

AES CORP  
Form 10-Q  
January 19, 2006

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

---

## FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2005

or

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

Commission file number 0-19281

## THE AES CORPORATION

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)  
**4300 Wilson Boulevard, Suite 1100,**  
**Arlington, Virginia**  
(Address of Principal Executive Offices)

**54-1163725**  
(I.R.S. Employer  
Identification No.)

**22203**  
(Zip Code)

**(703) 522-1315**

(Registrant's Telephone Number, Including Area Code)

---

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

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

---

The number of shares outstanding of Registrant's Common Stock, par value \$0.01 per share, at January 6, 2006, was 655,986,313.



**THE AES CORPORATION**  
**FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2005**  
**TABLE OF CONTENTS**

**PART I: Financial Information (unaudited)**

Item 1. Financial Statements

Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2005 and the Three and Six Months Ended June 30, 2004 (as restated) 3

Condensed Consolidated Balance Sheets as of June 30, 2005 and December 31, 2004 4

Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2005 and 2004 (as restated) 5

Notes to Condensed Consolidated Financial Statements 6

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 27

Item 3. Quantitative and Qualitative Disclosures about Market Risk 45

Item 4. Controls and Procedures 45

**PART II: Other Information**

Item 1. Legal Proceedings 50

Item 2. Unregistered Sales of Securities and Use of Proceeds 57

Item 3. Defaults Upon Senior Securities 57

Item 4. Submissions of Matters to a Vote of Security Holders 57

Item 5. Other Information 58

Item 6. Exhibits 58

Signatures 59

**PART I: FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****THE AES CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Amounts in Millions, Except Per Share Amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2005	2004 (Restated)*	June 30, 2005	2004 (Restated)*
Revenues				
Regulated	\$ 1,395	\$ 1,146	\$ 2,794	\$ 2,291
Non-regulated	1,273	1,116	2,537	2,227
Total revenues	2,668	2,262	5,331	4,518
Cost of sales				
Regulated	(1,281 )	(868 )	(2,313 )	(1,751 )
Non-regulated	(861 )	(738 )	(1,668 )	(1,427 )
Total cost of sales	(2,142 )	(1,606 )	(3,981 )	(3,178 )
Gross margin	526	656	1,350	1,340
General and administrative expenses	(45 )	(42 )	(94 )	(90 )
Interest expense	(475 )	(470 )	(942 )	(971 )
Interest income	93	70	183	139
Other income (expense), net	67	1	52	(13 )
Loss on sale of investments, asset and goodwill impairment expense				(1 )
Foreign currency transaction losses, net	(1 )	(47 )	(32 )	(81 )
Equity in earnings of affiliates	21	23	46	39
<b>INCOME BEFORE INCOME TAXES AND MINORITY INTEREST</b>	<b>186</b>	<b>191</b>	<b>563</b>	<b>362</b>
Income tax expense	(82 )	(17 )	(229 )	(92 )
Minority interest expense	(19 )	(71 )	(125 )	(125 )
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>85</b>	<b>103</b>	<b>209</b>	<b>145</b>
Loss from operations of discontinued businesses (net of income tax benefit of \$ , \$6, \$ and \$4, respectively)		(29 )		(55 )
<b>NET INCOME</b>	<b>\$ 85</b>	<b>\$ 74</b>	<b>\$ 209</b>	<b>\$ 90</b>
Basic Earnings Per Share:				
Income from continuing operations	\$ 0.13	\$ 0.16	\$ 0.32	\$ 0.23
Discontinued operations		(0.04 )		(0.09 )
<b>BASIC EARNINGS PER SHARE</b>	<b>\$ 0.13</b>	<b>\$ 0.12</b>	<b>\$ 0.32</b>	<b>\$ 0.14</b>
Diluted Earnings Per Share:				
Income from continuing operations	\$ 0.13	\$ 0.16	\$ 0.31	\$ 0.23
Discontinued operations		(0.05 )		(0.09 )
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 0.13</b>	<b>\$ 0.11</b>	<b>\$ 0.31</b>	<b>\$ 0.14</b>

\* See Note 1

See Notes to Condensed Consolidated Financial Statements.

**THE AES CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Amounts in Millions, Except Shares and Par Value)  
(Unaudited)

	June 30, 2005	December 31, 2004
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 1,381	\$ 1,281
Restricted cash	408	395
Short-term investments	104	268
Accounts receivable, net of allowances (\$340 and \$303, respectively)	1,650	1,575
Inventory	437	418
Receivable from affiliate	5	8
Deferred income taxes - current	348	218
Prepaid expenses	111	87
Other current assets	892	736
Total current assets	5,336	4,986
Property, Plant and Equipment:		
Land	850	788
Electric generation and distribution assets	22,367	21,729
Accumulated depreciation and amortization	(5,783 )	(5,259 )
Construction in progress	1,118	919
Property, plant, and equipment - net	18,552	18,177
Other Assets:		
Deferred financing costs - net	315	343
Investments in and advances to affiliates	695	655
Debt service reserves and other deposits	634	737
Goodwill - net	1,454	1,419
Deferred income taxes - noncurrent	759	774
Other assets	1,635	1,832
Total other assets	5,492	5,760
Total	\$ 29,380	\$ 28,923
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 1,094	\$ 1,142
Accrued interest	354	335
Accrued and other liabilities	2,005	1,656
Recourse debt - current portion	145	142
Non-recourse debt - current portion	1,771	1,619
Total current liabilities	5,369	4,894
Long-Term Liabilities:		
Non-recourse debt	11,441	11,817
Recourse debt	4,888	5,010
Deferred income taxes	772	685
Pension liabilities and other post-retirement liabilities	933	891
Other long-term liabilities	3,319	3,375
Total long-term liabilities	21,353	21,778
Minority Interest	1,430	1,279
Commitments and contingent liabilities (See Note 7)		
Stockholders' Equity:		
Common stock (\$.01 par value, 1,200,000,000 shares authorized; 654,043,358 and 650,093,402 shares issued and outstanding, respectively)	7	7
Additional paid-in capital	6,473	6,423
Accumulated deficit	(1,606 )	(1,815 )
Accumulated other comprehensive loss	(3,646 )	(3,643 )
Total stockholders' equity	1,228	972
Total	\$ 29,380	\$ 28,923

See Notes to Condensed Consolidated Financial Statements.



**THE AES CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Amounts in Millions)  
(Unaudited)

	Six Months Ended June 30,	
	2005	2004 (Restated)*
<b>OPERATING ACTIVITIES:</b>		
Net cash provided by operating activities	\$ 847	\$ 613
<b>INVESTING ACTIVITIES:</b>		
Property additions	(531 )	(377 )
Acquisitions net of cash acquired	(85 )	
Proceeds from the sales of assets	6	36
Proceeds from the sales of emission allowances	29	
Sale of short-term investments	802	727
Purchase of short-term investments	(611 )	(759 )
(Increase) decrease in restricted cash	(7 )	19
Decrease (increase) in debt service reserves and other assets	73	(28 )
Other investing	(10 )	7
Net cash used in investing activities	(334 )	(375 )
<b>FINANCING ACTIVITIES:</b>		
Issuance of recourse debt	6	491
Issuance of non-recourse debt and other coupon bearing securities	951	1,234
Repayments of recourse debt	(115 )	(809 )
Repayments of non-recourse debt and other coupon bearing securities	(1,248 )	(1,542 )
Payments for deferred financing costs	(10 )	(65 )
Distributions to minority interests	(47 )	(54 )
Contributions from minority interests	9	2
Issuance of common stock	16	4
Other financing	(2 )	(2 )
Net cash used in financing activities	(440 )	(741 )
Effect of exchange rate changes on cash	27	(28 )
Total increase (decrease) in cash and cash equivalents	100	(531 )
Cash and cash equivalents, beginning	1,281	1,663
Cash and cash equivalents, ending	\$ 1,381	\$ 1,132
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash payments for interest net of amounts capitalized	\$ 849	\$ 858
Cash payments for income taxes net of refunds	\$ 101	\$ 78
<b>SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:</b>		
Common stock issued for debt retirement	\$	\$ 145
Brasilia Energia debt exchange	\$	\$ 773

\* See Note 1

See Notes to Condensed Consolidated Financial Statements.

**THE AES CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. RESTATEMENT OF FINANCIAL STATEMENTS**

In our previously filed Form 10-K, for the year ended December 31, 2004, management reported that a material weakness existed in its internal controls over financial reporting related to accounting for income taxes. Specifically, the Company lacked effective controls for the proper reconciliation of the components of its foreign subsidiaries' income tax assets and liabilities to related consolidated balance sheet accounts.

After examining certain historical purchase transactions from 1999–2002 and reviewing the reconciliations of detailed historical income tax return records to reported book/income tax differences, various accounting errors were identified. As a result of these initial findings, on July 27, 2005 the Company announced that it would restate its previously filed financial statements. Management also expanded the scope of the review to include the composition of other material current and deferred income tax related balances including those recorded by or, on behalf of, our domestic subsidiaries and the parent company. As a result of this expanded review, additional non-tax items also were identified and corrected. A discussion of both income tax and non-tax adjustments follows.

The errors identified from the income tax review can be categorized into three types of deferred tax issues. Details regarding material findings associated with each issue are provided below:

**1. Deferred income tax adjustments associated with foreign acquisitions and restructurings**

*La Electricidad de Caracas ( EDC )*

The most significant deferred income tax restatement adjustment related to the purchase of a majority interest in EDC, a private integrated utility in Venezuela in June, 2000. At that time, a deferred income tax liability was recorded representing the difference between the non-inflation indexed income tax basis and the resulting adjusted purchase basis (assigned carrying value) of fixed assets. However, Venezuelan income tax provisions allow for the indexing of EDC's non-monetary assets and equity, as a result of inflation. This indexing created an additional layer of tax basis that should have been included as part of the acquisition income tax basis at the time of the acquisition.

In addition, several other purchase accounting adjustments were recorded to correctly account for the treatment of deferred charges and the fair value applied to an equity investment held by EDC at the time of acquisition. The recording of the deferred income tax asset related to indexation and the other noted adjustments affected the allocation of the excess fair value over cost (commonly referred to as negative goodwill) to non-monetary assets.

*Eletropaulo Metropolitana Electricidade de Sao Paulo S.A. ( Eletropaulo )*

At the time of the acquisition of Eletropaulo, a regulated utility located in Brazil, the Company did not record certain deferred income taxes on the difference between the tax basis of land and the related book basis which was adjusted to fair value under acquisition accounting guidelines. The correction of this error resulted in the recording of additional deferred income tax liabilities at the initial date of consolidation in February 2002. This increase in deferred income tax liability increased the original goodwill calculated as the excess purchase price over the fair value of assets and liabilities. As a further result, this adjustment also increased goodwill impairment expense subsequently recognized in 2002.



***Brasiliansa Energia, S.A. ( Brasiliansa )***

In January, 2004 the Company entered into a debt restructuring transaction with the Brazilian National Bank for Economic and Social Development ( BNDES ), whereby BNDES received a 54% economic interest in our Brazil distribution business and two generating facilities in exchange for the cancellation of \$863 million of debt and accrued interest owed by AES Elpa and AES Transgas, holding companies for the Brazilian operations. After the Company made a cash payment of \$90 million, the remaining indebtedness of \$510 million, was re-profiled at a 9% stated interest rate with extended maturities. This exchange was accounted for as a modification of debt. The terms of the agreement state that penalty interest as of December 31, 2004 of \$194 million would be cancelled in the future ratably as the principal of the new \$510 million debentures are paid within the stated timeframes. This treatment gave rise to a deferred income tax liability. As a result of the income tax review, it was determined that a deferred income tax liability should have been recorded for \$194 million of penalty interest anticipated to be forgiven in the future. To correct this error, the additional deferred income tax liability was recorded as part of the stock issued for debt restructuring transaction, with the following impacts:

- A deferred income tax liability at Brasiliansa (the new parent company of the restructured entities), was recorded as of January, 2004. This deferred liability is also subject to foreign currency remeasurement in each subsequent reporting period.
- Debt modification calculations were adjusted to include the fair value of the increased income tax expense due to the forgiveness of debt compared to the book value of debt remaining. The resulting impact reduced the debt discount and decreased the effective interest rate. This adjustment did not change our conclusion regarding the accounting treatment of the transaction as a modification of debt.

These adjustments also impacted the amounts recorded to reflect the BNDES debt restructuring described above. This impact is described below in the Other Non Income Tax Adjustments section.

***Other Acquisition Related Income Tax Adjustments***

As a result of the comprehensive review of income tax accounting, certain other adjustments were made to correct errors identified at other subsidiaries, primarily related to recording of deferred income taxes arising from the step up of acquired assets to fair value and/or from other purchase accounting items. These adjustments increased or decreased fixed assets or concession assets and as a result impacted depreciation or amortization charges recorded within the Company's statements of operations.

***2. Foreign currency remeasurement of deferred income tax balances where the U.S. dollar is the functional currency at certain subsidiaries***

The functional currency for certain of the Company's foreign subsidiaries is the U.S. dollar. After reviewing the income tax balances for certain of the Company's U.S. dollar entities in Venezuela, Brazil, Chile, Colombia, Dominican Republic, Argentina and Mexico, the Company discovered that deferred income taxes were remeasured from local currency to the U.S. dollar using the historical exchange rate versus the current exchange rate as prescribed by Statement of Financial Standard ( SFAS ), No. 52, Foreign Currency Translation and SFAS No. 109, Accounting for Income Taxes, starting in the year of acquisition or formation. In addition, as noted above, certain additional deferred tax amounts were recorded in these entities, which also required remeasurement the largest of which was the additional deferred tax asset related to the EDC purchase accounting indexation adjustment described above.

### 3. Reconciliation of income tax returns to U.S. GAAP income tax balances

The remediation plan involved a detailed review of current and temporary differences identified through an analysis of local income tax return filings. The completion of this review also required the Company to fully evaluate adjustments which had been previously recorded in consolidation, but which should have been recorded at a subsidiary level where the appropriate analysis of the tax jurisdiction could be made. This process led to the identification of errors that accounted for the remainder of the deferred income tax entries.

Major components of the income tax expense adjustments are described below:

*Establishment of Deferred Tax Liability for Brazilian Unrealized Foreign Currency Gains* Certain of the Company's Brazilian subsidiaries have designated the U.S. dollar as the functional currency for accounting purposes. For Brazilian tax purposes, these companies have elected to treat these exchange gains or losses as taxable or deductible only when cash payments are made. The Company did not record deferred assets or liabilities related to the unrealized gains and losses that occur on an interim basis related to its U.S. dollar denominated debt. Under U.S. GAAP, these increases/decreases in deferred liabilities/assets are permanent differences that are recorded as an adjustment to tax expense.

*Establishment of a U.S. Liability Related to Brazilian Deferred Tax Assets* One of the Company's Brazilian subsidiaries, Sul, which has designated its functional currency as the Brazilian real, has generated deferred tax assets mainly related to net operating losses, unrealized tax losses on foreign currency transactions and certain other taxable temporary differences. A restructuring transaction was undertaken in relation to this subsidiary in July 2002. At the time of this restructuring, the Company should have recorded a reduction to the deferred tax assets for the U.S. income tax liability associated with the future projected Brazilian taxable income.

*Establishment of Other Valuation Allowances* The Company determined that certain valuation allowances should have been provided at various subsidiaries in Chile, Colombia, Brazil and Argentina related to deferred tax assets recorded primarily related to net operating loss carryforwards. Under U.S. GAAP, the Company is required to assess its ability to utilize deferred tax assets under a more likely than not standard and provide a valuation allowance to the extent the asset or any part of it does not meet this test. As part of the deferred tax review, the Company determined that these deferred tax assets were unlikely to be utilized in full or in part, based on information available in these historical periods and consequently did not meet the more likely than not standard.

*Other Tax Expense Items* The Company undertook a detailed comparison of the tax returns filed to accounting records in a majority of the countries in which we operate and identified certain other adjustments related to this reconciliation. Most significantly, these adjustments included the following:

- non-deductibility of certain holding company interest and goodwill;
- capitalized interest on tax holiday projects;
- treatment of certain foreign investment tax credits;
- reconciliation of other deferred tax balances; and
- changes in pre-tax book income related to other non-tax restatement adjustments.

#### *Other Non-Income Tax Adjustments*

Other non-income tax accounting errors were also identified as part of the Company's review of certain other historical transactions. The Company has concluded that the reasons for these errors primarily related to the lack of sufficient control and documentation procedures in 2002 and prior



years related to certain consolidation and foreign currency translation processes. Significant non-income tax errors are described below:

*AES SONEL*

AES acquired 56% of SONEL located in Cameroon in July, 2001. Since that time, AES SONEL experienced a high degree of turnover of its senior accounting personnel. SONEL's accounting systems required a significant degree of manual intervention including the conversion of local GAAP financial statements into U.S. GAAP.

During the Company's 2004 year-end process, the Company discovered errors in minority interest calculations that were corrected in the Company's restated financial statements as of and for the years ended December 31, 2003 and 2002 as filed with the Securities and Exchange Commission on Form 10-K on March 30, 2005. Subsequently, as part of the Corporate process to ensure the correct communication and documentation of the correction of the initial error at the subsidiary level, a comprehensive additional review of the preparation of the U.S. GAAP financial statements was performed and the following errors were identified:

- translation errors from local currency to U.S. dollar financial statements;
- the omission of certain purchase accounting adjustments related to the final valuation of our concession assets and recording of severance provisions from the U.S. GAAP financial statements; and
- incorrect treatment related to the accounting for dividends.

*AES Elpa*

As a result of the income tax review performed at AES Elpa, one of the Company's Brazilian holding companies, the Company identified a long-term liability which had been recorded for Brazilian GAAP but which had been omitted from U.S. GAAP financial statements at the acquisition date. The proper recording of this liability at the acquisition date would have increased the opening balance of goodwill, which was subsequently impaired and thereby written off as of the end of December, 2002. The impact of this adjustment as of December 31, 2002, increased long term liabilities and increased goodwill impairment expense and prior retained earnings by the same combined amount. This long-term liability is accreted by an interest expense component on a monthly basis.

*AES Tiete*

The Company determined that an error had been made in the initial accounting for a debt instrument which had been assumed at the date of purchase of Tiete, a generation company in Brazil, in 1999. The debt requires an annual adjustment to principal based on changes in the local rate of inflation. The Company accounted for this by using estimates of future inflation over the life of the debt and amortizing these adjustments as a component of interest expense over the term of the loan. These future inflation estimates were recorded on the balance sheet as a deferred financing cost within long-term assets. Periodically, adjustments were made to these estimates when the actual annual inflation calculations were charged to the principal balance. Subsequently, it was determined that inflation changes should be calculated and adjusted on a monthly basis through interest expense based on the rate of inflation in that month, regardless of how the actual cash payment would finally be determined.

*SUL and Eletropaulo*

The Company determined that an error had been made regarding the timing of the recognition of certain revenues recorded by its Brazilian utilities - Eletropaulo and Sul. The tariff rates, as set by the

Brazilian regulatory authority (ANEEL) provide that a percentage of a distributor's revenue is added to the consumer tariff rate in return for the Company's future spending of these amounts on capital or operating expense projects approved by ANEEL for the express purpose of improving the efficiency of the electrical system. Eletropaulo and Sul had previously recognized the revenue related to this portion of the tariff when billed, and recorded the future operating expense and capital project expenditures when incurred, since the expenditures were not considered pass-through costs for purpose of a future tariff reset. However, under the guidance of SFAS 71 Accounting for the Effects of Certain Types of Regulation, Eletropaulo and Sul should have deferred this portion of revenue until such time that the related expenditures were incurred.

