacity is sold on one-year terms;

(2) Unless otherwise approved by the regulator, the capacity must be sold in standard bundled units;

(3) Where there remains any unsold capacity 30 days before the beginning of a storage year (May 1 to April 30), this capacity must be sold by auction under prescribed procedures and standard contracts approved by the regulator (although prior to such time, Dynegy Storage Limited may sell the capacity in its sole discretion); and



(4) Dynegy Storage Limited must maintain a robust financial information and systems separation (and separate accounts) of the storage business from other commercial activities.

ENVIRONMENTAL AND OTHER MATTERS

General. Dynegy's operations are subject to extensive federal, state and local statutes, rules and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. In addition, development of projects in international markets creates exposure to and obligations under the national, provincial and local laws of each host country, including environmental standards and requirements imposed by these governments. Environmental laws and regulations are complex, change frequently and have tended to become more stringent over time. Many environmental laws require permits from governmental authorities before construction on a project may be commenced or before wastes or other materials may be discharged into the environment. The process for obtaining necessary permits can be lengthy and complex, and can sometimes result in the establishment of permit conditions that make the project or activity for which the permit was sought either unprofitable or otherwise unattractive. Even where permits are not required, compliance with environmental laws and regulations can require significant capital and operating expenditures, and the Company may be required to incur costs to remediate contamination from past releases of wastes into the environment. Failure to comply with these statutes, rules and regulations may result in the assessment of administrative, civil and even criminal penalties. Furthermore, the failure to obtain or renew an environmental permit could prevent operation of one or more Dynegy facilities.

In general, the construction and operation of our facilities are subject to federal, state and local environmental laws and regulations governing the siting of energy facilities, the discharge of pollutants and other materials into the environment, the protection of wetlands, endangered species, and other natural resources, the control and abatement of noise and other similar requirements. A variety of permits are typically required before construction of a project commences, and additional permits are typically required for facility operation.

Environmental Expenditures. Dynegy's aggregate expenditures for compliance with laws and regulations related to the discharge of materials into the environment or otherwise related to the protection of the environment were approximately $81 million in 2001, compared to approximately $121 million in 2000. The 2000 costs exceeded 2001 costs due in large part to expenditures by the Company to bring certain power generation turbines into compliance with new environmental regulations ahead of the dates when such compliance was actually required. The Company estimates that total environmental expenditures (both capital and operating) in 2002 will be approximately $103 million. A substantial majority of the Company's environmental expenditures relate to the federal Clean Air Act ("CAA") and comparable state laws and regulations. Management does not expect capital spending on environmental matters to increase materially over the near term; however, changes in environmental regulations or the outcome of litigation could result in additional legal requirements that would necessitate increased spending. Please read "--The Clean Air Act" below for a discussion of the litigation brought by the Environmental Protection Agency against two Dynegy affiliates relating to activities at its Baldwin generating station in Illinois.

The Clean Air Act. The CAA and comparable state laws and regulations relating to air emissions impose responsibilities on owners and operators of sources of air emissions, including requirements to obtain construction and operating permits and annual compliance and reporting obligations. Although the impact of air quality regulations cannot be predicted with certainty, these regulations are expected to become increasingly stringent, particularly for electric power generating facilities. CAA requirements include the following:

- The CAA Amendments of 1990 required a two-phase reduction by electric utilities in emissions of sulfur dioxide and nitrogen oxide by 2000 as part of an overall plan to reduce acid rain in the eastern United States. Installation of control equipment and changes in fuel mix and operating practices have been completed to comply with the emission reduction requirements of the acid rain provision of the CAA Amendment of 1990.



- In October 1998, the EPA issued a final rule on regional ozone control that required 22 eastern states and the District of Columbia to revise their State Implementation Plans (SIPs) to significantly reduce emissions of nitrogen oxide. The compliance deadline for implementation of these emission reductions is May 31, 2004. In January 2000, the EPA finalized another ozone-related rule under Section 126 of the CAA that has similar emission control requirements. Installation of the necessary emission control equipment may involve large technical, design and construction projects that require significant time or expense for completion.

- Significant reductions in air emissions from Dynegy's facilities could be required if the U.S. Congress adopts legislation requiring additional reductions in emissions of sulfur dioxide, nitrogen oxides and mercury as outlined in various multi-pollutants proposals. Some of these proposals also include reductions in carbon dioxide and other "greenhouse gases" that allegedly contribute to global warming. The emissions reductions contemplated by these initiatives, if they are enacted, could eventually require significant capital expenditures for new pollution control equipment, but the adoption of emission reduction requirements pursuant to any of the various pending proposals is highly uncertain. Although the impact of possible future environmental requirements cannot be predicted with any degree of certainty, any expenditures that are ultimately required are not anticipated to have a more significant effect on Dynegy's operations or financial condition than on any similarly situated company that generates electricity through the burning of fossil fuels.

- The EPA and the Department of Justice ("DOJ") filed complaints against IP and DMG, alleging Clean Air Act violations, which are described in Item 8, Financial Statements and Supplementary Data, Note 11. In general, these allegations involve whether repair, maintenance, and replacement projects at the Baldwin facility required permitting under the Clean Air Act. The EPA has the authority to seek penalties for the alleged violations at the rate of up to $27,500 per day for each violation. The EPA may also seek to require installation of the "best available control technology" at the Baldwin facility and possibly other Company plants. An adverse ruling could impose liability on Dynegy, as well as increase the costs of ongoing operations to Dynegy. In the opinion of management, although significant capital expenditures could be required, the amount of ultimate liability with respect to these actions will not have a material adverse effect on the financial position or results of operations of the Company.

Remedial Laws. The Company is also subject to environmental remediation requirements, including provisions of the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund") and the corrective action provisions of the federal Resource Conservation and Recovery Act ("RCRA") and similar state laws. The Superfund law imposes liability, regardless of fault or the legality of the original conduct, on persons that contributed to the release of a "hazardous substance" into the environment. These persons include the current or previous owner and operator of a facility and companies that disposed, or arranged for the disposal, of the hazardous substance found at a facility. CERCLA also authorizes the EPA and, in some cases, private parties to take actions in response to threats to public health or the environment and to seek recovery for the costs of cleaning up the hazardous substances that have been released and for damages to natural resources from such responsible party. Further, it is not uncommon for neighboring landowners and other affected parties to file claims for personal injury and property damage allegedly caused by the hazardous substances released into the environment. RCRA applies to facilities that have been used to manage or are managing hazardous waste and which are either still in operation or have recently been closed. RCRA also requires facilities to remedy any releases of hazardous wastes or hazardous waste constituents at waste treatment, storage or disposal facilities. CERCLA or RCRA could impose remedial obligations at a variety of Dynegy facilities, including our electric power generating plants and NGL facilities.