### ***Brasiliana Energia***

The correction of the error related to AES Elpa described above and other adjustments prior to January 2004 which impacted the net assets of Eletropaulo, Tiete and Uruguaiana, also impacted the recording of the Brazilian debt restructuring transaction with our lender, BNDES, as described earlier. The impact on the 2004 restated financials decreased the minority interest share allocated to BNDES and increased additional paid-in capital, a component of stockholders' equity. The adjustment to additional paid-in capital was recorded in accordance with the Company's previously established accounting policy pertaining to gains or losses resulting from subsidiary sales of stock as permitted under SEC Staff Accounting Bulletin No. 51, Accounting for Sales of Stock by a Subsidiary.

### ***Corporate Consolidation Accounting***

During the restatement period, the Company undertook additional reviews of the consolidation process, including a review of consolidation journal entries to ascertain that appropriate supporting documentation existed and that current personnel who were performing the consolidation understood the basis for these entries. Several historical consolidation elimination adjustments were identified as errors which primarily affected deferred income taxes and other accumulated comprehensive income balances. The errors originated in years prior to 2002 and generally resulted from an inadequately controlled consolidation process including the elimination of investment accounts against subsidiary equity balances, general balancing controls related to the income statements and balance sheets submitted by our subsidiaries, and inadequate balance sheet reconciliations of consolidated deferred income tax accounts. The correcting entries resulted primarily in a decrease in deferred income tax liabilities and an increase in foreign currency translation, a component of other comprehensive income.

### ***Cash Classifications***

As part of an ongoing balance sheet review process, it came to the Company's attention that several of its subsidiaries incorrectly included certain short-term investments as cash and cash equivalents in the balance sheet.

### ***Cash Flow Reclassification***

The Company includes components of the cash flows for its discontinued operations within the Consolidated Statements of Cash Flows (Cash Flow Statement) in operating, investing and financing activities. A separate line entitled "Decrease in cash and cash equivalents of discontinued operations and businesses held for sale" was previously presented on the face of Cash Flow Statement to reconcile back to the Company's cash balance on the face of the Consolidated Balance Sheets, which excludes cash from discontinued operations. As part of the restatement, the Company has changed its presentation to include the net change in cash balances for discontinued operations as a component of net cash from operating activities.

**Other Immaterial Errors**

Certain other immaterial errors were identified and corrected in the appropriate periods.

The following tables set forth the previously reported and restatement amounts (in millions) of selected items within the condensed consolidated statements of operations and comprehensive income for the three months and six months ended June 30, 2004 and within the statement of cash flows for the six months ended June 30, 2004.

**Selected Statement of Operations and Comprehensive Income Data: (\$ in millions)**

	For the three months ended, June 30, 2004		For the six months ended, June 30, 2004	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Regulated revenues	\$ 1,147	\$ 1,146	\$ 2,293	\$ 2,291
Regulated cost of sales	\$ 878	\$ 868	\$ 1,767	\$ 1,751
Non-regulated cost of sales	\$ 737	\$ 738	\$ 1,425	\$ 1,427
Total cost of sales	\$ 1,615	\$ 1,606	\$ 3,192	\$ 3,178
Gross margin	\$ 648	\$ 656	\$ 1,328	\$ 1,340
Interest expense	\$ 460	\$ 470	\$ 953	\$ 971
Foreign currency transaction losses, net	\$ 55	\$ 47	\$ 63	\$ 81
Income before income taxes and minority interest	\$ 185	\$ 191	\$ 386	\$ 362
Income tax expense	\$ 59	\$ 17	\$ 123	\$ 92
Minority interest expense	\$ 59	\$ 71	\$ 122	\$ 125
Income from continuing operations	\$ 67	\$ 103	\$ 141	\$ 145
Net income	\$ 38	\$ 74	\$ 86	\$ 90
Unrealized currency translation (losses) gains	\$ (81 )	\$ (53 )	\$ (71 )	\$ (36 )
Change in fair value of derivatives in comprehensive income (losses)	\$ 36	\$ 35	\$ (71 )	\$ (72 )
Comprehensive (loss) income	\$ (5 )	\$ 58	\$ (54 )	\$ (16 )
<b>BASIC EARNINGS PER SHARE:</b>				
Income from continuing operations	\$ 0.10	\$ 0.16	\$ 0.22	\$ 0.23
Discontinued operations	(0.04 )	(0.04 )	(0.08 )	(0.09 )
Cumulative effect of accounting change				
<b>BASIC EARNINGS PER SHARE:</b>	\$ 0.06	\$ 0.12	\$ 0.14	\$ 0.14
<b>DILUTED EARNINGS PER SHARE:</b>				
Income from continuing operations	\$ 0.10	\$ 0.16	\$ 0.22	\$ 0.23
Discontinued operations	(0.04 )	(0.05 )	(0.09 )	(0.09 )
Cumulative effect of accounting change				
<b>DILUTED EARNINGS PER SHARE:</b>	\$ 0.06	\$ 0.11	\$ 0.13	\$ 0.14

**Selected Statement of Cash Flows Data: (\$ in millions)**

	<b>June 30, 2004</b>	
	<b>As</b>	
	<b>Previously</b>	
	<b>Reported</b>	<b>As Restated</b>
Net cash provided by operating activities	\$ 610	\$ 613
Net cash used in investing activities	\$ 327	\$ 375
Net cash used in financing activities	\$ 741	\$ 741
Cash and cash equivalents, beginning	\$ 1,737	\$ 1,663
Cash and cash equivalents, ending	\$ 1,248	\$ 1,132

**2. FINANCIAL STATEMENT PRESENTATION****Consolidation**

The condensed consolidated financial statements include the accounts of The AES Corporation, its subsidiaries and controlled affiliates ( Company or AES ). Furthermore, variable interest entities in which the Company has an interest have been consolidated where the Company is identified as the primary beneficiary. In all cases, AES holds a majority ownership interest in those variable interest entities that have been consolidated. All intercompany transactions and balances have been eliminated in consolidation. Investments in which the Company has the ability to exercise significant influence but not control are accounted for using the equity method.

**Interim Financial Presentation**

The accompanying unaudited Condensed Consolidated Financial Statements and footnotes have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and Article 10 of Regulation S-X of the Securities and Exchange Commission ( SEC ). Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles in the United States of America for annual fiscal reporting periods. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair statement of the results of operations, financial position and cash flows for the interim periods. The results of operations for the three and six months ended June 30, 2005, are not necessarily indicative of results that may be expected for the year ending December 31, 2005. The accompanying condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2004 consolidated financial statements and notes thereto, which are included in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2004 as filed with the SEC on January 19, 2006.

**New Accounting Standards**

*Share-Based Payment.* In December 2004, the Financial Accounting Standards Board ( FASB ) issued a revised Statement of Financial Accounting Standards ( SFAS ) No. 123, Share-Based Payment. SFAS 123R eliminates the intrinsic value method as an alternative method of accounting for stock-based awards under Accounting Principles Board ( APB ) No. 25 by requiring that all share-based payments to employees, including grants of stock options for all outstanding years, be recognized in the financial statements based on their fair values. It also revises the fair-value based method of accounting for share-based payment liabilities, forfeitures and modifications of stock-based awards and clarifies the guidance under SFAS No. 123 related to measurement of fair value, classifying an award as equity or as a liability and attributing compensation to reporting periods. In addition, SFAS No. 123R amends SFAS No. 95, Statement of Cash Flows, to require that excess tax benefits be reported as a financing cash flow rather than as an operating cash flow.

Management is currently evaluating the effect of the adoption of SFAS No. 123R under the modified prospective application transition method, but does not expect the adoption to have a material effect on the Company's financial condition, results of operations or cash flows, because the Company had previously adopted income statement treatment for compensation related to share-based payments under SFAS No. 123. On April 14, 2005, the SEC deferred the effective date of SFAS No. 123R until the beginning of 2006 for calendar year companies.

*Implicit Variable Interest Entities.* In March 2005, the FASB issued Staff Position ( FSP ) No. FIN 46(R)-5, *Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities*. This FSP clarifies that when applying the variable interest consolidation model, a reporting enterprise should consider whether it holds an implicit variable interest in a variable interest entity ( VIE ) or potential VIE. FSP No. FIN 46(R)-5 is effective as of April 1, 2005. Upon the adoption of FSP No. FIN 46(R)-5, the Company did not identify any potential or implicit VIEs.

*Asset Retirement Obligations.* In March 2005, the FASB issued FASB Interpretation ( FIN ) No. 47 *Accounting for Conditional Asset Retirement Obligations*, an interpretation of FASB Statement No. 143, which clarifies the term *conditional asset retirement obligation* as used in SFAS No. 143 *Accounting for Asset Retirement Obligations*. Specifically, FIN 47 provides that an asset retirement obligation is conditional when the timing and/or method of settling the obligation is conditioned on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. This interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective for fiscal years ending after December 15, 2005. Management is currently evaluating the effect that adoption of FIN 47 will have on the Company's financial position and results of operations.

### 3. INVENTORY

Inventory consists of the following (in millions):

	June 30, 2005	December 31, 2004
Coal, fuel oil and other raw materials	\$ 192	\$ 193
Spare parts and supplies	245	225
Total	\$ 437	\$ 418

### 4. LONG-TERM DEBT

#### *Non-Recourse Debt*

#### *Debt Defaults*

Subsidiary non-recourse debt in default as of June 30, 2005 is as follows (in millions):

Subsidiary	Primary Nature of Covenant Default	June 30, 2005 Default	Net Assets
Eden/Edes	Payment	\$ 98	\$ (52 )
Parana	Payment	53	(65 )
Hefei	Payment	4	
Los Mina	Payment	24	93
Andres	Payment	112	275
		\$ 291	\$ 251





Andres and Los Mina, both electricity generation companies which are wholly owned subsidiaries of the Company located in the Dominican Republic, entered into forbearance agreements with their respective lenders in December 2004. Pursuant to the forbearance agreements, the lenders agreed not to exercise any remedies under the respective credit agreements. The forbearance agreements for Andres and Los Mina expired on July 29, 2005 and June 10, 2005, respectively. Subsequently, in December 2005, AES Dominicana Energia Finance, S.A., a wholly owned subsidiary of the Company, issued a \$160 million Senior Secured Corporate Bond in the international capital markets under Rule 144A/Regulation S. The 10-year notes, with final maturity in December 2015, were priced to yield 11%. The net proceeds of the issuance were used to retire the current bank debt at both Andres and Los Mina of \$112 million and \$24 million, respectively. As of June 30, 2005, the debt for both of these subsidiaries is reported as current in the accompanying condensed consolidated balance sheet.

In September 2005, Indian Queens Power Ltd. ( Indian Queens ), an electricity generation company which is a wholly owned subsidiary of the Company located in the United Kingdom, was not able to meet the debt service coverage ratio as required pursuant to its term loan agreement. As a result, the debt is currently in default. The lenders have not issued a waiver for the default at this time.

#### ***Recourse Debt***

Recourse debt obligations are direct borrowings of the parent corporation.

On June 1, 2005, the Company redeemed all outstanding 8.5% Senior Subordinated Notes due 2007, at a redemption price of 101.417% and an aggregate principal amount of approximately \$112 million, including unamortized transaction costs.

On June 23, 2005, the Company amended its \$650 million Senior Secured Bank Facilities. The interest rate on the \$450 million Revolving Bank Loan was reduced to the London Interbank Offered Rate ( LIBOR ) plus 175 basis points. Previously, the rate was LIBOR plus 250 basis points. In addition, the Revolving Bank Loan maturity was extended from 2007 to 2010. The interest rate on the Senior Secured Term Loan also was reduced to LIBOR plus 175 basis points, from LIBOR plus 225 basis points, while its maturity in 2011 remains unchanged.

On August 15, 2005, the Company repaid at maturity all outstanding 4.5% Convertible Junior Subordinated Debentures ( the Debentures ) at par for an aggregate principal amount of \$142 million.

## **5. EARNINGS PER SHARE**

Basic and diluted earnings per share are based on the weighted average number of shares of common stock and potential common stock outstanding during the period, after giving effect to stock splits, as applicable. Potential common stock, for purposes of determining diluted earnings per share, includes the effects of dilutive stock options, warrants, deferred compensation arrangements, and convertible securities. The effect of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable.

## Edgar Filing: AES CORP - Form 10-Q

The following tables present a reconciliation (in millions) of the numerators and denominators of the basic and diluted earnings per share computations for income from continuing operations. In the table below, income represents the numerator and shares represent the denominator:

	Three Months Ended June 30, 2005			2004		
	Income	Shares	\$ per Share	Income	Shares	\$ per Share
<b>BASIC EARNINGS PER SHARE:</b>						
Income from continuing operations	\$ 85	652	\$ 0.13	\$ 103	638	\$ 0.16
<b>EFFECT OF DILUTIVE SECURITIES:</b>						
Stock options and warrants		10			6	
Restricted stock units		1			1	
Convertible debt						
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 85</b>	<b>663</b>	<b>\$ 0.13</b>	<b>\$ 103</b>	<b>645</b>	<b>\$ 0.16</b>

There were approximately 8.6 million and 29.2 million options outstanding at June 30, 2005 and 2004, respectively, that were omitted from the earnings per share calculation because they were anti-dilutive. For the three months ended June 30, 2005 and June 30, 2004, all convertible securities were omitted from the earnings per share calculation because they were anti-dilutive.

	Six Months Ended June 30, 2005			2004		
	Income	Shares	\$ per Share	Income	Shares	\$ per Share
<b>BASIC EARNINGS PER SHARE:</b>						
Income from continuing operations	\$ 209	653	\$ 0.32	\$ 145	633	\$ 0.23
<b>EFFECT OF DILUTIVE SECURITIES:</b>						
Stock options and warrants		10	(0.01 )		7	
Restricted stock units		1				
Convertible debt						
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 209</b>	<b>664</b>	<b>\$ 0.31</b>	<b>\$ 145</b>	<b>640</b>	<b>\$ 0.23</b>

There were approximately 8.6 million and 26.9 million options outstanding at June 30, 2005 and 2004, respectively, that were omitted from the earnings per share calculation because they were anti-dilutive. For the six months ended June 30, 2005 and June 30, 2004, all convertible securities were omitted from the earnings per share calculation because they were anti-dilutive.

### 6. SUMMARIZED INCOME STATEMENT INFORMATION OF AFFILIATES

The following table summarizes financial information (in millions) of the entities in which the Company has the ability to exercise significant influence but does not control, and therefore are accounted for using the equity method.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Revenues	\$ 282	\$ 238	\$ 532	\$ 468
Gross Margin	\$ 78	\$ 81	\$ 155	\$ 158
Net Income	\$ 48	\$ 39	\$ 99	\$ 85

The Company discontinues the application of the equity method when an investment is reduced to zero and does not provide for additional losses when the Company does not guarantee the obligations of the investee, or is not otherwise committed to provide further financial support for the investee. The above

table excludes income statement information for the Company's investments in which the Company has discontinued the application of the equity method. Furthermore, the Company's policy is to resume the application of the equity method if the investee subsequently reports net income only after the Company's share of that net income equals the share of net losses not recognized during the period the equity method was suspended.

## 7. CONTINGENCIES

### *Environmental*

The Company reviews its obligations as they relate to compliance with environmental laws, including site restoration and remediation. As of June 30, 2005, the Company recorded liabilities of \$12 million for projected environmental remediation costs. Because of the uncertainties associated with environmental assessment and remediation activities, future costs of compliance or remediation could be higher or lower than the amount currently accrued. Based on currently available information and analysis, the Company believes that it is possible that costs associated with such liabilities or as yet unknown liabilities may exceed current reserves in amounts that could be material but cannot be estimated as of June 30, 2005.

### *Financial Commitments*

At June 30, 2005, AES provided outstanding financial and performance related guarantees or other credit support commitments for the benefit of its subsidiaries, which were limited by the terms of the agreements to an aggregate of approximately \$457 million (excluding those collateralized by letter of credit and surety bond obligations discussed below).

At June 30, 2005, the Company had \$235 million in letters of credit outstanding under the Revolving Bank Loan that operate to guarantee performance relating to certain project development activities and subsidiary operations. The Company pays a letter of credit fee ranging from 0.50% to 2.75% per annum on the outstanding amounts. In addition, the Company had \$4 million in surety bonds outstanding at June 30, 2005.

### *Litigation*

The Company is involved in certain claims, suits and legal proceedings in the normal course of business. The Company has accrued for litigation and claims where it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company believes, based upon information it currently possesses and taking into account established reserves for estimated liabilities and its insurance coverage, that the ultimate outcome of these proceedings and actions is unlikely to have a material adverse effect on the Company's financial statements. It is possible, however, that some matters could be decided unfavorably to the Company, and could require the Company to pay damages or to make expenditures in amounts that could have a material adverse effect on the Company's financial position and results of operations.

In September 1999, a Brazilian appellate state court of Minas Gerais granted a temporary injunction suspending the effectiveness of a shareholders' agreement between Southern Electric Brasil Participacoes, Ltda. ( SEB ) and the state of Minas Gerais concerning CEMIG. AES's investment in CEMIG is through SEB. This shareholders' agreement granted SEB certain rights and powers in respect of CEMIG ( Special Rights ). In March 2000, a lower state court in Minas Gerais held the shareholders' agreement invalid where the agreement purported to grant SEB the Special Rights and the lower state court enjoined the exercise of Special Rights. In August 2001, a state appellate court denied an appeal of the decision, and extended the injunction. In October 2001, SEB filed two appeals against the decision on the merits of the state appellate court, one appeal to the Federal Superior Court and the other appeal to the Supreme Court of Justice. The state appellate court denied access of these two appeals to the higher courts, and in August 2002, SEB filed two interlocutory appeals against the state appellate court's decision, one directed to the Federal Superior Court and the other to the Supreme Court of Justice. In December 2004, the Federal Superior Court denied SEB's appeal. In June 2005, the Supreme Court of Justice formally accepted SEB's appeal. SEB intends to vigorously pursue a restoration of the value of its investment in CEMIG; however, there can be no assurances that it will be successful in its efforts. Failure to prevail in this matter may limit SEB's influence on the daily operation of CEMIG.