IP previously operated more than two dozen sites at which synthetic gas was manufactured from coal. Operation of these manufactured gas plant ("MGP") sites was generally discontinued in the 1950s when natural gas became available from interstate gas transmission pipelines. Many of these MGP sites were contaminated with residues from the gas manufacturing process and remediation of this historic contamination may be required under CERCLA or RCRA or analogous state laws.



Pipeline Safety. In addition to environmental regulatory issues, the design, construction, operation and maintenance of the Company's pipeline facilities are subject to the safety regulations established by the Secretary of the U.S. Department of Transportation ("DOT") pursuant to the Natural Gas Pipeline Safety Act ("NGPSA") and the Hazardous Liquid Pipeline Safety Act ("HLPSA"), or by state regulations meeting the requirements of the NGPSA and the HLPSA, or to similar statutes, rules and regulations in Canada or other jurisdictions. In December 2000, DOT adopted new regulations requiring operators of interstate pipelines to develop and follow an integrity management program that provides for continual assessment of the integrity of all pipeline segments that could affect so-called "high consequence" environmental impact areas, through periodic internal inspection, pressure testing, or other equally effective assessment means. An operator's program to comply with the new rule must also provide for periodically evaluating the pipeline segments through comprehensive information analysis, remediating potential problems found through the required assessment and evaluation, and assuring additional protection for the high consequence segments through preventative and mitigative measures. The requirements of this new DOT rule could increase the costs of pipeline operations.

Health and Safety. The Company's operations are subject to the requirements of the Federal Occupational Safety and Health Act ("OSHA") and other comparable federal, state and provincial statutes. The OSHA hazard communication standard, the EPA community right-to-know regulations under Title III of the Superfund Amendments and Reauthorized Act and similar state statutes require that information be organized and maintained about hazardous materials used or produced in the Company's operations. Certain of this information must be provided to employees, state and local government authorities and citizens. The

Company believes it is in substantial compliance, and expects to continue to comply in all material respects, with these rules and regulations.

Other Environmental Issues. Dynegy is also subject to a variety of other environmental laws, such as the Clean Water Act, which regulates facilities that discharge wastewater into the environment. Under the Clean Water Act and analogous state laws, permits are required for the discharge of any pollutant, including heat, into any regulated body of water. Failure to obtain or renew any environmental permit in a timely manner or the loss of a permit due to legal challenge could require a cessation of operations that involve discharges of pollutants or other materials into the environment.

Subject to resolution of the complaints filed by the EPA and the DOJ against IP and Dynegy Midwest Generation, which are described in Item 8, Financial Statements and Supplementary Data, Note 11, management believes that it is in substantial compliance with, and is expected to continue to comply in all material respects with, applicable environmental statutes, regulations, orders and rules. Further, to management's knowledge, other than the previously referenced complaints, there are no existing, pending or threatened actions, suits, investigations, inquiries, proceedings or clean-up obligations by any governmental authority or third party relating to any violations of any environmental laws with respect to the Company's assets or pertaining to any indemnification obligations with respect to properties previously owned or operated by the Company, which would have a material adverse effect on the Company's operations and financial condition.

OPERATIONAL RISKS AND INSURANCE

Dynegy is subject to all risks inherent in the various businesses in which it operates. These risks include, but are not limited to, explosions, fires, terrorist attacks and product spillage, which could result in damage to or destruction of operating assets and other property, or could result in personal injury, loss of life or pollution of the environment, as well as curtailment or suspension of operations at the affected facility. Dynegy maintains general public liability, property and business interruption insurance in amounts that it considers to be adequate for such risks. Such insurance is subject to deductibles that the Company considers reasonable and not excessive. The occurrence of a significant event not fully insured or indemnified against, or the failure of a party to meet its indemnification obligations, could materially and adversely affect Dynegy's operations and financial condition. In addition, the terrorist attacks on September 11, 2001 and the changes in the insurance markets attributable to those attacks may make some types of insurance more difficult to obtain. We may be unable to secure the levels

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and types of insurance we would otherwise have secured prior to September 11/th/. No assurance can be given that Dynegy will be able to maintain insurance in the future at rates it considers reasonable.

SIGNIFICANT CUSTOMER

For the year ended December 31, 2001, approximately 10% of the Company's consolidated revenues were derived from transactions with Enron Corp. and its affiliates. No other customer accounted for more than 10% of the Company's consolidated revenues.

EMPLOYEES

At December 31, 2001, the Company had approximately 3,019 employees at its administrative offices and approximately 3,120 employees at its operating facilities. Approximately 1,880 employees at Company-operated facilities are subject to collective bargaining agreements with one of the following unions: Paper, Allied-Industrial, Chemical & Workers International Union; International Brotherhood of Electrical Workers; Laborers International Union of North America; United Association of Journeymen Plumbers and Gas Fitters; International Association of Machinists and Aerospace Workers; and Communications, Energy and Paperworkers Union. Management believes that its relations with employees of the Company are satisfactory.



DYNEGY INC.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Class A common stock, no par value per share (the "Class A common stock"), is listed and traded on the New York Stock Exchange under the ticker symbol "DYN". The number of stockholders of record of the Class A common stock as of March 4, 2002, based upon records of registered holders maintained by the Company's transfer agent, was 23,408.

The Company's Class B common stock, no par value per share, is neither listed nor traded on any exchange. All of the shares of Class B common stock are owned by Chevron U.S.A. Inc.

The following table sets forth the high and low sales prices for the Class A common stock for each full quarterly period during the fiscal years ended December 31, 2001 and 2000, respectively, as reported on the New York Stock Exchange Composite Tape, and related dividends paid per share during such periods. Such prices and dividends paid are adjusted for a two-for-one stock split on August 22, 2000. Such prices and dividends paid per share prior to February 1, 2000 are adjusted for the 0.69-to-one exchange ratio used in the Illinova acquisition.

Summary of Dynegy's Common Stock Price and Dividend Payments

| | High | Low | Dividend |
|---|---|---|---|
| 2001: | | | |
| Fourth Quarter. | $46.94 | $20.90 | $0.075 |
| Third Quarter.. | 48.24 | 31.27 | 0.075 |
| Second Quarter. | 57.95 | 42.00 | 0.075 |
| First Quarter.. | 53.15 | 39.25 | 0.075 |
| 2000: | | | |
| Fourth Quarter. | $56.63 | $43.31 | $0.075 |

| | | | |
|---|---|---|---|
| Third Quarter.. | 57.58 | 34.76 | 0.075 |
| Second Quarter. | 39.94 | 27.63 | 0.075 |
| First Quarter.. | 31.37 | 17.30 | 0.022 |

Dynegy intends to continue to pay a quarterly cash dividend of $0.075 per common share, subject to the availability of funds legally available therefor and declaration by the Board of Directors.

In July 2001, the Company established the Dynegy Short-Term Executive Stock Purchase Loan Program. Under this program, the Company may loan eligible employees funds to acquire Class A common stock through market purchases. The related notes have a two-year maturity, bear interest at the greater of 5 percent or the Applicable Federal Rate as of the loan date and are full recourse to the participants. At December 31, 2001, the Company had outstanding approximately $13 million of loans pursuant to this program.

In December 2001, ten members of the Company's senior management purchased approximately 1.2 million shares of Class A common stock in a private placement transaction pursuant to Section 4(2) of the Securities Act of 1933. These officers received loans from the Company to purchase the common stock at $19.75 per share, the same price as the net proceeds to the Company in the December 2001 public offering. The officers paid for the shares by entering into promissory notes with the Company for an initial term of 60 days. The maturity date of the notes was extended for an additional 30 days with the approval of the Board of Directors. These loans bear interest at a rate of 3.25 percent and are full recourse to the borrowers. The Company recognized compensation expense in 2001 of approximately $1.2 million related to the shares purchased by these officers. This amount,



which was recorded as "General and Administrative Expense," is derived from the $1.00 per share discount these officers received based on the initial public offering price of $20.75 per share.

SHAREHOLDER AGREEMENT

In June 1999, Chevron U.S.A. Inc. ("Chevron"), now a subsidiary of ChevronTexaco Corporation, entered into a shareholder agreement with Dynegy governing certain aspects of their relationship, the material provisions of which are discussed below. The agreement was executed in February 2000 upon closing of the Illinova acquisition and reflected agreements negotiated between Dynegy and Chevron relating to Chevron's significant ownership interest in Dynegy. The agreement amended certain of the rights and obligations previously agreed between Dynegy and Chevron at the time of Chevron's initial investment in Dynegy in 1996. Before the Illinova acquisition, Chevron owned 38,789,876 shares of Dynegy common stock and 7,815,363 shares of Dynegy preferred stock. In connection with the Illinova acquisition, Chevron exchanged its common stock and preferred stock and paid $200 million in return for an aggregate of 40,521,250 shares of Dynegy's Class B common stock.

The shareholder agreement grants Chevron preemptive rights to acquire shares of Dynegy common stock in proportion to its then-existing interest in the equity value of Dynegy whenever Dynegy issues any equity securities, including securities issued pursuant to employee benefit plans. In addition, Chevron and its affiliates may acquire up to 40 percent of the total combined voting power of Dynegy's outstanding voting securities without restriction in the shareholder agreement. If Chevron or its affiliates wish to acquire more than 40 percent of the total combined voting power of Dynegy's outstanding voting securities, the shareholder agreement requires Chevron to make an offer to acquire all of the outstanding voting securities of Dynegy for cash or freely tradable securities listed on a national securities exchange. Any offer by Chevron and its affiliates for all of Dynegy's outstanding voting securities would be subject to the auction procedures outlined in the agreement.

Chevron's ownership of Class B common stock entitles it to designate three members of Dynegy's Board of Directors. The shareholder agreement prohibits Chevron from selling or transferring shares of Class B common stock except in the following transactions:

- in a widely-dispersed public offering;
- an unsolicited sale to a third party, provided that Dynegy or its designee is given the opportunity to purchase the shares proposed to be sold by Chevron; or
- a solicited sale to an acceptable third party, provided that if Dynegy advises Chevron that the sale to a third party is not acceptable, Dynegy must purchase all of the offered shares for cash at a purchase price equal to 105% of the third party offer.

Upon the sale or transfer to any person other than an affiliate of Chevron, the shares of Class B common stock automatically convert into shares of Class A common stock.

The shareholder agreement further provides that Dynegy may require Chevron and its affiliates to sell all of the shares of Class B common stock under specified circumstances. These rights are triggered if Chevron or its Board designees block--which they are entitled to do under Dynegy's Bylaws--any of the following transactions two times in any 24-month period or three times over any period of time:

- the issuance of new shares of stock where the aggregate consideration to be received exceeds the greater of $1 billion or one-quarter of Dynegy's total market capitalization;

- any disposition of all or substantially all of Dynegy's liquids business or gas marketing business while substantial agreements between Chevron and Dynegy exist (except for a contribution of such liquids business to an entity in which Dynegy has a majority direct or indirect interest);

- any merger, consolidation, joint venture, liquidation, dissolution, bankruptcy, acquisition of stock or assets, or issuance of common or preferred stock, any of which would result in payment or receipt of



consideration having a fair market value exceeding the greater of $1 billion or one-quarter of Dynegy's total market capitalization; or

- any other material transaction or series of related transactions which would result in the payment or receipt of consideration having a fair market value exceeding the greater of $1 billion or one-quarter of Dynegy's total market capitalization.

However, upon occurrence of one of these triggering events and in lieu of selling Class B common stock, Chevron may elect to retain the shares of Class B common stock but forfeit its right and the right of its Board designees to block the transaction listed above. A block consists of a vote against a proposed transaction by either (a) all of Chevron's representatives on the Board of Directors present at the meeting where the vote is taken (if the transaction would otherwise be approved by the Board of Directors) or (b) any of the Class B common stock held by Chevron and its affiliates if the transaction otherwise would be approved by at least two-thirds of all other shares entitled to vote on the transaction, excluding shares held by management, directors or subsidiaries of Dynegy.