In November 2000, the Company was named in a purported class action suit along with six other defendants, alleging unlawful manipulation of the California wholesale electricity market, resulting in inflated wholesale electricity prices throughout California. The alleged causes of action include violation of the Cartwright Act, the California Unfair Trade Practices Act and the California Consumers Legal Remedies Act. In December 2000, the case was removed from the San Diego County Superior Court to the U.S. District Court for the Southern District of California. On July 30, 2001, the Court remanded the case to San Diego Superior Court. The case was consolidated with five other lawsuits alleging similar claims against other defendants. In March 2002, the plaintiffs filed a new master complaint in the consolidated action, which reasserted the claims raised in the earlier action and names the Company, AES Redondo Beach, L.L.C., AES Alamitos, L.L.C., and AES Huntington Beach, L.L.C. as defendants. In May 2002, the case was removed by certain cross-defendants from the San Diego County Superior Court to the United States District Court for the Southern District of California. The plaintiffs filed a motion to remand the case to state court, which was granted on December 13, 2002. Certain defendants appealed aspects of that decision to the United States Court of Appeals for the Ninth Circuit. On December 8, 2004, a panel of the Ninth Circuit issued an opinion affirming in part and reversing in part the decision of the District Court, and remanding the case to state court. On July 8, 2005, defendants filed a demurrer in state court seeking dismissal of the case in its entirety. In October 2005, the state court dismissed the case. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In August 2000, the Federal Energy Regulatory Commission ( FERC ) announced an investigation into the organized California wholesale power markets in order to determine whether rates were just and reasonable. Further investigations involved alleged market manipulation. The FERC requested documents from each of the AES Southland plants and AES Placerita. AES Southland and AES Placerita have cooperated fully with the FERC investigation. AES Southland is not subject to refund liability because it did not sell into the organized spot markets due to the nature of its tolling agreement. The Ninth Circuit heard oral arguments on the time scope of the refunds. The Ninth Circuit Court of Appeals also addressed the appeal of the FERC's decision not to impose refunds for the alleged failure to file rates including transaction specific data for sales to the California Independent System Operator ( ISO ) for 2000 and 2001. See *State of California ex rel. Bill Lockyer*. Although in its order issued on September 9, 2004 the Ninth Circuit did not order refunds, the Ninth Circuit remanded the case to the FERC for a refund proceeding to consider remedial options. That remand order is pending rehearing at the Ninth Circuit. Placerita made sales during the referenced time period. Depending on the method of calculating refunds and the time period to which the method is applied, the alleged refunds sought from AES Placerita could approximate \$23 million.

In August 2001, a petition was filed against CESCO, an affiliate of the Company, by the Grid Corporation of Orissa, India ( Gridco ), with the Orissa Electricity Regulatory Commission ( OERC ), alleging that CESCO had defaulted on its obligations as an OERC-licensed distribution company, that CESCO management abandoned the management of CESCO, and asking for interim measures of protection, including the appointment of an administrator to manage CESCO. Gridco, a state-owned entity, is the sole wholesale energy provider to CESCO. Pursuant to the OERC's August 2001 order, the management of CESCO was replaced with a government administrator who was appointed by the OERC. The OERC later held that the Company and other CESCO shareholders were not necessary or proper parties to the OERC proceeding. In August 2004, the OERC issued a notice to CESCO, the Company and others giving the recipients of the notice until November 2004 to show cause why CESCO's distribution license should not be revoked. In response, CESCO submitted a business plan to the OERC. In February 2005, the OERC issued an order rejecting the proposed business plan. The order also stated that the CESCO distribution license would be revoked if an acceptable business plan for CESCO was not submitted to, and approved by, the OERC prior to March 31, 2005. In its April 2, 2005 order, the OERC revoked the CESCO distribution license. CESCO has filed an appeal against the April 2, 2005 OERC order and that appeal remains pending in the Indian courts. In addition, Gridco asserted that a comfort letter issued by the Company in connection with the Company's indirect investment in CESCO obligates the Company to provide additional financial support to cover all of CESCO's financial obligations to Gridco. In December 2001, Gridco served a notice to arbitrate pursuant to the Indian Arbitration and Conciliation Act of 1996 on the Company, AES Orissa Distribution Private Limited ( AES ODPL ), and Jyoti Structures ( Jyoti ) pursuant to the terms of the CESCO Shareholders Agreement between Gridco, the Company, AES ODPL, Jyoti and CESCO (the CESCO arbitration ). In the arbitration, Gridco appears to seek approximately \$188.5 million in damages plus undisclosed penalties and interest, but a detailed alleged damages analysis has yet to be filed by Gridco. The Company has counter-claimed against Gridco for damages. An arbitration hearing with respect to liability was conducted on August 3-9, 2005 in India. Final written arguments regarding liability were submitted by the parties to the arbitral tribunal in late October 2005. A decision on liability may be issued in the first quarter of 2006. A petition remains pending before the Indian Supreme Court concerning fees of the third neutral arbitrator and the venue of future hearings with respect to the CESCO arbitration. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In December 2001, a petition was filed by Gridco in the local Indian courts seeking an injunction to prohibit the Company and its subsidiaries from selling their shares in Orissa Power Generation Company Pvt. Ltd. ( OPGC ) pending the outcome of the above discussed CESCO arbitration. OPGC, located in Orissa, is a 420 MW coal-based electricity generation business from which Gridco is the sole off-taker of electricity. Gridco obtained a temporary injunction, but the District Court eventually dismissed Gridco's petition for an injunction in March 2002. Gridco appealed to the Orissa High Court, which in January 2005 allowed the appeal and granted the injunction. The Company has appealed the High Court's decision to the Supreme Court of India. In May 2005, the Supreme Court adjourned this matter until August 2005. In August 2005 the Supreme Court adjourned the matter again to await the award of the arbitral tribunal in the CESCO arbitration. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In early 2002, GRIDCO made an application to the OERC requesting that the OERC initiate proceedings regarding the terms of OPGC's existing power purchase agreement ( PPA ) with Gridco. In response, OPGC filed a petition in the India courts to block any such OERC proceedings. In early 2005 the Orissa High Court upheld the OERC's jurisdiction to initiate such proceedings as requested by Gridco. OPGC appealed that High Court's decision to the Supreme Court and sought stays of both the High Court's decision and the underlying OERC proceedings regarding the PPA terms. In April 2005, the Supreme Court granted OPGC's requests and ordered stays of the High Court's decision and the OERC proceedings with respect to the PPA terms. The matter is awaiting further hearing. Unless the Supreme Court finds in favor of OPGC's appeal or otherwise prevents the OERC's proceedings regarding the PPA

terms, the OERC will likely lower the tariff payable to OPGC under the PPA, which would have an adverse impact on OPGC's financials. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In July 2002, the Company, Dennis W. Bakke, Roger W. Sant, and Barry J. Sharp were named as defendants in a purported class action filed in the United States District Court for the Southern District of Indiana. In September 2002, two virtually identical complaints were filed against the same defendants in the same court. All three lawsuits purport to be filed on behalf of a class of all persons who exchanged their shares of IPALCO common stock for shares of AES common stock issued pursuant to a registration statement dated and filed with the SEC on August 16, 2000, (the Share Exchange). The complaints purport to allege violations of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 based on statements in or omissions from the registration statement concerning, among other things, an alleged breach by AES of obligations AES owed to Williams Energy Services Co. (Williams) under an agreement between the two companies in connection with the California energy market. On September 26, 2003, defendants filed a motion to dismiss the complaint. By Order dated November 17, 2004, the Court dismissed all of the claims asserted in the amended and consolidated complaint against all defendants except for the claim alleging that the registration statement and prospectus disseminated to the IPALCO stockholders for purposes of the Share Exchange failed to disclose AES's purported temporary default on its contract with Williams. On December 15, 2004, the AES Defendants filed a motion for judgment on the pleadings dismissing the remaining claims. On July 7, 2005, the district court granted defendants' motion for judgment on the pleadings and entered an order dismissing all claims and thereby terminating this action in the district court. The time to file an appeal to the action has expired without the filing of an appeal.

Commencing on May 2, 2003, the Indiana Securities Commissioner of Indiana's Office of the Secretary of State, Securities Division, pursuant to Indiana Code 23-2-1, served subpoenas on 30 former officers and directors of IPALCO Enterprises, Inc. (IPALCO), AES, and others, requesting the production of documents in connection with the March 27, 2001 share exchange between the Company and IPALCO pursuant to which stockholders exchanged shares of IPALCO common stock for shares of the Company's common stock and IPALCO became a wholly-owned subsidiary of the Company. IPALCO and the Company have produced documents pursuant to the subpoenas served on them. In addition, the Indiana Securities Commissioner's office has taken testimony from various individuals. On January 27, 2004, Indiana's Secretary of State issued a statement which provided that the investigative staff had determined that there did not appear to be a justifiable reason to focus further specific attention upon six non-employee former members of IPALCO's Board of Directors. In October 2005, the Secretary of State issued a press release announcing that the investigation had been concluded and that no charges would be sought.

In April 2002, IPALCO and certain former officers and directors of IPALCO were named as defendants in a purported class action lawsuit filed in the United States District Court for the Southern District of Indiana. On May 28, 2002, an amended complaint was filed in the lawsuit. The amended complaint asserts that IPALCO and former members of the pension committee for the Indianapolis Power & Light Company thrift plan breached their fiduciary duties to the plaintiffs under the Employees Retirement Income Security Act by investing assets of the thrift plan in the common stock of IPALCO prior to the acquisition of IPALCO by the Company. In December 2002, plaintiffs moved to certify this case as a class action. The Court granted the motion for class certification on September 30, 2003. On October 31, 2003, the parties filed cross-motions for summary judgment on liability. On August 11, 2005, the Court issued an Order denying the summary judgment motions, but striking one defense asserted by defendants. Trial has been scheduled for early February 2006 addressing only the allegations of breach of fiduciary duty. If necessary, one or more trials on reliance and damages issues will be conducted separately. IPALCO believes it has meritorious defenses to the claims asserted against it and intends to defend this lawsuit vigorously.

In November 2002, a lawsuit was filed against AES Wolf Hollow, L.P. ( AESWH ) and AES Frontier, L.P. ( AESF ) in the District Court of Hood County, Texas by Stone & Webster, Inc. ( S&W ). At the time of filing, AESWH and AESF were two indirect subsidiaries of the Company. In December 2004, the Company finalized agreements to transfer the ownership of AESWH and AESF. S&W contracted with AESWH and AESF to perform the engineering, procurement and construction of the Wolf Hollow project, a gas-fired combined cycle power plant in Hood County, Texas. In its initial complaint, S&W requested a declaratory judgment that a fire that took place at the project on June 16, 2002 constituted a force majeure event and that S&W was not required to pay rebates assessed for associated delays. As part of the initial complaint, S&W also sought to enjoin AESWH and AESF from drawing down on letters of credit provided by S&W. The Court refused to issue the injunction. S&W has since amended its complaint five times and joined additional parties, including the Company and Parsons Energy & Chemicals Group, Inc. In addition to the claims already mentioned, the current claims by S&W include claims for breach of contract, breach of warranty, wrongful liquidated damages, foreclosure of lien, fraud and negligent misrepresentation. S&W appears to assert damages against the subsidiaries and the Company in the amount of \$114 million in recently filed reports and seeks exemplary damages. S&W has filed a lien against the ownership interests of AESWH and AESF in the property, with each lien allegedly valued, after amendment on March 14, 2005, at approximately \$87 million. In January 2004, the Company filed a counterclaim against S&W and its parent, the Shaw Group, Inc. ( Shaw ). AESWH and AESF filed answers and counterclaims against S&W, which since have been amended. The amount of AESWH and AESF 's counterclaims are approximately \$215 million, according to calculations of the subsidiaries and of an expert retained in connection with the litigation, minus the Contract balance, currently not earned, in the amount of \$45.8 million. In March 2004, S&W and Shaw each filed an answer to the counterclaim. The counterclaim and answers subsequently were amended. In March 2005, the Court rescheduled the trial date for October 24, 2005. In September 2005, the trial date was re-scheduled for June 2006. In November 2005, the Company filed a motion for partial summary judgment. The Company believes that the allegations in S&W 's complaint are meritless, and that it has meritorious defenses to the claims asserted by S&W. The Company intends to defend the lawsuit and pursue its claims vigorously.

In March 2003, the office of the Federal Public Prosecutor for the State of Sao Paulo, Brazil ( MPF ) notified Eletropaulo that it had commenced an inquiry related to the BNDES financings provided to AES Elpa and AES Transgas and the rationing loan provided to Eletropaulo, changes in the control of Eletropaulo, sales of assets by Eletropaulo and the quality of service provided by Eletropaulo to its customers and requested various documents from Eletropaulo relating to these matters. In October 2003 this inquiry was sent to the MPF for continuing investigation. Also in March 2003, the Commission for Public Works and Services of the Sao Paulo Congress requested Eletropaulo to appear at a hearing concerning the default by AES Elpa and AES Transgas on the BNDES financings and the quality of service rendered by Eletropaulo. This hearing was postponed indefinitely. In addition, in April 2003, the office of the MPF notified Eletropaulo that it is conducting an inquiry into possible errors related to the collection by Eletropaulo of customers ' unpaid past-due debt and requesting the company to justify its procedures. In December 2003, ANEEL answered, as requested by the MPF, that the issue regarding the past-due debts are to be included in the analysis to the revision of the General Conditions for the Electric Energy Supply.

In May 2003, there were press reports of allegations that in April 1998 Light Serviços de Eletricidade S.A. ( Light ) colluded with Enron in connection with the auction of Eletropaulo. Enron and Light were among three potential bidders for Eletropaulo. At the time of the transaction in 1998, AES owned less than 15% of the stock of Light and shared representation in Light 's management and Board with three other shareholders. In June 2003, the Secretariat of Economic Law for the Brazilian Department of Economic Protection and Defense ( SDE ) issued a notice of preliminary investigation seeking information from a number of entities, including AES Brasil Energia, with respect to certain allegations arising out of the privatization of Eletropaulo. On August 1, 2003, AES Elpa responded on behalf of AES-affiliated companies and denied knowledge of these allegations. The SDE began a follow-up



administrative proceeding as reported in a notice published on October 31, 2003. In response to the Secretary of Economic Law's official letters requesting explanations on such accusation, Eletropaulo filed its defense on January 19, 2004. On April 7, 2005 Eletropaulo responded to a SDE request for additional information.

AES Florestal, Ltd., ( Florestal ), a wooden utility pole manufacturer located in Triunfo, in the state of Rio Grande do Sul, Brazil, has been operated by Sul since October 1997 as part of the original privatization transaction by the Government of the State of Rio Grande do Sul, Brazil, that created Sul. From 1997 to the present, the chemical compound chromated copper arsenate was used by Florestal to chemically treat the poles under an operating license issued by the Brazilian government. Prior to 1997, another chemical, creosote, was used to treat the poles. After becoming the operator of Florestal, Sul discovered approximately 200 barrels of solid creosote waste on the Florestal property. In 2002, a civil inquiry (Civil Inquiry No. 02/02) was initiated and a criminal lawsuit was filed in the city of Triunfo's Judiciary both by the Public Prosecutors office of the city of Triunfo. The civil lawsuit was settled in 2003, and on June 27, 2005, the criminal lawsuit was dismissed. Florestal hired an independent environmental assessment company to perform an environmental audit of the operational cycle at Florestal. Florestal submitted an action plan that was accepted by the environmental authority under which it voluntarily offered to do containment work at the site.

On January 27, 2004, the Company received notice of a Formulation of Charges filed against the Company by the Superintendence of Electricity of the Dominican Republic. In the Formulation of Charges, the Superintendence asserts that the existence of three generation companies (Empresa Generadora de Electricidad Itabo, S.A., Dominican Power Partners, and AES Andres BV) and one distribution company (Empresa Distribuidora de Electricidad del Este, S.A.) in the Dominican Republic, violates certain cross ownership restrictions contained in the General Electricity law of the Dominican Republic. On February 10, 2004, the Company filed in the First Instance Court of the National District of the Dominican Republic ( Court ) an action seeking injunctive relief based on several constitutional due process violations contained in the Formulation of Charges ( Constitutional Injunction ). On or about February 24, 2004, the Court granted the Constitutional Injunction and ordered the immediate cessation of any effects of the Formulation of Charges and the enactment by the Superintendence of Electricity of a special procedure to prosecute alleged antitrust complaints under the General Electricity Law. On March 1, 2004, the Superintendence of Electricity appealed the Court's decision. The appeal is pending.

In late July 2004, the Corporación Dominicana de Empresas Eléctricas Estatales ( CDEEE ), which is the government entity that currently owns 50% of Empresa Generadora de Electricidad Itabo, S.A. ( Itabo ), filed separate lawsuits in the Dominican Republic against Ede Este, a former subsidiary of AES, and Itabo, an AES affiliate. Lawsuits against Itabo also name the president of Itabo as a defendant. In one of the lawsuits against Itabo, CDEEE requested a rendering of accountability for the accounts of Itabo with regard to all transactions between Itabo and related parties. On November 29, 2004, the Court dismissed the case. CDEEE appealed the dismissal. A hearing was held on May 12, 2005 and Itabo requested the Court to declare the Courts' jurisdictional incompetence to decide the matter, in light of the arbitration clause set forth in the contracts executed between Itabo and CDEEE under the Capitalization Process. The Court ordered that the claims be heard on the merits and condemned Itabo for not complying with this request. The Court reserved judgment on Itabo's arguments that the matter should be resolved in an arbitration proceeding. On May 25, 2005, Itabo appealed the May 12 decision and requested a stay of the decision. On October 14, 2005 the Court of Appeals of Santo Domingo upheld Itabo's request of jurisdictional incompetence and remitted the lawsuit to the International Chamber of Commerce ( ICC ) for arbitration. On May 26, 2005, Itabo filed a motion with the United States District Court Southern District New York, seeking relief in aid of the ongoing arbitration. The petition was denied on July 18. Itabo appealed said decision on September 6, 2005. In the other Itabo lawsuit, CDEEE also requested that the court order Itabo to deliver its accounting books and records for the period from September 1999 to July 2004 to CDEEE. At a hearing that was held on March 30, 2005, Itabo submitted

that the court did not have jurisdiction to hear the case and that the case should be decided in an arbitration proceeding. On October 11, 2005 the Court upheld Itabo's petition of jurisdictional incompetence and declared that the lawsuit should be decided in an arbitral proceeding. In the Ede Este lawsuit, CDEEE requests a rendering of accountability of the accounts of all Ede Este's commercial and financial operations with affiliate companies since August 5, 1999. On February 9, 2005, Itabo filed a lawsuit against CDEEE and the Fondo Patrimonial para el Desarrollo ( FONPER ) seeking among other relief, to enforce the arbitration/dispute resolution processes set forth in the contracts among the parties. FONPER submitted an answer and asserted a counterclaim on April 21, 2005. CDEEE submitted an answer on April 23, 2005. Itabo answered FONPER's counterclaim on May 12, 2005. On August 25, Itabo filed an amended lawsuit. The Tribunal has been constituted. The arbitration is ongoing.

On February 18, 2004, AES Gener S.A. ( Gener SA ), a subsidiary of the Company, filed a lawsuit in the Federal District Court for the Southern District of New York. Gener SA is co-venturer with Coastal Itabo, Ltd. ( Coastal ) in Itabo, a Dominican Republic electric generation company. The lawsuit sought to enjoin the efforts initiated by Coastal to hire an alleged independent expert, purportedly pursuant to the Shareholder Agreement between the parties, to perform a valuation of Gener SA's aggregate interests in Itabo. Coastal asserts that Gener SA has committed a material breach under the parties' Shareholder Agreement, and therefore, Gener is required if requested by Coastal to sell its aggregate interests in Itabo to Coastal at a price equal to 75% of the independent expert's valuation. Coastal claims a breach occurred based on alleged violations by Gener SA of purported antitrust laws of the Dominican Republic. Gener SA disputes that any default has occurred. On March 11, 2004, upon motion by Gener SA, the court enjoined the evaluation being performed by the expert and ordered the parties to arbitration. On March 11, 2004, Gener SA commenced arbitration proceedings. The arbitration tribunal has been appointed and the arbitration is ongoing.