The shareholder agreement also prohibits Dynegy from taking the following actions:

- issuing any shares of Class B common stock to any person other than Chevron and its affiliates;

- amending any provisions in Dynegy's Articles of Incorporation or Bylaws which, in each case, contain or implement the special rights of holders of Class B common stock, without the consent of the holders of the shares of Class B common stock or the three directors elected by such holders;

- adopting a shareholder rights plan, "poison pill" or similar device that prevents Chevron from exercising its rights to acquire shares of common stock or from disposing of its shares when required by Dynegy; and

- acquiring, owning or operating a nuclear power facility, other than being a passive investor in a publicly-traded company that owns a nuclear facility.

Generally, the provisions of the shareholder agreement terminate on the date Chevron and its affiliates cease to own shares representing at least 15 percent of the outstanding voting power of Dynegy. At such time all of the shares of Class B common stock held by Chevron would convert to shares of Class A common stock.

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Item 6. SELECTED FINANCIAL DATA

The selected financial information presented below was derived from, and is qualified by reference to, the Consolidated Financial Statements of the Company, including the Notes thereto, contained elsewhere herein. The selected financial information should be read in conjunction with the Consolidated Financial Statements and related Notes and Management's Discussion and Analysis of Financial Condition and Results of Operations. Earnings (loss) per share ("EPS"), shares outstanding for EPS calculation and cash dividends per common share are adjusted for a two-for-one stock split on August 22, 2000 and, for all periods prior to February 1, 2000, for the 0.69-to-one exchange ratio in the Illinova acquisition.

As discussed in the Explanatory Note to the accompanying Consolidated Financial Statements, the accompanying Consolidated Financial Statements reflect various restatement items since the date of the Original Filing. Please read the Explanatory Note to the accompanying Consolidated Financial Statements for additional information about these restatements. The selected financial data that follows has been adjusted to reflect these restatements.

Dynegy's Selected Financial Data

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2001 | 2000 | 1999 | 1998 | 199 |
| | ($ in millions, except per share data) (Restated) | | | | |
| Statement of Operations Data/(1)(4)/: | | | | | |
| Revenues | $42,513 | $29,378 | $15,413 | $14,258 | $13,3 |
| General and administrative expenses | 510 | 341 | 199 | 186 | 1 |
| Depreciation and amortization expense | 484 | 388 | 129 | 113 | 1 |
| Asset impairment, abandonment and other charges | -- | -- | -- | 10 | 2 |
| Operating income (loss) | 760 | 727 | 172 | 120 | (1 |
| Net income (loss) | $ 421 | $ 494 | $ 118 | $ 108 | $ (1 |
| Earnings (loss) per share | $ 1.11 | $ 1.46 | $ 0.51 | $ 0.48 | $ (0. |
| Shares outstanding for EPS calculation | 340 | 315 | 230 | 227 | 2 |

| | | | | | |
|---|---|---|---|---|---|
| Cash dividends per common share...................... | $ 0.30 | $ 0.25 | $ 0.04 | $ 0.04 | $ 0. |
| Cash Flow Data: | | | | | |
| Cash flows from operating activities.................. | $ 535 | $ 410 | $ 40 | $ 251 | $ 2 |
| Cash flows from investing activities.................. | (3,836) | (1,558) | (391) | (295) | (5 |
| Cash flows from financing activities.................. | 3,448 | 1,144 | 399 | 50 | 2 |
| Other Financial Data: | | | | | |
| Cash dividends or distributions to partners, net....... | (98) | (112) | (8) | (8) | |
| Capital expenditures, acquisitions and investments/(3)/ | (4,695) | (2,414) | (521) | (478) | (1,0 |



| ($ in millions) | December 31, 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|
| Balance Sheet Data/(2)(4)/: | | | | | |
| Current assets.......................................... | $ 9,984 | $10,081 | $2,661 | $2,117 | $2,019 |
| Current liabilities..................................... | 9,606 | 9,481 | 2,490 | 2,026 | 1,753 |
| Property and equipment, net............................. | 9,201 | 7,081 | 2,090 | 1,932 | 1,522 |
| Total assets............................................ | 26,301 | 21,684 | 6,456 | 5,264 | 4,517 |
| Long-term debt.......................................... | 4,500 | 3,151 | 1,372 | 953 | 1,002 |
| Transitional funding notes.............................. | 516 | 603 | -- | -- | -- |
| Non-recourse debt....................................... | -- | -- | 35 | 94 | -- |
| Serial preferred securities of a subsidiary.............. | 46 | 46 | -- | -- | -- |
| Company obligated preferred securities of subsidiary trust | 200 | 300 | 200 | 200 | 200 |
| Series B convertible preferred securities/(5)/........... | 882 | -- | -- | -- | -- |
| Minority interest/(6)/.................................. | 1,040 | 1,022 | -- | -- | -- |
| Capital leases.......................................... | 44 | 15 | -- | -- | -- |
| Total equity............................................ | 5,014 | 3,497 | 1,238 | 1,128 | 1,019 |

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/(1)/ The following acquisitions were accounted for in accordance with the purchase method of accounting and the results of operations attributable to the acquired businesses are included in the Company's financial statements and operating statistics beginning on the acquisitions' effective date for accounting purposes:

- BG Storage Limited ("BGSL")--December 1, 2001;
- iaxis, Limited ("iaxis")--March 1, 2001;
- Extant, Inc. ("Extant")--October 1, 2000;
- Illinova Corporation ("Illinova")--January 1, 2000; and
- Destec Energy, Inc. ("Destec")--July 1, 1997.

/(2)/ The BGSL, iaxis, Extant, Illinova, and Destec acquisitions were each accounted for under the purchase method of accounting. Accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the effective dates of each transaction. See footnote 1 above for respective effective dates.

/(3)/ Includes the value assigned to the assets acquired in various business and asset acquisitions. Also includes expenditures associated with the leased assets brought onto the Company's balance sheet as a result of the restatement items described in the Explanatory Note to the Consolidated Financial Statements. The 1997 amount is before reduction for value received upon sale of Destec's foreign and non-strategic assets of approximately $735 million.

/(4) /As described elsewhere in this report, the restated financial statements contained herein reflect, among other things, the results of a balance sheet reconciliation project relating primarily to the Company's natural gas marketing business. This restatement reflects the re-allocation of an $80 million after-tax charge (previously recognized in the second quarter 2002) to prior periods. The impact of the re-allocation of this charge is reflected in the statement of operations, cash flow and other financial data for the three years ending December 31, 2001 and in the balance sheet data for the years ending December 31, 2001 and 2000. However, approximately $34 million of the total $80 million after-tax charge relates to periods prior to 1999 and has not been allocated to any particular period or reflected in the balance sheet, statement of operations, cash flow or other financial data for the years ended December 31, 1998 and 1997. The approximately $34 million after-tax charge is included in "Total equity" above in 2001, 2000 and 1999.

/(5)/ Amount equals the $1.5 billion in proceeds related to the Series B convertible preferred securities less the $660 million implied dividend recognized in connection with the beneficial conversion option plus the $42 million in accretion of the implied dividend through December 31, 2001.

/(6)/ Includes amounts relating to the Catlin transaction discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources--Financing Trigger Events" below.

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements of Dynegy Inc. ("Dynegy" or the "Company") and the notes thereto included herein. As discussed in the Introductory Note to this Form 10-K/A, the financial information contained in this report has been revised to reflect the restatement items described in the Explanatory Note to the accompanying Consolidated Financial Statements. These restatement items include adjustments previously announced by Dynegy in its Current Reports on Form 8-K dated November 14, 2002 and January 31, 2003, which have been further adjusted as described in the Explanatory Note to the accompanying Consolidated Financial Statements. The revised financial statements have been prepared by management and reflect all currently known restatement items as of the date hereof. However, as a result of the three-year re-audit currently being performed by PricewaterhouseCoopers LLP, it is possible that additional adjustments to the unaudited financial statements contained herein may result, some of which could be material. Following completion of the re-audit, which the Company expects will occur in March 2003, further amendment of the Form 10-K will be necessary in order to include the audit report of PricewaterhouseCoopers LLP as well as to reflect any other necessary changes. In addition, Dynegy's shelf registration statement filed on March 25, 2002 and the documents incorporated by reference therein, including this Form 10-K/A, remain subject to an ongoing review by the SEC Division of Corporation Finance.

PLEASE NOTE THAT THE INFORMATION CONTAINED IN THIS FORM 10-K/A, INCLUDING THE FINANCIAL STATEMENTS AND THE NOTES THERETO, DOES NOT REFLECT EVENTS OCCURRING AFTER MARCH 13, 2002 (THE DATE ON WHICH DYNEGY FILED ITS 2001 FORM 10-K) . FOR A DESCRIPTION OF THESE EVENTS, PLEASE READ THE COMPANY'S EXCHANGE ACT REPORTS FILED SINCE MARCH 13, 2002. SEE NOTE 19--SUBSEQUENT EVENTS FOR FURTHER DISCUSSION.

Dynegy is one of the world's leading energy merchants. Through its global energy delivery network and marketing, logistics and risk-management capabilities, the Company provides innovative solutions to customers in North America, the United Kingdom and Continental Europe. Dynegy's operations are reported in four segments: Wholesale Energy Network ("WEN"), Dynegy Midstream Services ("DMS"), Transmission and Distribution ("T&D") and Dynegy Global Communications ("DGC"). WEN is engaged in the physical supply of and risk-management activities around wholesale natural gas, power, coal and other similar products. This segment is focused on optimizing the Company's and its customers' global portfolio of energy assets and contracts, as well as direct commercial and industrial sales and retail marketing alliances. DMS consists of the Company's North American midstream gas processing and NGL marketing businesses and worldwide natural gas liquids marketing and transportation operations. Dynegy's T&D segment includes the operations of Illinois Power Company ("IP"), an energy delivery company engaged in the transmission, distribution and sale of electricity and natural gas to customers across a 15,000-square-mile area of Illinois. DGC is engaged in the telecommunications business. DGC has a global long-haul fiber optic and metropolitan network located in cities in the United States and Europe.

LIQUIDITY AND CAPITAL RESOURCES

The Company's business strategy has historically focused on acquiring, constructing or contracting for a regionally diverse network of energy assets to capture potential synergies existing among these types of assets and Dynegy's marketing businesses. Dynegy relies upon operating cash flow along with borrowings under a combination of commercial paper programs, money market lines of credit, credit facilities and project-specific debt financings, as well as public debt and equity issuances for its liquidity and capital resource requirements.

In December 2001, Dynegy announced a $1.25 billion capital program to respond to concerns of credit rating agencies and trade counterparties regarding balance sheet strength in the merchant energy sector. In accordance with the plan, Dynegy raised $744 million in net proceeds by selling approximately 37.9 million shares of common stock, including 10.4 million shares purchased by ChevronTexaco. Net proceeds from the sale of these shares were used to reduce indebtedness under Holdings' revolving credit facility by approximately $540 million. The remainder of the proceeds were held as cash.

In addition, the Company reduced its original 2002 capital-spending program by over $500 million to approximately $1.2 billion. This reduction in capital spending related to funds originally budgeted for capital expenditure opportunities that were anticipated to arise during the year. The Company's primary capital expenditure focus will be the acquisition and/or construction of energy assets that will enable the Company to expand its energy network. Expenditures will include maintenance capital at existing facilities of approximately $430 million. The Company also anticipates limiting future capital expenditures associated with its communications network.

The Company believes it prudent to continue to increase liquidity and strengthen its balance sheet and, as a result, is assessing additional alternatives, including possible joint ventures or sales of assets and businesses. These steps are designed to continue the Company's capital program. Such steps are also being taken to reduce leverage and to establish revised targets for debt to capitalization and coverage ratios.