Pursuant to the pesification established by the Public Emergency Law and related decrees in Argentina, since the beginning of 2002, the Company's subsidiary TermoAndes has converted its obligations under its gas supply and gas transportation contracts into pesos. In accordance with the Argentine regulations, payments were made in Argentine pesos at a 1:1 exchange rate. Certain gas suppliers (Tecpetrol, Mobil and Compañía General de Combustibles S.A.) which represented 50% of the gas supply contract have objected to the payment in pesos. On January 30, 2004, such gas suppliers filed for arbitration with the ICC requesting the re-dollarization of the gas price. TermoAndes replied on March 10, 2004 with a counter-lawsuit related to (i) the default of suppliers regarding the most favored nation clause, (ii) the unilateral modification of the point of gas injection by the suppliers, (iii) the obligations to supply the contracted quantities and (iv) the ability of TermoAndes to resell the gas not consumed. On May 12, 2004, the plaintiffs responded to TermoAndes' counterclaims. In October 2004, the case was submitted to a court of arbitration for determination of the Terms of Reference. Hearings to show evidence were held in Buenos Aires in June 2005. The arbitration seeks approximately \$12 million for past gas supplies plus interest.

On or about October 27, 2004, AES Red Oak LLC ( Red Oak ) was named as a defendant in a lawsuit filed by Raytheon Company ( Raytheon ) in the Supreme Court of the State of New York, County of New York. The complaint purports to allege claims for breach of contract, fraud, interference with contractual rights and equitable relief concerning alleged issues related to the construction and/or performance of the Red Oak project. The complaint seeks the return from Red Oak of approximately \$30 million that was drawn by Red Oak under a letter of credit that was posted by Raytheon related to the construction and/or performance of the Red Oak project. Raytheon also seeks \$110 million in purported additional expense allegedly incurred by Raytheon in connection with the guaranty and construction agreements entered with Red Oak. In December 2004, Red Oak answered the complaint and filed counterclaims against Raytheon. In January 2005, Raytheon moved for dismissal of Red Oak's counterclaims. In March 2005, the motion to dismiss was withdrawn and a partial motion for summary judgment was filed by Raytheon seeking return of approximately \$16 million of the letter of credit draw.

Red Oak submitted its opposition to the partial motion for summary judgment in April. Meanwhile, Raytheon re-filed its motion to dismiss the fraud allegations in the counterclaim. In late April 2005, Red Oak filed its response opposing the renewed motion to dismiss. In December 2005, the Court granted a dismissal of Red Oak's fraud claim. The Court ordered the return of approximately \$16 million of the letter of credit draw that had yet to be utilized for the performance/construction issues. The parties are conducting discovery. Red Oak expects to defend itself vigorously in the action. Raytheon also filed a related action against Red Oak in the Superior Court of Middlesex County, New Jersey, on May 27, 2005, seeking to foreclose on a construction lien filed against property allegedly owned by Red Oak, in the amount of \$31 million. Red Oak was served with the Complaint in September of 2005, and filed its answer, affirmative defenses, and counterclaim in October of 2005. Raytheon has stated that it wishes to stay the New Jersey action pending the outcome of the New York action. Red Oak has not decided whether it wishes to oppose the lien, or consent to a stay.

On January 26, 2005, the City of Redondo Beach, California, sent Williams Power Co., Inc., ( Williams ) and AES Redondo Beach, LLC ( AES Redondo Beach ), a subsidiary of the Company, a notice of assessment for utility users' tax ( UUT ) for the period of May 1998 through September 2004 taxing the natural gas used at AES Redondo's plant to generate electricity during that time period. The original assessment included alleged amounts owing of \$32.8 million for gas usage and \$38.9 million in interest and penalties. The City lowered the assessment to total \$56.7 million on July 13. An administrative hearing before the City's Tax Administrator was held on July 18-21 to hear Williams' and AES Redondo Beach's objections to the assessment. On September 23, the Tax Administrator issued a decision holding AES Redondo Beach and Williams jointly and severally liable for approximately \$56.7 million, over \$20 million of which is interest and penalties. AES Redondo Beach filed with the City Manager of Redondo Beach an appeal of that decision on October 7. Under its Ordinance, the City of Redondo Beach has 45 days to hold the appeal hearing from the date of the filing of the appeal. A hearing on the appeal will likely be scheduled for late January or February 2006. In addition, in July 2005, AES Redondo Beach filed a lawsuit in Los Angeles Superior Court seeking a refund of UUT that was paid from February 2005 through final judgment of that case and an order that the City cannot charge AES Redondo Beach that tax going forward. On August 11, 2005, the City filed a demurrer seeking a dismissal of that lawsuit.

On April 26, 2003 approximately 4,000 gallons of distillate fuel oil spilled as a result of incorrect loading and storage tank valve settings at the Company's gas turbine plant at Condado del Rey, Panama. Remediation efforts were promptly conducted and completed. AES Panama agreed with Autoridad Nacional del Ambiente ( ANAM ), the Panamanian National Environmental Authority, to pay a fine of \$250 thousand, execute a soil remediation program, present an audit and new environmental management plan for the plant, and present a project to improve the domestic wastewater treatment system of the Condado del Rey neighborhood and the environmental recovery of the Abajo river watershed. As part of recent discussions and in response to a letter received by AES Panama from ANAM on May 25, 2005, clarifying the scope of the watershed project, AES Panama paid the fine on June 6, 2005, and complied with the agreed initiatives. The Company considers this issue to be closed and does not expect that any remaining costs or efforts to be material to our operations or results.

#### ***Tax Examinations***

The Company and certain of its subsidiaries are under examination by the relevant taxing authorities for various tax years. The Company regularly assesses the potential outcome of these examinations in each of the taxing jurisdictions when determining the adequacy of the provision for income taxes. Tax reserves have been established, which the Company believes to be adequate in relation to the potential for additional assessments. Once established, reserves are adjusted only when there is more information available or when an event occurs necessitating a change to the reserves. While the Company believes that the amount of the tax estimates is reasonable, it is possible that the ultimate outcome of current or future

examinations may exceed current reserves in amounts that could be material but cannot be estimated as of June 30, 2005.

***Other***

In exchange for the termination of \$863 million of outstanding Brasileira Energia debt and accrued interest during 2004, the Brazilian National Development Bank ( BNDES ) received \$90 million in cash, 53.85% ownership of Brasileira Energia and a one-year call option ( Sul Option ) to acquire a 53.85% ownership interest of Sul. The Sul Option, which would require the Company to contribute its equity interest in Sul to Brasileira Energia, became exercisable on December 22, 2005. The probability of BNDES exercising the Sul Option is unknown at this time. BNDES' s ability to exercise the Sul Option is contingent upon several factors. The most significant factor requires BNDES to obtain consent for the exercise of the option from the Sul syndicated lenders. In the event BNDES exercises its option, 100% of the Company' s ownership in Sul would be transferred to Brasileira Energia and the Company would be required to recognize a non-cash after-tax loss on its investment in Sul currently estimated at approximately \$455 million. This amount primarily includes the recognition of currency translation losses and recording minority interest for BNDES' s share of Sul offset by the recorded estimated fair value of the Sul Option. If the Sul Option is exercised, the Company' s ownership of Sul would be reduced from approximately 100% to approximately 46%.

**8. COMPREHENSIVE INCOME (LOSS)**

## Edgar Filing: AES CORP - Form 10-Q

The components of comprehensive income (loss) for the three and six months ended June 30, 2005 and 2004 are as follows (in millions):

	Three Months Ended		Six Months Ended	
	June 30, 2005	2004	June 30, 2005	2004
Net income	\$ 85	\$ 74	\$ 209	\$ 90
Foreign currency translation adjustments (net of income taxes of \$-)	91	(53 )	81	(36 )
Cash flow hedging activity:				
Reclassification to earnings (net of income tax benefit of \$12, \$10, \$21 and \$24, respectively)	42	34	61	75
Change in derivative fair value (net of income tax benefit of \$13, \$4, \$39 and \$38, respectively)	(102 )	1	(145 )	(147 )
Change in fair value of derivatives	(60 )	35	(84 )	(72 )
Minimum pension liability (net of income taxes of \$-, \$2, \$- and \$2, respectively)		2		2
Comprehensive income (loss)	\$116	\$ 58	\$ 206	\$ (16 )

Accumulated other comprehensive loss is as follows at June 30, 2005 (in millions):

	Six Months Ended June 30, 2005
Accumulated other comprehensive loss December 31, 2004	\$ (3,643 )
Total foreign currency translation adjustments	81
Change in fair value of derivatives	(84 )
Accumulated other comprehensive loss June 30, 2005	\$ (3,646 )

## 9. SEGMENTS

AES previously reported its financial results in four business segments of the electricity industry: large utilities, growth distribution, contract generation and competitive supply. After review and consideration of the Company's operating segments during the second quarter, the Company determined that the businesses within the large utilities and growth distribution segments were similar in terms of exposure to government regulation of their tariffs and the type of customer base served. The Company further determined that the similarities now outweigh the characteristics of size, location and growth potential that previously differentiated the two regulated distribution segments. Beginning in the second quarter of 2005, the large utilities and growth distribution segments were merged into one segment entitled regulated utilities.

Although the nature of the product is the same in all three segments, the segments are differentiated by the nature of the customers, operational differences, cost structure, regulatory environment and risk exposure.

- The regulated utilities segment primarily consists of 14 distribution companies in seven countries that maintain a monopoly franchise within a defined service area.
- The contract generation segment consists of facilities that have contractually limited their exposure to electricity price volatility by entering into long-term (five years or longer) power sales agreements for 75% or more of their output capacity. Exposure to fuel supply risks is also limited through long-term fuel supply contracts or through tolling arrangements. These contractual agreements generally reduce exposure to fuel commodity and electricity price volatility, and thereby increase the predictability of their cash flows and earnings.
- The competitive supply segment consists primarily of power plants selling electricity to wholesale customers through competitive markets, and as a result, the cash flows and earnings of such businesses are more sensitive to fluctuations in the market price of electricity, natural gas, coal, oil and other fuels.

All income statement information for businesses that were discontinued during the period is segregated and is shown in the line Income (loss) from operations of discontinued businesses in the accompanying consolidated statements of operations.

Information about the Company's operations by segment for the three and six months ended June 30, 2005 and 2004, respectively, is as follows (in millions):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2005	2004(3)	2005	2004(3)	2005	2004(3)	2005	2004(3)
	Revenue(1)		Gross Margin(2)		Revenue(1)		Gross Margin(2)	
Regulated Utilities	\$ 1,395	\$ 1,146	\$ 114	\$ 278	\$ 2,794	\$ 2,291	\$ 481	\$ 540
Contract Generation	988	868	353	325	1,973	1,736	745	683
Competitive Supply	285	248	59	53	564	491	124	117
Total	\$ 2,668	\$ 2,262	\$ 526	\$ 656	\$ 5,331	\$ 4,518	\$ 1,350	\$ 1,340

(1) Sales between the segments ( intersegment revenues ) are accounted for at fair value as if the sales were to third parties. Intersegment revenues for the three months ended June 30, 2005 and 2004 were \$194 million and \$109 million, respectively, and \$351 million and \$209 million for the six months ended June 30, 2005 and 2004, respectively. These amounts have been eliminated in the appropriate segment on a consolidated basis.

(2) For consolidated subsidiaries, the Company uses gross margin as a measure of profit or loss for the Company's reportable segments. Gross margin equals revenues less cost of sales on the condensed consolidated statement of operations for each period presented.

(3) The Company's 2004 information has been restated to conform to the 2005 segment presentation.

Information about the Company's assets as of June 30, 2005 and December 31, 2004, respectively, is as follows (in millions):

	<b>Total Assets</b>	
	<b>June 30, 2005</b>	<b>December 31, 2004</b>
Regulated Utilities	\$ 11,735	\$ 11,546
Contract Generation	13,997	14,034
Competitive Supply	2,197	2,156
Corporate	1,451	1,187
<b>Total</b>	<b>\$ 29,380</b>	<b>\$ 28,923</b>

## 10. BENEFIT PLANS

Certain of the Company's subsidiaries have defined benefit pension plans covering substantially all of their respective employees. Pension benefits are based on years of credited service, age of the participant and average earnings. Of the thirteen defined benefit plans, two are at U.S. subsidiaries and the remaining plans are at foreign subsidiaries.

Total pension cost for the three and six months ended June 30, 2005 and 2004 include the following components (in millions):

	<b>Three Months Ended June 30,</b>				<b>Six Months Ended June 30,</b>			
	<b>2005</b>		<b>2004</b>		<b>2005</b>		<b>2004</b>	
	<b>U.S.</b>	<b>Foreign</b>	<b>U.S.</b>	<b>Foreign</b>	<b>U.S.</b>	<b>Foreign</b>	<b>U.S.</b>	<b>Foreign</b>
Service cost	\$ 1	\$ 1	\$ 1	\$ 1	\$ 2	\$ 3	\$ 2	\$ 3
Interest cost on projected benefit obligation	7	73	7	55	14	140	14	112
Expected return on plan assets	(7 )	(48 )	(7 )	(32 )	(14 )	(93 )	(14 )	(66 )
Amortization of unrecognized actuarial loss	1	1	1	1	2	2	2	2
<b>Total pension cost</b>	<b>\$ 2</b>	<b>\$ 27</b>	<b>\$ 2</b>	<b>\$ 25</b>	<b>\$ 4</b>	<b>\$ 52</b>	<b>\$ 4</b>	<b>\$ 51</b>

The expected remaining scheduled annual employer contributions for 2005 are \$19 million for U.S. subsidiaries and \$70 million for foreign subsidiaries at June 30, 2005.

## 11. RECENT TAX LEGISLATION

On October 22, 2004, the American Jobs Creation Act (the AJCA) was signed into law. The AJCA included a special one-time dividends received deduction of 85% of certain foreign earnings that are repatriated to the Company, as defined in the AJCA. The Company has reviewed the effects of the repatriation provision in accordance with recently issued Treasury Department guidance and it has determined it will not repatriate under the AJCA.

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

**Restatement of Previously Issued Quarterly Financial Statements**

This Form 10-Q restates certain financial information for the three and six months ended June 30, 2004 to correct certain accounting errors that were contained in the condensed consolidated financial statements in the previously filed Form 10-Q for the quarterly period ended June 30, 2004. See Note 1 to the condensed consolidated financial statements included in this Form 10-Q. The discussion below includes the effect of the restated condensed consolidated financial statements for the three and six months ended June 30, 2004.

**Executive Summary**

AES is a global power company managed to meet the growing demand for electricity in ways that benefit all of our stakeholders. Through our subsidiaries and affiliates, we own and operate a portfolio of electricity generation and distribution businesses in 26 countries. We seek to capture the benefits of our global expertise and economies of scale in our operations. Predictable cash flow, an efficient capital structure and world-class operating performance are the continuing focus of our management efforts.

As we indicated in the previous quarter, we realigned our management reporting structure into four regions: North America; Latin America; Europe, Middle East and Africa ( EMEA ); and Asia, each led by a regional president who reports directly to the Chief Executive Officer ( CEO ). This realignment allows us to place senior leaders and resources closer to the businesses to further improve operating performance and integrate operations and development on a more localized level. The new structure will help us leverage regional market trends to enhance our competitiveness and identify and capitalize on key business development opportunities. The organizational changes are expected to streamline some corporate functions to more effectively support AES businesses around the globe.

We continue to operate in two types of businesses within the power sector: first, we engage in the generation of power for sale to utilities and other wholesale customers; second, we operate utilities that distribute power to retail, commercial, industrial and governmental customers. Each type of business generates approximately one half of the Company's revenues. Our financial results are reported within three business segments on a regulated and non-regulated basis within the above defined regions, which further refines our core business structure.

Our generation business segments Contract Generation and Competitive Supply consist of approximately 37 gigawatts of generating capacity from 98 power plants in 22 countries. Our contract generation plants have limited their exposure to electricity price volatility by entering into power sales agreements of five years or longer for 75% or more of their output capacity at the time of origination. Exposure to fuel supply risks is also limited through long-term fuel supply contracts or through fuel tolling arrangements whereby the customer assumes full responsibility for purchasing and supplying the fuel to the power plant. As a result of these contractual agreements, the businesses generally reduce commodity and electricity price volatility and thereby increase the predictability of their cash flows and earnings. Our competitive supply segment consists primarily of power plants selling electricity to wholesale customers through competitive markets and, as a result, the cash flows and earnings of such businesses are more sensitive to fluctuations in the market price of electricity and of natural gas, coal and other fuels. However, for our U.S. competitive supply business which includes a fleet of low-cost coal fired plants in New York, we typically hedge the majority of our exposure to fuel, energy and emissions pricing simultaneously and on a rolling two-year basis.

Beginning in the second quarter of 2005, our Large Utilities and Growth Distribution business segments have been merged into one business segment entitled Regulated Utilities. After careful review



and consideration of our operating segments during the second quarter, we determined that the businesses within these two segments are similar in terms of exposure to government regulation of their tariffs and the type of customer base served. We further determined that these similarities now outweigh the characteristics of size, location and growth potential that previously differentiated the two regulated distribution segments. Consequently, all of our businesses engaged in the distribution of electricity will be reported under the Regulated Utilities segment.

The Regulated Utilities business segment consists of 14 distribution companies in seven countries with over 10.9 million customers. All of our companies maintain a monopoly franchise within a defined service area. This segment is composed of one integrated utility located in the U.S. (IPL), two distribution companies in Brazil (Eletropaulo and Sul), one integrated utility in Venezuela (EDC), as well as our interests in an integrated utility in Cameroon (AES SONEL) and electricity distribution businesses located in Argentina (EDELAP, EDEN and EDES), El Salvador (CAESS, CLESA, DEUSEM and EEO), and Ukraine (Kievoblenergo and Rivneenergo).

### Second Quarter Operating Highlights

	Three Months Ended June 30,			Six Months Ended June 30,		
	2005	2004	% Change	2005	2004	% Change
	(\$ in millions)					
Revenue	\$2,668	\$ 2,262	18 %	\$5,331	\$ 4,518	18 %
Gross Margin	\$ 526	\$ 656	(20 )%	\$ 1,350	\$ 1,340	1 %
Gross Margin as a % of Revenue	19.7 %	29.0 %	N/A	25.3 %	29.7 %	N/A
Diluted Earnings Per Share from Continuing Operations	\$ 0.13	\$ 0.16	(19 )%	\$ 0.32	\$ 0.23	39 %
Net Cash Provided By Operating Activities	329	212	55 %	\$ 847	\$ 613	38 %

**Revenue** increased 18% to \$2.7 billion for the three months ended June 30, 2005 from \$2.3 billion for the three months ended June 30, 2004. For the six months ended June 30, 2005, revenues increased 18% to \$5.3 billion from \$4.5 billion for the prior year period with contributions from all segments; primarily from Regulated Utilities. **Key factors leading to the increases include favorable foreign currency exchange rates and higher realized prices at our Latin American distribution companies.**

**Gross margin** decreased 20% to **\$526 million** for the three months ended June 30, 2005 from \$656 million for the three months ended June 30, 2004, primarily due to a significant increase in receivable reserves recorded at our Brazilian distribution businesses related to receivables from certain municipalities. Gross margin increased slightly by 1% to \$1.4 billion for the six months ended June 30, 2005 from \$1.3 billion for the prior year period due to higher year over year revenues, offset by the increase in receivable reserves. Gross margin as a percent of sales declined from 29.0% in the second quarter of 2004 to 19.7% in the second quarter of 2005 and declined from 29.7% from the first six months of 2004 to 25.3% in the first six months of 2005. These declines were largely driven by the significant increase in receivable reserves and higher electricity costs recorded at our Brazilian distribution businesses and higher fuel costs in our Latin America and North American contract generation businesses, partially offset by higher realized prices in the Latin America and EMEA Regulated Utilities businesses.