In January 2002, the Company completed its acquisition of Northern Natural. Enron Corp. ("Enron") has the option to reacquire Northern Natural through June 30, 2002 for $1.5 billion plus various adjustments. Dynegy's acquisition of this asset increases the Company's financial leverage. This increased leverage results partially from Northern Natural's $950 million of indebtedness and partially from the $1.5 billion of Series B Mandatorily Convertible Redeemable Preferred Stock ("Series B Preferred Stock") sold to ChevronTexaco, the proceeds of which were used to purchase preferred stock in Northern Natural. The Series B Preferred Stock is mandatorily redeemable by Dynegy in November 2003. The Company is actively assessing alternatives regarding the Series B Preferred Stock and its capital structure to accommodate Northern Natural in the event Enron does not exercise its repurchase option. See "---Enron/Northern Natural."

Available Credit Capacity

The following table provides the components of the Company's available credit capacity.

Available Credit Capacity as of December 31, 2001

| ($ in millions) | Total | Dynegy Inc. | Dynegy Holdings Inc. | Illinois Power |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Outstanding Commercial Paper, Loans and Letters of Credit | $1,300 | $ -- | $1,022 | $278 |
| Unused Borrowing Capacity................................ | 940 | 300 | 618 | 22 |
| Total Credit Capacity.................................. | $2,240 | $300 | $1,640 | $300 |

Dynegy does not have access to the commercial paper markets and has relied on bank credit facilities, operating cash flow, public equity and debt issuances and cash on hand for its short-term liquidity requirements. Sales of common stock in December 2001 and January 2002 generated aggregate net proceeds of approximately $744 million which were used to pay down approximately $540 million of indebtedness under Holdings' revolving credit facility; the remainder was invested in cash. In February 2002, Holdings issued $500 million of 8.75% senior notes due 2012 and used the net proceeds to pay down approximately $250 million of indebtedness under Holdings' revolving credit facility; the remainder was invested in cash. The Company's 364-day revolving credit facilities--a $1.2 billion facility at Holdings, a $300 million facility at IP, a $300 million facility at Dynegy and a $400 million facility at Holdings--mature in May 2002, May 2002, November 2002 and May 2003, respectively. In addition, Northern Natural has a $450 million 364-day revolving credit facility that matures in November 2002.



As of February 27, 2002, the Company and its subsidiaries had committed credit lines of approximately $2.7 billion (including the Northern Natural revolving credit facility). As of such date, there were outstanding borrowings of approximately $1.1 billion and outstanding letters of credit of approximately $427 million under these credit facilities, leaving approximately $1.2 billion of available borrowing capacity under these credit facilities. In addition, the Company had cash of approximately $560 million. As a result, the Company's liquidity position was approximately $1.7 billion. Management believes this level of liquidity is adequate to allow Dynegy to operate its business, even in the event of a downgrade in credit rating.

Credit Rating Discussion

Credit ratings impact the Company's ability to obtain short- and long-term financing, the cost of such financing and the execution of its commercial strategies in a cost-effective manner. In determining the Company's credit ratings, the rating agencies consider a number of factors. Quantitative factors that appear to be given significant weight include, among other things, earnings before interest, taxes and depreciation and amortization ("EBITDA"); operating cash flow; total debt outstanding; off balance sheet obligations and other commitments; fixed charges such as interest expense, rent or lease payments; payments to preferred stockholders; liquidity needs and availability; and various ratios calculated from these factors. Qualitative factors include, among other things, predictability of cash flows, business strategy, industry position and contingencies. Although these factors are among those considered by the rating agencies, each agency may calculate and weigh each factor differently.

Substantially all of the credit ratings of Dynegy Inc. and its subsidiaries are under review for possible downgrade in part due to uncertainties regarding the litigation by Enron against Dynegy (which is more fully discussed in Note 11 to the consolidated financial statements). In addition, the credit rating agencies have refocused their attention on the credit characteristics and credit protection measures of industry participants, and appear to have tightened the standards for a given rating level. Before Dynegy's capital program was announced, Moody's downgraded its ratings of Dynegy and its subsidiaries. The initial phase of the capital program was designed to restore the Moody's ratings and maintain the Fitch and Standard & Poors' ratings. There can be no assurance that these results will be achieved, but the Company believes it is taking action to accomplish these results.

As of February 28, 2002, Dynegy's senior unsecured debt ratings, as assessed by the three major credit rating agencies, were as follows:

| Rated Enterprises | Standard & Poors' | Moody's | Fitch |
|---|---|---|---|
| Senior Unsecured Debt Rating: | | | |
| Dynegy Holdings Inc./(1)/.......... | BBB+ | Baa3 | BBB+ |
| Dynegy Inc./(2)/................... | BBB | Ba1 | BBB |
| Illinois Power/(3)/................ | BBB | Baa3 | BBB+ |
| Illinova Corporation/(4)/.......... | BBB | Ba1 | BBB |
| Northern Natural/(5)/.............. | CC | B3 | CC |
| Commercial Paper/Short-Term Rating: | | | |
| Dynegy Holdings Inc................ | A-2 | P-3 | F2 |
| Dynegy Inc......................... | A-2 | NP | F2 |
| Illinois Power..................... | A-2 | P-3 | F2 |

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/(1)/ Dynegy Holdings Inc. is the primary debt financing entity for the enterprise. This entity is a subsidiary of Dynegy Inc. and is a holding company that includes substantially all of the operations of the WEN and DMS business segments.

/(2)/ Dynegy Inc. is the parent holding company. This entity generally provides financing to the enterprise through issuance of capital stock.

/(3)/ Illinois Power is a stand-alone entity from a financial credit perspective. This entity includes the Company's regulated transmission and distribution business in Illinois.

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/(4)/ Illinova Corporation is the holding company for Illinois Power and is not used to raise capital.

/(5)/ Ratings have not changed since Dynegy's acquisition of Northern Natural and reflect Enron's repurchase option.

The abbreviations for the investment grade credit ratings assigned by the three major credit rating agencies are set forth below, in order of declining credit:

| Standard & Poor's | Moody's | Fitch |
|---|---|---|
| AAA | Aaa | AAA |
| AA+ | Aa1 | AA+ |
| AA | Aa2 | AA |
| AA- | Aa3 | AA- |
| A+ | A1 | A+ |
| A | A2 | A |
| A- | A3 | A- |
| BBB+ | Baa1 | BBB+ |
| BBB | Baa2 | BBB |
| BBB- | Baa3 | BBB- |

A downgrade in Dynegy's credit ratings to below investment grade would cause a material reduction in the amount of trade credit expected to be extended by Dynegy's counterparties until these ratings could be restored. The Company also anticipates that counterparties would increase their collateral demands relating to its wholesale marketing and risk-management business. Downgrades in Dynegy's credit ratings to below investment grade also would trigger the financing covenants described below under "--Financing Trigger Events." Such a downgrade also could increase the risk that the Company would be unable to refinance debt obligations as they mature and could increase the borrowing costs incurred by the Company in connection with any such refinancings. The Company's financial flexibility would likewise be reduced as a result of restrictive covenants and other terms that are typically imposed on non-investment grade borrowers.