**Diluted earnings per share from continuing operations** decreased 19% to **\$0.13** for the three months ended June 30, 2005 from \$0.16 for the three months ended June 30, 2004. For the six months ended June 30, 2005 **diluted earnings per share from continuing operations** increased to **\$0.31** from \$0.23 in the

same prior year period. These year to date increases were driven by lower net interest expense, higher other income, and lower foreign currency transaction losses partially offset by higher income tax expense.

**Net cash from operating activities** for the six months ended June 30, 2005 increased 38% to \$847 million from \$613 million for the six months ended June 30, 2004. This year over year increase was largely driven by higher earnings, a net increase in other assets and liabilities and a decrease in working capital.

*Strategic Highlights*

AES continued its pursuit of its long-term growth strategy through the expansion of existing business platforms in the second quarter while meeting environmental requirements. In May 2005, AES's Hungarian subsidiary, Tisza II, completed its two-year refurbishment project, which extends the life of the plant to 2016 and is designed to ensure compliance with recent European Union environmental regulations. Also in May 2005, IPL, a U.S. regulated utility, completed a capital project for NOx removal via selective catalytic reduction systems at one unit at its Harding Street plant at a total capital cost of approximately \$55 million. This is another element of IPL's ongoing air pollution investment program to reduce emissions. Indiana regulators approved a plan that allows IPL to recover the capital and operating costs of the equipment, including a return on investment. Both of these efforts demonstrate AES's desire to continue to provide clean, competitive and reliable electricity through the completion of financially viable projects.

As part of our strategy to continue to strengthen our balance sheet, we amended our parent company \$650 million credit facilities in June 2005 in order to reduce our borrowing costs. The interest rate on the \$450 million Revolving Bank Loan was reduced from the London Interbank Offered Rate ( LIBOR ) plus 250 basis points to LIBOR plus 175 basis points. The maturity on the Revolving Bank Loan was extended from 2007 to 2010. The interest rate on the \$200 million term loan facility was also reduced from LIBOR plus 225 basis points to LIBOR plus 175 basis points. We will continue to seek to identify similar restructuring opportunities that arise as a result of AES's improving credit quality.

## Results of Operations

	Three Months Ended June 30,			Six Months Ended June 30,		
	2005	2004	\$ change 2005 vs. 2004	2005	2004	\$ change 2005 vs. 2004
<b>Gross Margin:</b>						
Regulated Utilities	\$ 114	\$ 278	\$ (164 )	\$ 481	\$ 540	\$ (59 )
Contract Generation	353	325	28	745	683	62
Competitive Supply	59	53	6	124	117	7
Total gross margin	526	656	(130 )	1,350	1,340	10
General and administrative expenses(1)	(45 )	(42 )	(3 )	(94 )	(90 )	(4 )
Interest expense	(475 )	(470 )	(5 )	(942 )	(971 )	29
Interest income	93	70	23	183	139	44
Other income (expense), net	67	1	66	52	(13 )	65
Loss on sale of investments, asset and goodwill impairment expense					(1 )	1
Foreign currency transaction gains (losses), net	(1 )	(47 )	46	(32 )	(81 )	49
Equity in earnings of affiliates	21	23	(2 )	46	39	7
Income tax expense	(82 )	(17 )	(65 )	(229 )	(92 )	(137 )
Minority interest expense	(19 )	(71 )	52	(125 )	(125 )	
Income from continuing operations	85	103	(18 )	209	145	64
Income (loss) from operations of discontinued businesses		(29 )	29		(55 )	55
Net income	\$ 85	\$ 74	\$ 11	\$ 209	\$ 90	\$ 119
<b>PER SHARE DATA:</b>						
Basic income per share from continuing operations	\$ 0.13	\$ 0.16	\$ (0.03 )	\$ 0.32	\$ 0.23	\$ 0.09
Diluted income per share from continuing operations	\$ 0.13	\$ 0.16	\$ (0.03 )	\$ 0.31	\$ 0.23	\$ 0.08

(1) General and administrative expenses are corporate and business development expenses.

## Overview

## Revenue

	For the Three Months Ended June 30,		For the Six Months Ended June 30,			For the Three Months Ended June 30,		
	2005	2004	2005	2004		2005	2004	
	Revenue (\$ in millions)	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues
Regulated Utilities	\$ 1,395	52 %	\$1,146	51 %	\$2,794	52 %	\$ 2,291	51 %
Contract Generation	988	37 %	868	38 %	1,973	37 %	1,736	38 %
Competitive Supply	285	11 %	248	11 %	564	11 %	491	11 %
Non-Regulated	1,273	48 %	1,116	49 %	2,537	48 %	2,227	49 %
Total	\$ 2,668	100 %	\$ 2,262	100 %	\$ 5,331	100 %	\$ 4,518	100 %

## Edgar Filing: AES CORP - Form 10-Q

Revenues increased \$406 million, or 18%, to \$2.7 billion for the three months ended June 30, 2005 from \$2.3 billion for the three months ended June 30, 2004. Excluding the estimated impacts of foreign currency translation, revenues would have increased approximately 10% for the three months ended June 30, 2005 from the three months ended June 30, 2004.

Revenues increased \$813 million, or 18%, to \$5.3 billion for the six months ended June 30, 2005 from \$4.5 billion for the prior year period. Excluding the estimated impacts of foreign currency translation, revenues would have increased approximately 13% for the six months ended June 30, 2005 from the prior year period.

The increase in revenues for both periods presented occurred across all segments, particularly within Regulated Utilities, due to the positive impacts of foreign currency translation and higher tariffs.

### Gross Margin

	For the Three Months Ended June 30, 2005		For the Three Months Ended June 30, 2004		For the Six Months Ended June 30, 2005		For the Six Months Ended June 30, 2004	
	Gross Margin (\$ in millions)	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin
Regulated Utilities	\$ 114	22 %	\$ 278	42 %	\$ 481	36 %	\$ 540	40 %
Contract Generation	353	67 %	325	50 %	745	55 %	683	51 %
Competitive Supply	59	11 %	53	8 %	124	9 %	117	9 %
Non-Regulated	412	78 %	378	58 %	869	64 %	800	60 %
<b>Total</b>	<b>\$ 526</b>	<b>100 %</b>	<b>\$ 656</b>	<b>100 %</b>	<b>\$ 1,350</b>	<b>100 %</b>	<b>\$ 1,340</b>	<b>100 %</b>
Gross Margin as a % of Revenue	19.7 %		29.0 %		25.3 %		29.7 %	

Gross margin decreased \$130 million, or 20%, to \$526 million for the three months ended June 30, 2005 from \$656 million for the three months ended June 30, 2004. Gross margin increased \$10 million, or 1%, to \$1.4 billion for the six months ended June 30, 2005 from \$1.3 billion for the six months ended June 30, 2004.

Gross margin as a percent of revenues decreased from 29.0% in the second quarter of 2004 to 19.7% in the second quarter of 2005 and declined from 29.7% from the six months of 2004 to 25.3% in the six months of 2005. The decline for both periods is driven by the recording of a \$192 million receivable reserve related to certain municipal receivables owed to our Brazilian distribution businesses, higher purchased electricity costs in our Brazilian distribution businesses, higher fuel costs in our Latin America and North American contract generation businesses, partially offset by higher realized prices in the Latin America and EMEA Regulated Utilities businesses.

*Segment Analysis***Regulated Utilities Revenue**

	For the Three Months Ended June 30, 2005			For the Three Months Ended June 30, 2004			For the Six Months Ended June 30, 2005			For the Six Months Ended June 30, 2004		
	Revenue (\$ in millions)	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues
North America	\$ 229	8 %	\$ 213	10 %	\$ 456	8 %	\$ 427	10 %				
Latin America	1,039	39 %	821	36 %	2,078	39 %	1,632	36 %				
EMEA	127	5 %	112	5 %	260	5 %	232	5 %				
Total	\$ 1,395	52 %	\$ 1,146	51 %	\$ 2,794	52 %	\$ 2,291	51 %				

Revenue for the three months ended June 30, 2005 increased \$249 million, or 22%, compared to the three months ended June 30, 2004. Excluding the estimated impacts of foreign currency translation, revenues would have increased approximately 8% for the three months ended June 30, 2005 as compared to the same period in 2004.

Revenue for the six months ended June 30, 2005 increased \$503 million, or 22%, compared to the six months ended June 30, 2004. Excluding the estimated impacts of foreign currency translation, revenues would have increased 13% for the six months ended June 30, 2005 as compared to the same period in 2004.

Revenue increases for both periods were primarily due to favorable exchange rates and the impacts of the tariff reset at Eletropaulo in Brazil. Marginal improvements were also achieved at IPL in the U.S., AES SONEL in Cameroon and EDELAP, EDEN and EDES in Argentina. The revenues at EDC in Venezuela remained relatively flat for both the quarter and six months as improved demand was largely offset by the negative impacts of foreign currency remeasurement.

**Regulated Utilities Gross Margin**

	For the Three Months Ended June 30, 2005			For the Three Months Ended June 30, 2004			For the Six Months Ended June 30, 2005			For the Six Months Ended June 30, 2004		
	Gross Margin (\$ in millions)	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin
North America	\$ 77	15 %	\$ 71	11 %	\$ 159	12 %	\$ 149	11 %				
Latin America	6	1 %	182	27 %	257	19 %	351	26 %				
EMEA	31	6 %	25	4 %	65	5 %	40	3 %				
Total	\$ 114	22 %	\$ 278	42 %	\$ 481	36 %	\$ 540	40 %				
Regulated Utilities Gross Margin as a % of Regulated Utilities Revenue	8.2 %		24.3 %		17.2 %		23.6 %					

Gross margin decreased \$164 million, or 59%, for the three months ended June 30, 2005 compared to the three months ended June 30, 2004. Gross margin as a percentage of revenue decreased to 8.2% during the three months ended June 30, 2005 compared to 24.3% in the prior year period.

Gross margin decreased \$59 million, or 11%, for the six months ended June 30, 2005 compared to the six months ended June 30, 2004. Gross margin as a percentage of revenue decreased to 17.2% in the six months ended June 30, 2005 compared to 23.6% in the prior year period.

The decrease in gross margin and gross margin as a percent of revenues on a quarter and six month basis is primarily due to the impact of recognizing a \$192 million receivable reserve related to certain municipal receivables owed to our Brazilian distribution businesses and primarily relates to past due amounts from the city of Sao Paulo, Brazil. The Company continues to pursue all remedies to collect amounts that are due. Additionally, the gross margin decline was due to higher purchased electricity costs at Eletropaulo and Sul in Brazil, partially offset by favorable revenues and the net positive impacts of foreign currency translation. AES SONEL in Cameroon also showed positive results with better demand, lower fixed expenses and the positive impacts of foreign currency translation. The gross margin at EDC in Venezuela declined slightly for these periods due to the negative impacts of foreign currency remeasurement and higher fuel and fixed costs which are not yet being recovered due to a delay in the tariff increase. The gross margin at IPL in the U.S. improved slightly, with no change in gross margin as a percent of sales, as tariff increases have served to mitigate other higher variable and fixed costs.

### Contract Generation Revenue

	For the Three Months Ended June 30, 2005		2004		For the Six Months Ended June 30, 2005		2004	
	Revenue (\$ in millions)	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues
North America	\$ 318	12 %	\$ 309	14 %	\$ 613	12 %	\$ 615	13 %
Latin America	420	16 %	314	14 %	814	15 %	621	14 %
EMEA	215	8 %	212	9 %	471	9 %	423	9 %
Asia	35	1 %	33	1 %	75	1 %	77	2 %
Total	\$ 988	37 %	\$ 868	38 %	\$ 1,973	37 %	\$ 1,736	38 %

Revenue for the three months ended June 30, 2005 increased \$120 million, or 14%, compared to the three months ended June 30, 2004. Excluding the estimated impacts of foreign currency translation, revenues would have increased approximately 12% for the three months ended June 30, 2005 compared to the prior year period.

Revenue for the six months ended June 30, 2005 increased \$237 million, or 14%, compared to the six months ended June 30, 2004. Excluding the estimated impacts of foreign currency translation, revenues would have increased approximately 12% for the six months ended June 30, 2005 compared to the prior year period.

Revenue increases are attributable to increased contract pricing at Tiete in Brazil, (Tiete consists of a group of hydro-electric plants providing electricity primarily to Eletropaulo, also in Brazil) and at Gener in Chile, partially offset by scheduled decreases in the contracted capacity payments at Shady Point in the U.S. Higher production volumes favorably impacted revenues at Gener and at Ras Laffan in Qatar, with the latter operating as a combined cycle facility during the three and six months ended June 30, 2005 versus a simple cycle facility in the same prior year periods. Favorable foreign currency translation effects positively impacted revenues largely at Gener and at Uruguaiana in Brazil. (Uruguaiana is a gas-fired plant providing electricity to Sul and Eletropaulo, both in Brazil, as well as to third-party customers).

**Contract Generation Gross Margin**

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2005		2004		2005		2004	
	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin	Gross Margin	% of Total Gross Margin
	(\$ in millions)							
North America	\$ 105	20 %	\$ 122	19 %	\$ 210	16 %	\$ 242	18 %
Latin America	139	26 %	109	17 %	297	22 %	238	18 %
EMEA	100	19 %	85	13 %	220	16 %	187	14 %
Asia	9	2 %	9	1 %	18	1 %	16	1 %
Total	\$ 353	67 %	\$ 325	50 %	\$ 745	55 %	\$ 683	51 %
Contract Generation Gross Margin as a % of Contract Generation Revenue	35.7 %		37.4 %		37.8 %		39.3 %	

Gross margin increased \$28 million, or 9%, for the three months ended June 30, 2005 compared to the three months ended June 30, 2004. Gross margin as a percentage of revenues decreased to 35.7% for the three months ended June 30, 2005 compared to 37.4% for the prior year period.

Gross margin for the six months ended June 30, 2005 increased \$62 million, or 9%, compared to the six months ended June 30, 2004. Gross margin as a percentage of revenues for this period decreased to 37.8% for the six months ended June 30, 2005 compared to 39.3% for the prior year period.

Gross margin increases for both periods were primarily due to increased contract pricing at Gener in Chile and Tiete in Brazil, and higher production volumes at Ras Laffan in Qatar and at Gener. The decreases in gross margin as a percentage of revenues are primarily due to higher priced fuel and purchased electricity at Gener as a result of gas shortages caused by restrictions on imports of natural gas from Argentina, and the scheduled decrease in contracted capacity payments at Shady Point in the U.S.

**Competitive Supply Revenue**

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2005		2004		2005		2004	
	Revenue	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues	Revenue	% of Total Revenues
	(\$ in millions)							
North America	\$ 126	5 %	\$ 108	5 %	\$ 243	5 %	\$ 222	5 %
Latin America	95	4 %	82	4 %	176	3 %	143	3 %
EMEA	32	1 %	32	1 %	67	1 %	64	2 %
Asia	32	1 %	26	1 %	78	2 %	62	1 %
Total	\$ 285	11 %	\$ 248	11 %	\$ 564	11 %	\$ 491	11 %

Revenue for the three months ended June 30, 2005 increased \$37 million, or 15%, compared to the three months ended June 30, 2004. Excluding the estimated impacts of foreign currency translation, revenues would have increased approximately 14% for the three months ended June 30, 2005 compared to the prior year period. Revenue increases were primarily due to increased sales of excess emissions allowances at our New York plants in the U.S., offset by lower production volumes in New York due to a planned maintenance outage in the second quarter of 2005. Sales of excess emissions allowances were \$27 million for the three months ended June 30, 2005, compared to none for the prior year period.

Favorable foreign currency translation effects positively impacted revenues at Borsod in Hungary and at Ekibastuz and Altai, both in Kazakhstan.

Revenue for the six months ended June 30, 2005 increased \$73 million, or 15%, compared to the six months ended June 30, 2004. Excluding the estimated impacts of foreign currency translation, revenues would have increased approximately 13% for the six months ended June 30, 2005 compared to the prior year period. Revenue increases were primarily due to increased sales of emissions allowances at our New York plants in the U.S. combined with higher competitive market prices for electricity sold at Parana in Argentina and at Panama. Sales of excess emissions allowances were \$29 million for the six months ended June 30, 2005, compared to none for the prior year period. Higher production volumes at Alicura in Argentina were offset by lower production volumes at New York in the U.S. due to a planned maintenance outage in the second quarter of 2005. Favorable foreign currency translation effects positively impacted revenues at Borsod in Hungary and at Ekibastuz and Altai, both in Kazakhstan.

### Competitive Supply Gross Margin

	For the Three Months Ended June 30,			For the Six Months Ended June 30,				
	2005	% of Total	2004	2005	% of Total	2004		
	Gross Margin	Gross Margin	Gross Margin	Gross Margin	Gross Margin	Gross Margin	Gross Margin	Gross Margin
	(\$ in millions)							
North America	\$ 29	5 %	\$ 16	3 %	\$ 57	4 %	\$ 43	3 %
Latin America	30	6 %	27	4 %	53	4 %	48	4 %
EMEA	(6 )	(1 )%	2	%	(8 )	(1 )%	5	%
Asia	6	1 %	8	1 %	22	2 %	21	2 %
Total	\$ 59	11 %	\$ 53	8 %	\$ 124	9 %	\$ 117	9 %
Competitive Supply Gross Margin as a % of Competitive Supply Revenue	20.7 %		21.4 %		22.0 %		23.8 %	

Gross margin increased \$6 million, or 11%, for the three months ended June 30, 2005 compared to the three months ended June 30, 2004, primarily due to increased sales of excess emissions allowances at our New York plants in the U.S. The competitive supply gross margin as a percentage of revenues decreased slightly to 20.7% for the three months ended June 30, 2005 from 21.4% for the prior year period. This decrease is primarily due to higher fuel prices at Borsod in Hungary, Ottana in Italy and our plants in New York, partially offset by the positive margin impacts of emissions allowance sales in New York.

Gross margin increased \$7 million, or 6%, for the six months ended June 30, 2005 compared to the six months ended June 30, 2004, primarily due to increased sales of excess emissions allowances at our New York plants in the U.S. and higher competitive market prices for electricity sold at Parana in Argentina. The competitive supply gross margin as a percentage of revenues decreased to 22.0% for the six months ended June 30, 2005 from 23.8% for the prior year period. This decrease is primarily due to higher fuel prices at Parana and Alicura, our plants in Argentina, Borsod in Hungary, Ottana in Italy, and our plants in New York, partially offset by the positive margin impacts of excess emissions allowances sales in New York.



***General and administrative expenses***

General and administrative expenses increased \$3 million to \$45 million for the three months ended June 30, 2005 from \$42 million for the three months ended June 30, 2004. The increase is a result of higher corporate insurance and project development expenses, partially offset by lower professional fees.

General and administrative expenses increased \$4 million to \$94 million for the six months ended June 30, 2005 from \$90 million for the six months ended June 30, 2004. The increase is a result of higher employee related costs and corporate depreciation, slightly offset by lower professional fees.

***Interest expense***

Interest expense increased \$5 million, or 1%, to \$475 million for the three months ended June 30, 2005 from \$470 million for the three months ended June 30, 2004 primarily due to the negative impacts from foreign currency translation and higher interest rates at certain of our businesses partially offset by the benefits of debt retirements.

Interest expense decreased \$29 million, or 3%, to \$942 million for the six months ended June 30, 2005 from \$971 million for the six months ended June 30, 2004 primarily due to lower net hedge related costs and lower recourse debt levels, partially offset by negative impacts from foreign currency translation.

***Interest income***

Interest income increased \$23 million to \$93 million for the three months ended June 30, 2005 from \$70 million for the three months ended June 30, 2004. Interest income increased \$44 million to \$183 million for the six months ended June 30, 2005 from \$139 million for the six months ended June 30, 2004. Interest income increases in both periods were primarily due to positive impacts on foreign currency fluctuations and higher interest rates.

***Other income (expense)***

Other income (expense) increased \$66 million to \$67 million for the three months ended June 30, 2005 from \$1 million for the three months ended June 30, 2004 and also increased \$65 million to \$52 million for the six months ended June 30, 2005 from \$(13) million for the six months ended June 30, 2004. The quarter and year to date increases are primarily due to the reversal in the second quarter of 2005 of a business tax accrual no longer required by Eletropaulo, our Brazilian distribution business.

***Loss on sale of investments, asset and goodwill impairment expense***

There was no loss on sale of investments, asset and goodwill impairment expense for the three months ended June 30, 2005 and 2004.

There was no loss on sale of investments, asset and goodwill impairment expense for the six months ended June 30, 2005. A \$1 million loss was recorded for the six months ended June 30, 2004 as a result of an adjustment to an estimate related to the December 2003 sale of approximately 39% of AES's interest in AES Oasis Limited (AES Oasis).

***Foreign currency transaction losses, net***

The Company recognized a net foreign currency transaction loss of \$1 million for the three months ended June 30, 2005 compared to \$47 million of losses for the three months ended June 30, 2004. The \$46 million decrease in overall losses was primarily related to gains at Sul in Brazil, EDC in Venezuela and Parana in Argentina. Foreign currency gains at Sul increased primarily due to transaction gains on U.S. dollar denominated floating interest rate notes. Foreign currency gains at EDC increased primarily due to non-regulated market currency conversion gains in 2005 versus losses in 2004 and gains on mark-to-market

foreign currency transaction hedges. Parana's foreign currency gains increased primarily due to transaction gains on U.S. dollar denominated debt.

The Company recognized foreign currency transaction losses of \$32 million for the six months ended June 30, 2005 compared to \$81 million for the six months ended June 30, 2004. The \$49 million decrease in overall losses was primarily related to gains at EDC in Venezuela offset by losses at Sul in Brazil. Foreign currency gains at EDC increased primarily due to transaction gains on Bolivar denominated debt, non-regulated market currency conversion gains in 2005 versus losses in 2004 and gains on mark-to-market foreign currency transaction hedges. Foreign currency gains at Sul increased primarily due to transaction gains on floating interest rate notes. This was offset by foreign currency losses at Sul primarily due to mark-to-market losses on foreign currency transaction hedges offset by foreign currency transaction gains on U.S. dollar denominated debt.

Foreign currency transaction gains (losses) at certain of the Company's foreign subsidiaries and affiliates were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Argentina	\$ 2	\$ (12 )	\$ 7	\$ (5 )
Brazil	(9 )	(28 )	(38 )	(37 )
Venezuela	10	(7 )	22	(30 )
Dominican Republic	3	2	(5 )	
Pakistan	(5 )	(5 )	(11 )	(9 )
Other	(2 )	3	(7 )	
Total(1)	\$ (1 )	\$ (47 )	\$ (32 )	\$ (81 )

(1) Includes \$56 million and \$6 million of losses on foreign currency derivatives contracts for the three months ended June 30, 2005 and 2004, respectively; and includes \$79 million and \$14 million of losses on foreign currency derivative contracts for the six months ended June 30, 2005 and 2004, respectively.

#### *Equity in earnings of affiliates*

Equity in earnings of affiliates decreased \$2 million, or 9%, to \$21 million for the three months ended June 30, 2005 from \$23 million for the three months ended June 30, 2004. The decrease was primarily due to reduced earnings as a result of higher coal prices at our affiliates in China.

Equity in earnings of affiliates increased \$7 million, or 18%, to \$46 million for the six months ended June 30, 2005 from \$39 million for the six months ended June 30, 2004. The increase was primarily due to improved operations at our affiliates in Chile and Canada, partially offset by reduced earnings due to higher coal prices at our affiliates in China.

#### *Income taxes*

Income tax expense on continuing operations increased \$65 million to \$82 million for the three months ended June 30, 2005 from \$17 million for the three months ended June 30, 2004. The Company's effective tax rates were 44% and 9% for the three months ended June 30, 2005 and 2004, respectively. Income tax expense on continuing operations increased \$137 million to \$229 million for the six months ended June 30, 2005 from \$92 million for the six months ended June 30, 2004. The Company's effective tax rates were 41% and 25% for the six months ended June 30, 2005 and 2004, respectively. The net increase in effective tax rates for both the second quarter and six month periods in 2005 compared to the same periods in 2004 were due to higher U.S. taxes on distributions from and earnings of certain non-U.S. subsidiaries, and the treatment of unrealized foreign currency gains on U.S. dollar debt held by certain of our Latin American subsidiaries. These items were partially offset by a tax rate change that resulted in the

reduction of the deferred tax liability at our subsidiary in Puerto Rico, which was recorded in the second quarter of 2005. The effective tax rates of 9% for the second quarter and 25% for the six months of 2004 resulted primarily from tax benefits on unrealized foreign currency losses at certain of our Latin American subsidiaries compared to the foreign currency gains which were experienced in 2005.

#### **Minority Interest**

Minority interest expense, net of tax, decreased \$52 million to \$19 million for the three months ended June 30, 2005 from \$71 million for the three months ended June 30, 2004, and remained flat at \$125 million for the six months ended June 30, 2005 and June 30, 2004.

#### **Contingent Matters**

As disclosed in Note 7 to the Condensed Consolidated Financial Statements included in Item 1 of this Form 10-Q, in exchange for the termination of \$863 million of outstanding Brasileira Energia debt and accrued interest during 2004, the Brazilian National Development Bank ( BNDES ) received \$90 million in cash, 53.85% ownership of Brasileira Energia and a one-year call option ( Sul Option ) to acquire a 53.85% ownership interest of Sul. The Sul Option, which would require the Company to contribute its equity interest in Sul to Brasileira Energia, became exercisable on December 22, 2005. The probability of BNDES exercising the Sul Option is unknown at this time. BNDES' s ability to exercise the Sul Option is contingent upon several factors. The most significant factor requires BNDES to obtain consent for the exercise of the option from the Sul syndicated lenders. In the event BNDES exercises its option, 100% of the Company' s ownership in Sul would be transferred to Brasileira Energia and the Company would be required to recognize a non-cash after-tax loss on its investment in Sul currently estimated at approximately \$455 million. This amount primarily includes the recognition of currency translation losses and recording minority interest for BNDES' s share of Sul offset by the recorded estimated fair value of the Sul Option. If the Sul Option is exercised, the Company' s ownership of Sul would be reduced from approximately 100% to approximately 46%.

#### **Critical Accounting Policies and Estimates**

The consolidated financial statements of AES are prepared in conformity with generally accepted accounting principles in the United States of America, which requires the use of estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The Company's significant accounting policies are described in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004 filed with the Securities and Exchange Commission on January 19, 2006. The Company' s critical accounting estimates are described in Management' s Discussion and Analysis included in the Company' s 2004 Form 10-K/A. An accounting estimate is considered critical if: the estimate requires management to make assumptions about matters that were highly uncertain at the time the estimate was made; different estimates reasonably could have been used; or if changes in the estimate that would have a material impact on the Company' s financial condition or results of operations are reasonably likely to occur from period to period. Management believes that the accounting estimates employed are appropriate and resulting balances are reasonable; however, actual accounting estimates could differ from the original estimates, requiring adjustments to these balances in future periods.

The Company has reviewed and determined that those policies remain the Company's critical accounting policies as of and for the six months ended June 30, 2005. The Company did not make any changes to those policies during the period.

#### **Recent Accounting Developments**

See Note 2 to the condensed consolidated financial statements included in this Form 10-Q for a discussion of new accounting standards.

## Capital Resources and Liquidity

### Overview

We are a holding company that conducts all of our operations through subsidiaries. We have, to the extent achievable, utilized non-recourse debt to fund a significant portion of the capital expenditures and investments required to construct and acquire our electric power plants, distribution companies and related assets. This type of financing is non-recourse to other subsidiaries and affiliates and to us (as parent company), and is generally secured by the capital stock, physical assets, contracts and cash flow of the related subsidiary or affiliate. At June 30, 2005, we had \$5.0 billion of recourse debt and \$13.2 billion of non-recourse debt outstanding.

In addition to the non-recourse debt, if available, we provide a portion, or in certain instances all, of the long-term financing or credit required to fund development, construction or acquisition of power projects. These investments generally take the form of equity investments or loans, which are subordinated to the project's non-recourse loans. We generally obtain the funds for these investments from our cash flows from operations and/or the proceeds from our issuances of debt, common stock and other securities or asset sales.

In certain of our businesses, we may provide financial guarantees or other credit support for the benefit of counterparties who have entered into contracts for the purchase or sale of electricity with our subsidiaries. In such circumstances, if a subsidiary defaults on its payment or supply obligation, we will be responsible for the subsidiary's obligations up to the amount provided for in the relevant guarantee or other credit support.

We intend to continue to seek where possible non-recourse debt financing in connection with the assets or businesses that our affiliates or we may develop, construct or acquire. However, depending on market conditions and the unique characteristics of individual businesses, non-recourse debt may not be available or available on economically attractive terms. If we decide not to provide any additional funding or credit support to a subsidiary that has a project under construction or has near-term debt payment obligations and that subsidiary is unable to obtain additional non-recourse debt, such subsidiary may become insolvent and we may lose our investment in such subsidiary. Additionally, if any of our subsidiaries lose a significant customer, the subsidiary may need to restructure the non-recourse debt financing. If such subsidiary is unable to successfully complete a restructuring of the non-recourse debt, we may lose our investment in such subsidiary.

As a result of AES parent's below-investment-grade rating, counterparties may be unwilling to accept our general unsecured commitments to provide credit support. Accordingly, with respect to both new and existing commitments, we may be required to provide some other form of assurance, such as a letter of credit, to backstop or replace our credit support. We may not be able to provide adequate assurances to such counterparties. In addition, to the extent we are required and able to provide letters of credit or other collateral to such counterparties, this will reduce the amount of credit available to us to meet our other liquidity needs. At June 30, 2005, we had provided outstanding financial and performance related guarantees or other credit support commitments to or for the benefit of our subsidiaries, which were limited by the terms of the agreements, in an aggregate of approximately \$457 million (excluding those collateralized by letters of credit and other obligations discussed below).

At June 30, 2005, we had \$235 million in letters of credit outstanding, which operate to guarantee performance relating to certain project development activities and subsidiary operations. All of these letters of credit were provided under our Revolving Bank Loan. We pay letter of credit fees ranging from 0.50% to 2.75% per annum on the outstanding amounts. In addition, we had \$4 million in surety bonds outstanding at June 30, 2005.

Many of our subsidiaries including those in the Caribbean and South America depend on timely and continued access to capital markets to manage their liquidity needs. The inability to raise capital on favorable terms, to refinance existing indebtedness or to fund operations and other commitments during times of political or economic uncertainty may adversely affect those subsidiaries' financial condition and

results of operations. In addition, changes in the timing of tariff increases or delays in the regulatory determinations under the relevant concessions could affect the cash flows and results of operations of our businesses in Brazil and Venezuela. Management believes that cash on hand, along with cash generated through operations, and our financing availability will be sufficient to fund normal operations, capital expenditures, and debt service requirements.

### *Cash Flows*

During the six months ended June 30, 2005, we increased cash and cash equivalents by \$100 million from December 31, 2004 to a total of \$1.38 billion. The change in cash balances was impacted by \$847 million of cash provided by operating activities offset by the use of cash for investing and financing activities of \$334 million and \$440 million, respectively, and by the positive effect of exchange rates on cash of \$27 million. Cash used for financing activities included a net reduction in debt of \$406 million for the six months ended June 30, 2005.

### *Operating Activities*

Net cash provided by operating activities increased by \$234 million to \$847 million during the six months ended June 30, 2005, compared to \$613 million during the same period in 2004 due to a decrease in net earnings (adjusted for non-cash items) of \$146 million, a net increase in other assets and liabilities of \$325 million, and a decrease in working capital of \$55 million.

Other non-cash charges include the reversal of items such as deferred tax provisions, minority interest earnings, pension charges and unrealized foreign currency transaction gains and losses. The \$319 million decline in other non-cash charges from \$437 million in 2004 to \$118 million in 2005 is due primarily to unrealized foreign currency gains related to Brazil and Venezuela incurred in 2005 versus unrealized losses incurred in the prior year, the reversal of a loss associated with discontinued operations in 2004, reversal of a contingent liability in 2005 at Brazil due to the expiration of the statute of limitations, and a gain on the sale of emission allowances.

The net increase in other assets and liabilities is due to higher non-cash mark-to-market derivative liabilities, a decrease in a long-term receivable due to a reserve adjustment made in Brazil and movements in regulatory liabilities and assets. Regulatory liabilities increased due to a higher tariff dollar against the market performance of the dollar.

The change in working capital is due to reductions in accounts receivable offset by increases in inventory, prepaid expenses and other assets, and a decrease in accounts payable and other liabilities. Accounts receivable declined in the current year mainly due to collections on outstanding invoices at Ras Laffan, as well as the increase in bad debt reserves in Brazil. The prior year also included an increase in receivables from discontinued businesses. Inventory increased in our contract generation segment mainly due to resuming normal operations in the current year after our generation plant in the Dominican Republic was shut down during the first half of 2004 as well as an increase in the purchase of fuel in EMEA. Prepaid expenses and other assets increased mainly due to an increase in VAT receivable for VAT taxes paid on invoices in our contract generation segment, as well as an increase in current regulatory assets in Brazil due to previously incurred costs which are now allowed to be passed on to the customer.

### *Investing Activities*

Net cash used in investing activities totaled \$334 million during the first half of 2005 as compared to \$375 million in the first half of 2004. In 2005, cash used in investing activities includes \$531 million for property additions and \$85 million for acquisitions, partially offset by \$191 million of net sales of short-term investments and a net decrease in restricted cash and debt service reserves and other assets of \$66 million.

Property additions increased \$154 million during the six months ended June 30, 2005 as compared to the same period in 2004 primarily due to additional expenditures of \$182 million at our construction

project in Spain, \$20 million in Brazil for the purchase of computer software and \$11 million in contract generation for a turbine overhaul and equipment replacement, offset by a reduction in spending at IPALCO of approximately \$26 million due to spending in the first half of 2004 for environmental compliance projects that did not continue at the same level in the first half of 2005.

In the first quarter of 2005, we spent a total of \$85 million related to the purchase of the SeaWest wind development business, including \$60 million for the existing net assets of the business and an additional \$25 million advance payment for pre-construction costs for SeaWest's development of Buffalo Gap, a wind power project in Texas.

The increase in the net sales of short-term investments of \$223 million during the six months ended June 30, 2005 as compared to the same period in 2004 was mainly due to a release of collateral at EDC of \$132 million as a result of a repayment of approximately \$264 million of related debt. In addition, Brazil had net proceeds of \$44 million in the first half of 2005 compared to net purchases of \$53 million in the first half of 2004. The net proceeds received in 2005 were used to pay down debt and various operational expenses, including taxes. This was offset by a decrease in the sale of short-term investments at AES Gener of \$29 million due to the higher liquidations of short-term investments in the prior year to refinance their syndicated loan.

The decrease in the net proceeds from the sale of assets of \$30 million during the six months ended June 30, 2005 as compared to the same period in 2004 was due to the sale of discontinued businesses (primarily Mountainview) for \$14 million, net of expenses, and to the sale of a substation property at IPALCO for \$13 million in the first half of 2004.

Debt service reserves and other assets decreased \$101 million during the first half of 2005 as compared to the first half of 2004 primarily due to the payment of \$110 million of construction costs from a reserve account related to our construction project in Spain, and a \$9 million decrease in reserves in Brazil due to funds deposited in an escrow account in the first quarter of 2004 required as part of the debt restructuring in late 2003, offset by an increase in debt service reserves in our contract generation segment of \$20 million due to debt requirements on \$120 million of financing at Ebute.

Restricted cash balances increased by \$26 million during the first half of 2005 as compared to the first half of 2004 primarily due to an increase in restricted cash of \$32 million at our New York plant from higher excess emission sales in the first half of 2005, increased restricted cash of \$14 million at EDC due to the release in the prior year of restricted deposits, offset by a reduction in restricted cash at Ras Laffan for payments to their construction contractor and dividends.

#### *Financing Activities*

Net cash used in financing activities was \$440 million during the first half of 2005 as compared to \$741 million during the first half of 2004 as we reduced debt, net of issuances, by \$406 million in 2005 versus \$626 million in 2004.

Debt issuances declined during the first half of 2005 by \$768 million primarily due to parent company debt issuances of \$491 million in the first half of 2004 compared to \$6 million in the first half of 2005, a bond issuance of \$400 million in 2004 at Gener and other debt issuances of \$151 million in the second quarter of 2004 compared to \$119 million of debt issuances in the current year from a bridge loan refinancing, a decrease of \$73 million over the prior year at EDC due to debt restructuring that occurred in the prior year, offset by a \$200 million U.S. dollar equivalent bond issuance in Brazil in June 2005 and an increase of \$95 million at our Spain construction project to meet contractor milestone payments.

Debt repayments declined during the first half of 2005 by \$988 million due to parent company debt repayments of \$809 million in the first half of 2004 versus \$115 million in the first half of 2005 mainly for payments on senior subordinated debt. Additionally, AES Gener decreased debt repayments by \$624 million in 2005 due to the completion of the debt restructuring and refinancing that occurred during 2004. These decreases were partially offset by increased debt repayments at EDC of \$218 million in the

first half of 2005 mainly due to the payment of 200 million Euro debt in March 2005 and increased debt repayments in Brazil of \$122 million due to the bond issuance in June 2005 which was used to reduce higher interest-bearing debt.