Financing Trigger Events

Dynegy's debt instruments and other financial obligations include routine provisions, which, if not met, could require early payment, additional collateral support or similar actions. For Dynegy, these trigger events include leverage ratios, insolvency events, defaults on scheduled principal or interest payments, acceleration of other financial obligations and change of control provisions. Dynegy does not have any trigger events tied to specified credit ratings or stock price in its debt instruments and has not executed any transactions that require it to issue equity based on credit rating or other trigger events.

The Company has two non-commercial agreements that have trigger events tied to credit ratings. At December 31, 2001, the amount of cash collateral that the Company could be required to post in the event of a ratings trigger under these two agreements was approximately $300 million. The Company's investment in Catlin Associates, LLC, described below, accounts for $270 million of the possible $300 million in possible cash collateralization and would be triggered only if the senior unsecured debt ratings for Dynegy Holdings were below investment grade with both Standard & Poor's and Moody's. The remaining approximate $30 million relates to the Company's guarantee of environmental obligations of West Coast Power, a 50 percent owned equity investment. This obligation would be triggered by a downgrade in Dynegy Holdings' credit rating to below investment grade by either Moody's or Standard & Poor's. Dynegy's credit ratings are under review for possible downgrade by Moody's, Standard & Poor's and Fitch. Please see "--Credit Rating Discussion."

In June 2000, Dynegy and Black Thunder Investors LLC ("Investor") invested in Catlin Associates, L.L.C. ("Catlin"), an entity that is consolidated by Dynegy into its financial statements, with the Investor's ownership in Catlin reflected as Minority Interest in the Consolidated Balance Sheet. Dynegy invested $100 million in Catlin



and the Investor invested $850 million. As a result of its investment, the Investor received a preferred interest in Catlin, which has a security interest in the stock of Dynegy Midwest Generation, Inc. ("DMG"), an entity holding certain of Dynegy's midwest generation assets, including the coal-fired generation units in Illinois. This preferred interest is a passive interest and generally is not entitled to management rights.

On or before June 29, 2005, Dynegy is effectively obligated to purchase the Investor's preferred interest for $850 million unless the Investor agrees to extend or refinance this obligation. Alternatively, Dynegy could liquidate Catlin's assets, including DMG's generating assets, to satisfy this obligation.

In addition to granting Catlin a security interest in the stock of DMG, Dynegy also has agreed to pay to DMG, to the extent that DMG has either distributed or loaned money directly or indirectly to Dynegy, an amount not to exceed $270 million. This payment obligation builds over time to a maximum of $270 million in 2005. As of December 31, 2001, Dynegy's obligation to DMG under the agreement was approximately $35 million. In addition, in the event projected cash flow is insufficient to cover capital expenditures and certain other fixed charges, Dynegy may be required to make an additional capital contribution of up to $60 million to Catlin. The $60 million contingent obligation expires on December 31, 2002.

If Holdings' senior unsecured debt is downgraded below investment grade by both Standard & Poor's and Moody's, Dynegy would be required to post cash collateral in an aggregate amount of $270 million and, within 30 days, obtain an investment grade rating for the Catlin membership interest held by the Investor by either Standard & Poor's or Moody's or obtain a waiver from the Investor.

If Dynegy were unable to obtain the required rating for the interest held by the Investor or waiver, Dynegy would have the option of purchasing or refinancing the Investor's interest in Catlin. If Dynegy was unable or otherwise elected not to exercise this option, it could ultimately result in an election by the Investor to cause the liquidation of the underlying generation assets in an amount sufficient to redeem the Investor's interest. Given the strategic importance of these generation assets, it is likely that Dynegy would seek to refinance or purchase the Investor's interest under such circumstances.

Trade Credit

The Company's commercial agreements typically include adequate assurance provisions relating to trade credit and some agreements also have credit rating triggers. These trigger events typically would give counterparties the right to suspend or terminate credit if the Company's credit ratings were downgraded to non-investment grade status. Under such circumstances, Dynegy would need to post collateral to continue transacting risk-management business with many of its counterparties under either adequate assurance or specific credit rating trigger clauses. The cost of posting collateral would increase the Company's financing costs and could adversely impact the Company's profitability. If such collateral was not posted, the Company's ability to continue transacting its risk-management business as before the downgrade would be materially adversely affected.

Following the Enron bankruptcy, there has been a general industry-wide contraction in trade credit in the wholesale energy markets. Open or unsecured credit lines generally have been reduced, and counterparties are more stringent in requiring credit support in the form of cash in advance, letters of credit or guarantees as a condition to transacting business above open credit limits. In addition, parties engaged in the wholesale marketing business, including Dynegy, are moving towards the implementation of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. Most commercial agreements typically include "adequate assurance" provisions or specific ratings triggers. These clauses typically give counterparties the right to suspend or terminate credit if the Company's credit ratings fall below investment grade.

Dynegy's wholesale marketing and risk-management business has historically relied upon Holdings' senior unsecured debt investment grade credit rating to satisfy the credit support requirements of many counterparties.



Disclosure of Financial Obligations and Contingent Financial Commitments

Dynegy has incurred financial obligations and commitments in the normal course of its operations and financing activities. Financial obligations include future cash payments required under existing contractual arrangements, such as debt and lease agreements. These obligations may result from both general financing activities as well as from commercial arrangements that are directly supported by related revenue-producing activities. Financial commitments represent contingent obligations, which become payable only if pre-defined events were to occur, such as financial guarantees.