Payments for deferred financing costs decreased \$55 million during the first half of 2005 due to parent company debt issuances in the prior year that did not occur at the same level in the current year, higher deferred financing costs in the prior year at Gener due to the size of their debt offering in 2004, and higher deferred financing costs in 2004 in Brazil due to their reprofiling of debt in the first quarter of 2004.

#### ***Parent Company Liquidity***

Because of the non-recourse nature of most of our indebtedness, we believe that unconsolidated parent company liquidity is an important measure of liquidity. Our principal sources of liquidity at the parent company level are:

- dividends and other distributions from our subsidiaries, including refinancing proceeds;
- proceeds from debt and equity financings at the parent company level, including borrowings under our Revolving Bank Loan; and
- proceeds from asset sales.

Our cash requirements at the parent company level are primarily to fund:

- interest and preferred dividends;
- principal repayments of debt;
- acquisitions;
- construction commitments;
- other equity commitments;
- taxes; and
- parent company overhead and development costs.

Since 2002, the Company has undertaken various initiatives to improve the credit and risk profile of both the parent and the consolidated company while continuing to pursue disciplined growth.

On June 1, 2005, the Company redeemed all outstanding 8.5% Senior Subordinated Notes due 2007, at a redemption price of 101.417%, and an aggregate principal amount of approximately \$112 million, including unamortized transaction costs.

On June 23, 2005, the Company amended its \$650 million Senior Secured Bank Facilities. The interest rate on the \$450 million Revolving Bank Loan was reduced to the London Interbank Offered Rate ( LIBOR ) plus 175 basis points. Previously, the rate was LIBOR plus 250 basis points. In addition, the Revolving Bank Loan maturity was extended from 2007 to 2010. The interest rate on the term \$200 million Senior Secured Term Loan was also reduced to LIBOR plus 175 basis points, from LIBOR plus 225 basis points, while its maturity in 2011 remains unchanged.

On August 15, 2005, the Company repaid at maturity all outstanding 4.5% Convertible Junior Subordinated Debentures ( the Debentures ) at par for an aggregate principal amount of \$142 million.





## Edgar Filing: AES CORP - Form 10-Q

During the first half of 2005, the Company also funded the purchase of the SeaWest wind development business and posted letters of credit to support ongoing construction and operating activities. Parent liquidity was as follows at June 30, 2005 and December 31, 2004:

	June 30, 2005 (in millions)	December 31, 2004
Cash and cash equivalents	\$ 1,381	\$ 1,281
Less: cash and cash equivalents at subsidiaries	1,236	994
Parent cash and cash equivalents	145	287
Borrowing available under revolving credit facility	215	352
Cash at qualified holding companies(1)	19	4
<b>Total parent liquidity</b>	<b>\$ 379</b>	<b>\$ 643</b>

(1) The cash held at qualified holding companies represents cash sent from subsidiaries of the Company domiciled outside of the U.S. Such subsidiaries have no contractual restrictions on their ability to send cash to the parent company.

The following table sets forth our parent company contingent contractual obligations as of June 30, 2005:

Contingent contractual obligations	Amount (\$ in millions)	Number of Agreements	Term Range (years)	Exposure Range for Each Agreement
Guarantees(1)	\$ 457	42	<1 - 20+	<\$1 - \$100
Letters of credit under the Revolving Bank Loan	235	20	<1 - 3	<\$1 - \$53
Surety bonds	4	3	<1	<\$1 - \$3
<b>Total</b>	<b>\$ 696</b>	<b>65</b>		

(1) Excluding those collateralized by letters of credit and other obligations

We have a varied portfolio of performance related contingent contractual obligations. Amounts related to the balance sheet items represent credit enhancements made by us at the parent company level and by other third parties for the benefit of the lenders associated with the non-recourse debt recorded as liabilities in the accompanying consolidated balance sheets. These obligations are designed to cover potential risks and only require payment if certain targets are not met or certain contingencies occur. The risks associated with these obligations include change of control, construction cost overruns, political risk, tax indemnities, spot market power prices, supplier support and liquidated damages under power sales agreements for projects in development, under construction and operating. While we do not expect that we will be required to fund any material amounts under these contingent contractual obligations during 2005 or beyond that are not recorded on the balance sheet, many of the events which would give rise to such an obligation are beyond our control. We can provide no assurance that we will be able to fund our obligations under these contingent contractual obligations if we are required to make substantial payments thereunder.

While we believe that our sources of liquidity will be adequate to meet our needs through the end of 2005, this belief is based on a number of material assumptions, including, without limitation, assumptions about exchange rates, power market pool prices and the ability of our subsidiaries to pay dividends. In addition, our project subsidiaries' ability to declare and pay cash dividends to us (at the parent company level) is subject to certain limitations contained in project loans, governmental provisions and other agreements. We can provide no assurance that these sources will be available when needed or that our actual cash requirements will not be greater than anticipated. We have met our interim needs for shorter-term and working capital financing at the parent company level with a Revolving Bank Loan of

\$450 million. At June 30, 2005, we had \$235 million of letters of credit outstanding under the Revolving Bank Loan.

Various debt instruments at the parent company level, including our Senior Secured Bank Facilities, Senior Secured Notes and Senior Subordinated Notes contain certain restrictive covenants. The covenants provide for, among other items:

- limitations on other indebtedness, liens, investments and guarantees;
- restrictions on dividends and redemptions and payments of unsecured and subordinated debt and the use of proceeds of project financings and asset sales;
- restrictions on mergers and acquisitions, sales of assets, leases, transactions with affiliates and off balance sheet and derivative arrangements; and
- maintenance of certain financial ratios.

#### *Non-Recourse Debt Financing*

While the lenders under our non-recourse debt financings generally do not have direct recourse to the parent company, defaults thereunder can still have important consequences for our results of operations and liquidity, including, without limitation:

- reducing our cash flows as the subsidiary will typically be prohibited from distributing cash to the parent level during the time period of any default;
- triggering our obligation to make payments under any financial guarantee, letter of credit or other credit support we have provided to or on behalf of such subsidiary;
- causing us to record a loss in the event the lender forecloses on the assets; and
- triggering defaults in our outstanding debt at the parent level. For example, our Revolving Bank Loan and outstanding Senior Notes, Senior Subordinated Notes and Junior Subordinated Notes at the parent level include events of default for certain bankruptcy related events involving material subsidiaries. In addition, our Revolving Bank Loan at the parent level includes events of default related to payment defaults and accelerations of outstanding debt of material subsidiaries.

Some of our subsidiaries are currently in default with respect to all or a portion of their outstanding indebtedness. The total debt classified as current in the accompanying consolidated balance sheets related to such defaults was \$291 million at June 30, 2005.

Andres and Los Mina, both electricity generation companies which are wholly owned subsidiaries of the Company located in the Dominican Republic, entered into forbearance agreements with their respective lenders in December 2004. Pursuant to the forbearance agreements, the lenders agreed not to exercise any remedies under the respective credit agreements. The forbearance agreements for Andres and Los Mina expired on July 29, 2005 and June 10, 2005, respectively. Subsequently, in December 2005, AES Dominicana Energia Finance, S.A., a wholly owned subsidiary of the Company, issued a \$160 million Senior Secured Corporate Bond in the international capital markets under Rule 144A/Regulation S. The 10-year notes, with final maturity in December 2015, were priced to yield 11%. The net proceeds of the issuance were used to retire the current bank debt at both Andres and Los Mina of \$112 million and \$24 million, respectively. As of June 30, 2005, the debt for both of these subsidiaries is reported as current in the accompanying condensed consolidated balance sheet.

None of the subsidiaries that are currently in default currently meet the applicable definition of materiality in AES's corporate debt agreements in order for such defaults to trigger an event of default or permit an acceleration under such indebtedness. However, as a result of additional dispositions of assets,



other significant reductions in asset carrying values or other matters in the future that may impact our financial position and results of operations, it is possible that one or more of these subsidiaries could fall within the definition of a material subsidiary and thereby upon an acceleration trigger an event of default and possible acceleration of the indebtedness under the AES parent company's Senior Notes, Senior Subordinated Notes and Junior Subordinated Notes.

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

The Company believes that there have been no material changes in its exposure to market risks during the six months ended June 30, 2005 compared with the exposure set forth in the Company's Annual Report filed with the U.S. Securities and Exchange Commission (SEC) on Form 10-K/A for the year ended December 31, 2004 as filed on January 19, 2006.

We have performed a company wide value at risk analysis (VaR) of all of our material financial assets, liabilities and derivative instruments. The VaR calculation incorporates numerous variables that could impact the fair value of our instruments, including interest rates, foreign exchange rates and commodity prices, as well as correlation within and across these variables. We express Analytic VaR herein as a dollar amount of the potential loss in the fair value of our portfolio based on a 95% confidence level and a one day holding period. Our commodity analysis is an Analytic VaR utilizing a variance-covariance analysis within the commodity transaction management system.

The Value at Risk as of June 30, 2005 for foreign exchange, interest rate and commodities was \$38 million, \$129 million and \$19 million, respectively.

**ITEM 4. CONTROLS AND PROCEDURES**

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities and Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the chief executive officer (CEO) and chief financial officer (CFO), as appropriate, to allow timely decisions regarding required disclosures.

The Company carried out the evaluation required by paragraph (b) of the Exchange Act Rules 13a-15 and 15d-15, under the supervision and with the participation of our management, including the CEO and CFO, of the effectiveness of our disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)). Based upon this evaluation, the CEO and CFO concluded that as of June 30, 2005, our disclosure controls and procedures were ineffective.

As reported in Item 9A of the Company's 2004 Form 10-K/A, management reported that material weaknesses existed in our internal controls as of December 31, 2004 and is in the process of taking remedial steps to correct these weaknesses. Due to the fact that these remedial steps have not been completed as of June 30, 2005, the Company performed additional analysis and other post-closing procedures in order to prepare the consolidated financial statements in accordance with generally accepted accounting principles in the United States of America.

*Changes in Internal Controls*

As reported in Item 9A of our 2004 Form 10-K/A, the Company determined that the following material weaknesses in internal control over financial reporting existed as of December 31, 2004:

*Income Taxes:*

The Company lacked effective controls for the proper reconciliation of the components of its parent company and subsidiaries' income tax assets and liabilities to related consolidated balance sheet accounts, including a detailed comparison of items filed in the subsidiaries' tax returns to the corresponding calculation of U.S. GAAP balance sheet tax accounts. Management determined that the Company lacked an effective control to ensure that foreign subsidiaries whose functional currency is the U.S. dollar had properly classified income tax accounts as monetary, rather than non-monetary, assets and liabilities at the time of acquisition. These subsidiaries were not re-measuring their deferred tax balances each period in accordance with Statement of Financial Accounting Standard (SFAS) No. 52, Foreign Currency Translation and SFAS No. 109, Accounting for Income Taxes. Finally, the Company determined that it lacked effective controls and procedures for evaluating and recording tax related purchase accounting adjustments to the financial statements.

Although the Company believes it has taken appropriate steps to correct the errors identified and record the appropriate adjustments to the financial statements, it is currently in the process of implementing new controls and procedures related to income tax accounting. These controls include the following:

- Adopting a more rigorous approach to communicate, document and reconcile the detailed components of subsidiary income tax assets and liabilities;
- Expanding staffing and resources, including the continued use of external third party assistance, along with providing training related to the income tax accounting function throughout the Company;
- Continuing to identify and implement additional best practice solutions regarding efficient data collection, integration and controls, including processes to ensure tax related purchase accounting adjustments are properly evaluated and recorded;
- Implementing additional procedures for tax and accounting personnel in the identification and evaluation of non-recurring tax adjustments and in tracking movements in deferred tax accounts recorded by the parent company and its subsidiaries; and
- Recording all tax accounting adjustments on the appropriate subsidiaries' books for ongoing tracking, reconciliation and translation, where appropriate.

*Aggregation of Control Deficiencies at our Cameroonian Subsidiary:*

AES SONEL, a 56% owned subsidiary of the Company located in Cameroon, lacked adequate and effective controls related to transactional accounting and financial reporting. These deficiencies included a lack of timely and sufficient financial statement account reconciliation and analysis, lack of sufficient support resources within the accounting and finance group, and inadequate preparation and review of purchase accounting adjustments incorrectly recorded in 2002, that were not identified or corrected until 2004 and 2005. Management previously reported to the Audit Committee that the aggregation of control deficiencies identified at AES SONEL represented a significant deficiency as of December 31, 2004. Management believed that certain review procedures executed at the parent company mitigated the risk of a more than remote likelihood that a material misstatement to the Company's consolidated financial statements would not be prevented or detected. However, subsequent to the filing of our 2004 Form 10-K, additional accounting errors were identified in 2005 related to the application of purchase accounting principles in 2002 and the translation of local currency financial statements to the U.S. dollar. As a result, the Company revised its previous assessment and determined that the aggregate of control deficiencies constituted a material weakness.

The Company currently is engaged in carrying out its remediation plan that includes the following:

- Hired a new local chief financial officer during the second quarter of 2005 and other key accounting personnel at AES SONEL during the second and third quarters of 2005;
- Implementing controls related to the preparation and review of key balance sheet account analyses and conversion of local currency financial statements to the U.S. dollar;
- Utilizing the Company's internal audit resources to provide remediation assistance and review and evaluate new control procedures; and
- Providing additional detailed accounting policy and procedures guidance for the identification of and accounting for complex or unusual transactions by the subsidiaries, including specific guidance on the proper application of U.S. GAAP.

*Lack of U.S. GAAP Expertise in Brazilian Businesses:*

The Company lacked effective controls to ensure the proper application of SFAS No. 95, Statement of Cash Flows, at Tiete, our 24% owned subsidiary located in Brazil. Although the business had appropriately classified these investments as cash under Brazilian GAAP, the nature of the financial instruments required that they be classified as short term investments in accordance with U.S. GAAP. The Company also lacked effective controls to ensure appropriate conversion and analysis of Brazilian GAAP to U.S. GAAP financial statements for Elpa, one of our Brazilian holding companies, where a long term liability had been appropriately recorded in Brazilian GAAP in 2002 but had been improperly excluded from the U.S. GAAP financial statements. Finally, the Company lacked effective controls at its Brazilian distribution businesses, Eletropaulo and Sul, to ensure the proper application of SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, as it relates to recording a deferral of revenue and corresponding liability associated with costs yet to be incurred for energy efficiency projects.

Management previously reported to the Audit Committee that a lack of U.S. GAAP expertise at Eletropaulo represented a significant deficiency as of December 31, 2004. This determination was made after the discovery of the errors in the calculation of minority interest expense and deferred taxes, as reported in our 2004 Form 10-K filed on March 30, 2005. At that time, management concluded that these errors, in and of themselves, did not constitute material weaknesses and believed that certain review procedures executed at the parent mitigated the risk of a more than remote likelihood that a material misstatement to the Company's consolidated financial statements would not be prevented or detected. However, as a result of the subsequent identification of control failures resulting in the restatement adjustments described above, the Company revised its previous assessment and determined that the aggregate of control deficiencies and the need for U.S. GAAP expertise in our Brazilian businesses constituted a material weakness.

The Company currently is engaged in carrying out its remediation plan that includes the following:

- Performed a detailed evaluation of all material cash balances at all our subsidiaries to ensure appropriate application of SFAS No. 95. In addition, the Company supplemented its existing accounting policies with additional guidance related to the proper classification of cash and investments in accordance with SFAS No. 95 and communicated this additional guidance to all subsidiaries;
- Added additional supervisory personnel with U.S. GAAP knowledge who are responsible for reviewing and analyzing the financial results of the businesses in Brazil, including an experienced chief financial officer at the regional office level and a chief financial officer at the Brazil country office level, during the second and third quarters of 2005; and

- Providing additional detailed accounting policy and procedures guidance for the identification of and accounting for complex or unusual transactions by the subsidiaries, including specific guidance on the proper application of U.S. GAAP.

*Consolidation Accounting:*

The Company lacked effective controls related to adequate evaluation and documentation of certain journal entries made as part of the preparation of the consolidated financial statements. During the course of the Company's tax remediation activities and in conjunction with other post-closing procedures initiated during the first quarter of 2005, management determined that there were errors in certain entries made in the consolidation process that were initially recorded prior to 2002 and carried forward as unchanged amounts from 2002 through 2004. Management reported in the 2004 Form 10-K/A that it has adequately remediated this material weakness.

*Treatment of Intercompany Loans Denominated in Other Than the Functional Currency:*

The Company lacked effective controls to ensure the proper application of SFAS No. 52, Foreign Currency Translation, related to the treatment of foreign currency gains or losses on certain long term intercompany loan balances denominated in other than the entity's functional currency. In addition, the Company lacked appropriate documentation for the determination of certain of its holding companies' functional currencies. According to SFAS No. 52, intercompany loans, advances or other receivable or payable instruments denominated in other than the entity's functional currency are re-measured with resulting gains or losses recorded to the statement of operations, if payments are being made currently or will be made within the foreseeable future. If settlement is not anticipated in the foreseeable future, then foreign currency exchange gains and losses are to be recorded within other comprehensive income within the equity section of the balance sheet, as the transactions and balances are considered to be part of the net investment. The Company determined it was incorrectly translating certain loan balances due to the fact that it lacked an effective assessment process to identify and document whether or not a loan was to be repaid in the foreseeable future at inception and to update this determination on a periodic basis. Also, the Company had incorrectly determined the functional currency for one of its holding companies which impacted the proper translation of its intercompany loan balances.

The Company currently is engaged in carrying out its remediation plan that includes the following:

- Performed a review and confirmation of the correct evaluation and documentation of certain material intercompany loans with the parent denominated in currencies other than the entity's functional currency to ensure proper application of SFAS No. 52;
- Re-evaluated and documented the functional currencies of certain U.S. and non U.S. holding companies to ensure that proper SFAS No. 52 translations were being performed;
- Providing additional guidance to its subsidiaries to communicate the requirements of SFAS No. 52 related to intercompany loan transactions to ensure proper evaluation of existing and future transactions; and
- Implementing additional procedures to ensure documentation and testing of the proper determination of an entity's functional currency on a periodic basis, particularly as it relates to the company's active material holding company structures.

Although the Company has made progress in this area, additional steps need to be taken, as indicated above, and sufficient time needs to elapse before management can conclude that newly implemented controls are operating effectively and that the material weakness has been adequately remediated.

*Derivative Accounting:*

The Company lacked effective controls related to accounting for certain derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. Specifically, a deficiency was identified related to sufficient controls designed to adequately ensure that the analysis and documentation of whether or not certain fuel contracts or power purchase contracts met the criteria of being accounted for as a derivative instrument at inception and on an ongoing basis. No adjustments to the consolidated financial statements were required to be recorded as a result of this deficiency; however, management concluded that the potential likelihood of a future material error was greater than remote and therefore constituted a material weakness.

The Company currently is engaged in carrying out its remediation plan that includes the following:

- Performed a reassessment of certain material fuel contracts and power purchase contracts to confirm that appropriate documentation existed or that the contracts did not qualify as derivatives;
- Provided additional training regarding identification of derivative instruments and embedded derivatives and the application of the Company's approval policy. Continuing education in this area will be provided on a routine basis and include other non-financial employees who are responsible for hedging activities, development of power purchase agreements and negotiation of significant purchase contracts;
- Enhancing risk management policies and procedures related to the review and approval of material purchase or sale contracts that may qualify as derivatives; and
- Continuing to expand the technical accounting personnel who will support our subsidiaries in the evaluation of derivative implications within hedge instruments and purchase/sale contracts.