As discussed in the Explanatory Note to the accompanying Consolidated

Financial Statements, the accompanying Consolidated Financial Statements reflect various restatement items that have become known to management since the date of the Original Filing. Please read the Explanatory Note to the accompanying Consolidated Financial Statements for additional information about these restatements. The tables that follow have been adjusted since the Original Filing to reflect these restatements.

The following table provides a summary of general financial obligations as of December 31, 2001. This table includes cash obligations related to outstanding debt, redeemable preferred stock and similar financing transactions. This table also includes cash obligations for minimum lease payments associated with general corporate services, such as office and equipment leases.

General Financial Obligations as of December 31, 2001

| Cash Obligations* ($ in millions) | Payments Due By Period Total | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter |
|---|---|---|---|---|---|---|---|
| Current Portion of Long Term Debt and Transitional Funding Trust Notes/(1)/... | $ 458 | $458 | $ -- | $ -- | $ -- | $ -- | $ -- |
| Long Term Debt/(1)/...................... | 4,500 | -- | 254 | 169 | 918 | 388 | 2,771 |
| Transitional Funding Trust Notes/(1)/..... | 516 | -- | 86 | 86 | 86 | 86 | 172 |
| Series B Mandatorily Convertible Preferred Securities/(1)/........................ | 1,500 | -- | 1,500 | -- | -- | -- | -- |
| Other Mezzanine Preferred Securities/(1)/. | 246 | -- | -- | -- | -- | -- | 246 |
| Operating Leases/(2)/.................... | 305 | 48 | 44 | 43 | 42 | 40 | 88 |
| Other Long Term Obligations/(3)/......... | 15 | 5 | 5 | 5 | -- | -- | -- |
| Total General Financial Obligations....... | $7,540 | $511 | $1,889 | $303 | $1,046 | $514 | $3,277 |

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* Cash obligations herein are not discounted and do not include related interest, accretion or dividends.

/(1)/ Total amounts are included in the December 31, 2001 consolidated balance sheet. Debt amounts include borrowings outstanding under the following arrangements:

- U.S. telecommunications network debt ($324 million);
- Commercial paper at Dynegy Holdings and Illinois Power ($44 million);
- Revolving credit facilities at Dynegy Holdings ($600 million in borrowings) and Illinois Power ($240 million in borrowings);
- Canadian credit agreements ($40 million);

- Dynegy Holdings senior notes ($1,693 million);
- ABG Gas Supply debt financing ($282 million);
- Lease arrangements relating to the Heard and Riverside generating facilities in Georgia and Kentucky ($342 million);
- Illinova Corporation senior and medium-term notes ($122 million);
- Illinois Power mortgage bonds and pollution control bonds ($1,185 million); and
- Transitional Funding Trust Notes issued by a special purpose trust and serviced by Illinois Power ($602 million).

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Please read Note 7--Debt to the Consolidated Financial Statements. The approximate $900 million increase in Long-Term Debt over the amount originally reported primarily relates to the consolidation of ABG Gas Supply, an entity originally formed in connection with Project Alpha, and the recognition of debt related to generation and telecommunications assets previously accounted for under operating leases.

/(2)/ Includes primarily minimum lease payment obligations associated with office and office equipment leases.

/(3)/ Includes decommissioning costs related to the sale of the Clinton nuclear facility in 1999.

The following table provides a summary of contingent financial commitments as of December 31, 2001. These commitments represent contingent obligations of the Company, which may require a payment of cash upon pre-defined events.

Contingent Financial Commitments as of December 31, 2001

| | Expiration By Period | | | | | | |
|---|---|---|---|---|---|---|---|
| Contingent Obligations* ($ in millions) | Total | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter |
| Letters of Credit/(1)/............... | $ 474 | $453 | $21 | $-- | $ -- | $-- | $-- |
| Surety Bonds/(2)/.................... | 288 | 204 | 31 | 12 | 13 | 14 | 14 |
| Guarantees/(3)/...................... | 270 | -- | -- | 69 | 145 | -- | 56 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total Contingent Financial Commitments | $1,032 | $657 | $52 | $81 | $158 | $14 | $70 |

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* Contingent obligations are presented on an undiscounted basis.

/(1)/ Amounts include outstanding letters of credit and uncommitted lines.

/(2)/ Surety bonds are generally on a rolling twelve-month basis.

/(3)/ Amounts include $214 million of residual value guarantees related to commercial leasing arrangements, further discussed in footnote (1) to the Commercial Financial Obligations table below. Based on the estimated fair value of the underlying assets, the Company does not anticipate funding such amounts. Approximately $30 million of the balance represents a cash collateralization requirement as described in "Trigger Events" above and is related to West Coast Power. The remaining $25 million relates to an insurance program also for West Coast Power. These guarantees do not have specific expiration dates, thus they have been included in the "Thereafter" category.

The following table provides a summary of commercial financial obligations, which are directly associated with revenue-producing activities. These arrangements provide Dynegy access to assets that provide it with manufacturing and logistical capacity needed to execute its business strategy, which is focused upon the physical delivery of energy products to its customers. These obligations include unconditional purchase obligations associated with generation turbines, minimum lease payments associated with operating leases on generation assets, long-haul fiber optic network capacity and other assets used in its operations, as well as capacity payments under generation supply tolling arrangements and transportation, transmission and storage arrangements.

Commercial Financial Obligations as of December 31, 2001

| Cash Obligations* ($ in millions) | Payments Due By Period | | | | | | |
|---|---|---|---|---|---|---|---|
| | Total | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter |
| Operating Leases/(1)/.................. | $1,845 | $ 98 | $ 99 | $ 94 | $ 77 | $ 73 | $1,404/(5)/ |
| Unconditional Purchase Obligations/(2)/ | 75 | 60 | 5 | 4 | 3 | 3 | -- |
| Firm Capacity Payments/(3)/............ | 2,726 | 328 | 297 | 273 | 241 | 226 | 1,361 |
| Conditional Purchase Obligations/(4)/.. | 400 | 9 | 57 | 76 | 124 | 110 | 24 |
| Other Long Term Obligations............ | 44 | 14 | 5 | 5 | 5 | 5 | 10 |
| Total Commercial Financial Obligations. | $5,090 | $509 | $463 | $452 | $450 | $417 | $2,799 |

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* Cash obligations are presented on an undiscounted basis.

/(1)/ Amounts include the minimum lease payment obligation