Although the Company has made progress in this area, additional steps need to be taken, as indicated above, and sufficient time needs to elapse before management can conclude that newly implemented controls are operating effectively and that the material weakness has been adequately remediated.

In the course of our evaluation of disclosure controls and procedures, management considered certain internal control areas in which we have made and are continuing to make changes to improve and enhance controls. Based upon that evaluation, the CEO and CFO concluded that there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the quarter ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.



**PART II**

**ITEM 1. LEGAL PROCEEDINGS**

The following disclosure provides a summary and update of significant changes, if any, from December 31, 2004, related to our significant claims, suits and legal proceedings. Readers should also refer to Item 3 in Part I of our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004 filed with the U.S. Securities and Exchange Commission ( SEC ) on January 19, 2006 and Note 11 of the notes to our consolidated financial statements in Part II of such Annual Report on Form 10-K/A for a more detailed description of each claim.

The Company is involved in certain claims, suits and legal proceedings in the normal course of business. The Company has accrued for litigation and claims where it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company believes, based upon information it currently possesses and taking into account established reserves for estimated liabilities and its insurance coverage, that the ultimate outcome of these proceedings and actions is unlikely to have a material adverse effect on the Company's financial statements. It is possible, however, that some matters could be decided unfavorably to the Company, and could require the Company to pay damages or to make expenditures in amounts that could have a material adverse effect on the Company's financial position and results of operations.

In September 1999, a Brazilian appellate state court of Minas Gerais granted a temporary injunction suspending the effectiveness of a shareholders' agreement between Southern Electric Brasil Participacoes, Ltda. ( SEB ) and the state of Minas Gerais concerning CEMIG. AES's investment in CEMIG is through SEB. This shareholders' agreement granted SEB certain rights and powers in respect of CEMIG ( Special Rights ). In March 2000, a lower state court in Minas Gerais held the shareholders' agreement invalid where the agreement purported to grant SEB the Special Rights and the lower state court enjoined the exercise of Special Rights. In August 2001, a state appellate court denied an appeal of the decision, and extended the injunction. In October 2001, SEB filed two appeals against the decision on the merits of the state appellate court, one appeal to the Federal Superior Court and the other appeal to the Supreme Court of Justice. The state appellate court denied access of these two appeals to the higher courts, and in August 2002, SEB filed two interlocutory appeals against the state appellate court's decision, one directed to the Federal Superior Court and the other to the Supreme Court of Justice. In December 2004, the Federal Superior Court denied SEB's appeal. In June 2005, the Supreme Court of Justice formally accepted SEB's appeal. SEB intends to vigorously pursue a restoration of the value of its investment in CEMIG; however, there can be no assurances that it will be successful in its efforts. Failure to prevail in this matter may limit SEB's influence on the daily operation of CEMIG.

In November 2000, the Company was named in a purported class action suit along with six other defendants, alleging unlawful manipulation of the California wholesale electricity market, resulting in inflated wholesale electricity prices throughout California. The alleged causes of action include violation of the Cartwright Act, the California Unfair Trade Practices Act and the California Consumers Legal Remedies Act. In December 2000, the case was removed from the San Diego County Superior Court to the U.S. District Court for the Southern District of California. On July 30, 2001, the Court remanded the case to San Diego Superior Court. The case was consolidated with five other lawsuits alleging similar claims against other defendants. In March 2002, the plaintiffs filed a new master complaint in the consolidated action, which reasserted the claims raised in the earlier action and names the Company, AES Redondo Beach, L.L.C., AES Alamitos, L.L.C., and AES Huntington Beach, L.L.C. as defendants. In May 2002, the case was removed by certain cross-defendants from the San Diego County Superior Court to the United States District Court for the Southern District of California. The plaintiffs filed a motion to remand the case to state court, which was granted on December 13, 2002. Certain defendants appealed aspects of that decision to the United States Court of Appeals for the Ninth Circuit. On December 8, 2004,

a panel of the Ninth Circuit issued an opinion affirming in part and reversing in part the decision of the District Court, and remanding the case to state court. On July 8, 2005, defendants filed a demurrer in state court seeking dismissal of the case in its entirety. In October 2005, the state court dismissed the case. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In August 2000, the Federal Energy Regulatory Commission (FERC) announced an investigation into the organized California wholesale power markets in order to determine whether rates were just and reasonable. Further investigations involved alleged market manipulation. The FERC requested documents from each of the AES Southland plants and AES Placerita. AES Southland and AES Placerita have cooperated fully with the FERC investigation. AES Southland is not subject to refund liability because it did not sell into the organized spot markets due to the nature of its tolling agreement. The Ninth Circuit heard oral arguments on the time scope of the refunds. The Ninth Circuit Court of Appeals also addressed the appeal of the FERC's decision not to impose refunds for the alleged failure to file rates including transaction specific data for sales to the California Independent System Operator (ISO) for 2000 and 2001. See *State of California ex rel. Bill Lockyer*. Although in its order issued on September 9, 2004 the Ninth Circuit did not order refunds, the Ninth Circuit remanded the case to the FERC for a refund proceeding to consider remedial options. That remand order is pending rehearing at the Ninth Circuit. Placerita made sales during the referenced time period. Depending on the method of calculating refunds and the time period to which the method is applied, the alleged refunds sought from AES Placerita could approximate \$23 million.

In August 2001, a petition was filed against CESCO, an affiliate of the Company, by the Grid Corporation of Orissa, India (Gridco), with the Orissa Electricity Regulatory Commission (OERC), alleging that CESCO had defaulted on its obligations as an OERC-licensed distribution company, that CESCO management abandoned the management of CESCO, and asking for interim measures of protection, including the appointment of an administrator to manage CESCO. Gridco, a state-owned entity, is the sole wholesale energy provider to CESCO. Pursuant to the OERC's August 2001 order, the management of CESCO was replaced with a government administrator who was appointed by the OERC. The OERC later held that the Company and other CESCO shareholders were not necessary or proper parties to the OERC proceeding. In August 2004, the OERC issued a notice to CESCO, the Company and others giving the recipients of the notice until November 2004 to show cause why CESCO's distribution license should not be revoked. In response, CESCO submitted a business plan to the OERC. In February 2005, the OERC issued an order rejecting the proposed business plan. The order also stated that the CESCO distribution license would be revoked if an acceptable business plan for CESCO was not submitted to, and approved by, the OERC prior to March 31, 2005. In its April 2, 2005 order, the OERC revoked the CESCO distribution license. CESCO has filed an appeal against the April 2, 2005 OERC order and that appeal remains pending in the Indian courts. In addition, Gridco asserted that a comfort letter issued by the Company in connection with the Company's indirect investment in CESCO obligates the Company to provide additional financial support to cover all of CESCO's financial obligations to Gridco. In December 2001, Gridco served a notice to arbitrate pursuant to the Indian Arbitration and Conciliation Act of 1996 on the Company, AES Orissa Distribution Private Limited (AES ODPL), and Jyoti Structures (Jyoti) pursuant to the terms of the CESCO Shareholders Agreement between Gridco, the Company, AES ODPL, Jyoti and CESCO (the CESCO arbitration). In the arbitration, Gridco appears to seek approximately \$188.5 million in damages plus undisclosed penalties and interest, but a detailed alleged damages analysis has yet to be filed by Gridco. The Company has counter-claimed against Gridco for damages. A arbitration hearing with respect to liability was conducted on August 3-9, 2005 in India. Final written arguments regarding liability were submitted by the parties to the arbitral tribunal in late October 2005. A decision on liability may be issued in the first quarter of 2006. A petition remains pending before the Indian Supreme Court concerning fees of the third neutral arbitrator and the venue of

future hearings with respect to the CESCO arbitration. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In December 2001, a petition was filed by Gridco in the local Indian courts seeking an injunction to prohibit the Company and its subsidiaries from selling their shares in Orissa Power Generation Company Pvt. Ltd. ( OPGC ) pending the outcome of the above discussed CESCO arbitration. OPGC, located in Orissa, is a 420 MW coal-based electricity generation business from which Gridco is the sole off-taker of electricity. Gridco obtained a temporary injunction, but the District Court eventually dismissed Gridco's petition for an injunction in March 2002. Gridco appealed to the Orissa High Court, which in January 2005 allowed the appeal and granted the injunction. The Company has appealed the High Court's decision to the Supreme Court of India. In May 2005, the Supreme Court adjourned this matter until August 2005. In August 2005, the Supreme Court adjourned the matter again to await the award of the arbitral tribunal in the CESCO arbitration. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In early 2002, GRIDCO made an application to the OERC requesting that the OERC initiate proceedings regarding the terms of OPGC's existing power purchase agreement ( PPA ) with Gridco. In response, OPGC filed a petition in the India courts to block any such OERC proceedings. In early 2005 the Orissa High Court upheld the OERC's jurisdiction to initiate such proceedings as requested by Gridco. OPGC appealed that High Court's decision to the Supreme Court and sought stays of both the High Court's decision and the underlying OERC proceedings regarding the PPA terms. In April 2005, the Supreme Court granted OPGC's requests and ordered stays of the High Court's decision and the OERC proceedings with respect to the PPA terms. The matter is awaiting further hearing. Unless the Supreme Court finds in favor of OPGC's appeal or otherwise prevents the OERC's proceedings regarding the PPA terms, the OERC will likely lower the tariff payable to OPGC under the PPA, which would have an adverse impact on OPGC's financials. The Company believes that it has meritorious defenses to any actions asserted against it and will defend itself vigorously against the allegations.

In July 2002, the Company, Dennis W. Bakke, Roger W. Sant, and Barry J. Sharp were named as defendants in a purported class action filed in the United States District Court for the Southern District of Indiana. In September 2002, two virtually identical complaints were filed against the same defendants in the same court. All three lawsuits purport to be filed on behalf of a class of all persons who exchanged their shares of IPALCO common stock for shares of AES common stock issued pursuant to a registration statement dated and filed with the SEC on August 16, 2000, (the Share Exchange ). The complaints purport to allege violations of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 based on statements in or omissions from the registration statement concerning, among other things, an alleged breach by AES of obligations AES owed to Williams Energy Services Co. ( Williams ) under an agreement between the two companies in connection with the California energy market. On September 26, 2003, defendants filed a motion to dismiss the complaint. By Order dated November 17, 2004, the Court dismissed all of the claims asserted in the amended and consolidated complaint against all defendants except for the claim alleging that the registration statement and prospectus disseminated to the IPALCO stockholders for purposes of the Share Exchange failed to disclose AES's purported temporary default on its contract with Williams. On December 15, 2004, the AES Defendants filed a motion for judgment on the pleadings dismissing the remaining claims. On July 7, 2005, the district court granted defendants' motion for judgment on the pleadings and entered an order dismissing all claims and thereby terminating this action in the district court. The time to file an appeal to the action has expired without the filing of an appeal.

Commencing on May 2, 2003, the Indiana Securities Commissioner of Indiana's Office of the Secretary of State, Securities Division, pursuant to Indiana Code 23-2-1, served subpoenas on 30 former officers and directors of IPALCO Enterprises, Inc. ( IPALCO ), AES, and others, requesting the production of documents in connection with the March 27, 2001 share exchange between the Company

and IPALCO pursuant to which stockholders exchanged shares of IPALCO common stock for shares of the Company's common stock and IPALCO became a wholly-owned subsidiary of the Company. IPALCO and the Company have produced documents pursuant to the subpoenas served on them. In addition, the Indiana Securities Commissioner's office has taken testimony from various individuals. On January 27, 2004, Indiana's Secretary of State issued a statement which provided that the investigative staff had determined that there did not appear to be a justifiable reason to focus further specific attention upon six non-employee former members of IPALCO's board of directors. In October 2005, the Secretary of State issued a press release announcing that the investigation had been concluded and that no charges would be sought.

In April 2002, IPALCO and certain former officers and directors of IPALCO were named as defendants in a purported class action lawsuit filed in the United States District Court for the Southern District of Indiana. On May 28, 2002, an amended complaint was filed in the lawsuit. The amended complaint asserts that IPALCO and former members of the pension committee for the Indianapolis Power & Light Company thrift plan breached their fiduciary duties to the plaintiffs under the Employees Retirement Income Security Act by investing assets of the thrift plan in the common stock of IPALCO prior to the acquisition of IPALCO by the Company. In December 2002, plaintiffs moved to certify this case as a class action. The Court granted the motion for class certification on September 30, 2003. On October 31, 2003, the parties filed cross-motions for summary judgment on liability. On August 11, 2005, the Court issued an Order denying the summary judgment motions, but striking one defense asserted by defendants. Trial has been scheduled for early February 2006 addressing only the allegations of breach of fiduciary duty. If necessary, one or more trials on reliance and damages issues will be conducted separately. IPALCO believes it has meritorious defenses to the claims asserted against it and intends to defend this lawsuit vigorously.

In November 2002, a lawsuit was filed against AES Wolf Hollow, L.P. ( AESWH ) and AES Frontier, L.P. ( AESF ) in the District Court of Hood County, Texas by Stone & Webster, Inc. ( S&W ). At the time of filing, AESWH and AESF were two indirect subsidiaries of the Company. In December 2004, the Company finalized agreements to transfer the ownership of AESWH and AESF. S&W with AESWH and AESF contracted to perform the engineering, procurement and construction of the Wolf Hollow project, a gas-fired combined cycle power plant in Hood County, Texas. In its initial complaint, S&W requested a declaratory judgment that a fire that took place at the project on June 16, 2002 constituted a force majeure event and that S&W was not required to pay rebates assessed for associated delays. As part of the initial complaint, S&W also sought to enjoin AESWH and AESF from drawing down on letters of credit provided by S&W. The Court refused to issue the injunction. S&W has since amended its complaint five times and joined additional parties, including the Company and Parsons Energy & Chemicals Group, Inc. In addition to the claims already mentioned, the current claims by S&W include claims for breach of contract, breach of warranty, wrongful liquidated damages, foreclosure of lien, fraud and negligent misrepresentation. S&W appears to assert damages against the subsidiaries and the Company in the amount of \$114 million in recently filed reports and seeks exemplary damages. S&W has filed a lien against the ownership interests of AESWH and AESF in the property, with each lien allegedly valued, after amendment on March 14, 2005, at approximately \$87 million. In January 2004, the Company filed a counterclaim against S&W and its parent, the Shaw Group, Inc. ( Shaw ). AESWH and AESF filed answers and counterclaims against S&W, which since have been amended. The amount of AESWH and AESF's counterclaims are approximately \$215 million, according to calculations of the subsidiaries and of an expert retained in connection with the litigation, minus the Contract balance, currently not earned, in the amount of \$45.8 million. In March 2004, S&W and Shaw each filed an answer to the counterclaim. The counterclaim and answers subsequently were amended. In March 2005, the Court rescheduled the trial date for October 24, 2005. In September 2005, the trial date was re-scheduled for June 2006. In November 2005, the Company filed a motion for partial summary judgment. The Company believes that

the allegations in S&W's complaint are meritless, and that it has meritorious defenses to the claims asserted by S&W. The Company intends to defend the lawsuit and pursue its claims vigorously.

In March 2003, the office of the Federal Public Prosecutor for the State of Sao Paulo, Brazil (MPF) notified Eletropaulo that it had commenced an inquiry related to the BNDES financings provided to AES Elpa and AES Transgas and the rationing loan provided to Eletropaulo, changes in the control of Eletropaulo, sales of assets by Eletropaulo and the quality of service provided by Eletropaulo to its customers and requested various documents from Eletropaulo relating to these matters. In October 2003 this inquiry was sent to the MPF for continuing investigation. Also in March 2003, the Commission for Public Works and Services of the Sao Paulo Congress requested Eletropaulo to appear at a hearing concerning the default by AES Elpa and AES Transgas on the BNDES financings and the quality of service rendered by Eletropaulo. This hearing was postponed indefinitely. In addition, in April 2003, the office of the MPF notified Eletropaulo that it is conducting an inquiry into possible errors related to the collection by Eletropaulo of customers' unpaid past-due debt and requesting the company to justify its procedures. In December 2003, ANEEL answered, as requested by the MPF, that the issue regarding the past-due debts are to be included in the analysis to the revision of the General Conditions for the Electric Energy Supply.

In May 2003, there were press reports of allegations that in April 1998 Light Serviços de Eletricidade S.A. (Light) colluded with Enron in connection with the auction of Eletropaulo. Enron and Light were among three potential bidders for Eletropaulo. At the time of the transaction in 1998, AES owned less than 15% of the stock of Light and shared representation in Light's management and Board with three other shareholders. In June 2003, the Secretariat of Economic Law for the Brazilian Department of Economic Protection and Defense (SDE) issued a notice of preliminary investigation seeking information from a number of entities, including AES Brasil Energia, with respect to certain allegations arising out of the privatization of Eletropaulo. On August 1, 2003, AES Elpa responded on behalf of AES-affiliated companies and denied knowledge of these allegations. The SDE began a follow-up administrative proceeding as reported in a notice published on October 31, 2003. In response to the Secretary of Economic Law's official letters requesting explanations on such accusation, Eletropaulo filed its defense on January 19, 2004. On April 7, 2005 Eletropaulo responded to a SDE request for additional information.

AES Florestal, Ltd., (Florestal), a wooden utility pole manufacturer located in Triunfo, in the state of Rio Grande do Sul, Brazil, has been operated by Sul since October 1997 as part of the original privatization transaction by the Government of the State of Rio Grande do Sul, Brazil, that created Sul. From 1997 to the present, the chemical compound chromated copper arsenate was used by Florestal to chemically treat the poles under an operating license issued by the Brazilian government. Prior to 1997, another chemical, creosote, was used to treat the poles. After becoming the operator of Florestal, Sul discovered approximately 200 barrels of solid creosote waste on the Florestal property. In 2002, a civil inquiry (Civil Inquiry No. 02/02) was initiated and a criminal lawsuit was filed in the city of Triunfo's Judiciary both by the Public Prosecutors office of the city of Triunfo. The civil lawsuit was settled in 2003, and on June 27, 2005, the criminal lawsuit was dismissed. Florestal hired an independent environmental assessment company to perform an environmental audit of the operational cycle at Florestal. Florestal submitted an action plan that was accepted by the environmental authority under which it voluntarily offered to do containment work at the site.

On January 27, 2004, the Company received notice of a Formulation of Charges filed against the Company by the Superintendencia of Electricity of the Dominican Republic. In the Formulation of Charges, the Superintendencia asserts that the existence of three generation companies (Empresa Generadora de Electricidad Itabo, S.A., Dominican Power Partners, and AES Andres BV) and one distribution company (Empresa Distribuidora de Electricidad del Este, S.A.) in the Dominican Republic, violates certain cross ownership restrictions contained in the General Electricity law of the Dominican Republic. On February 10, 2004, the Company filed in the First Instance Court of the National District of the Dominican Republic ( Court ) an action seeking injunctive relief based on several constitutional due process violations contained in the

Formulation of Charges ( Constitutional Injunction ). On or about February 24, 2004, the Court granted the Constitutional Injunction and ordered the immediate cessation of any effects of the Formulation of Charges and the enactment by the Superintendencia of Electricity of a special procedure to prosecute alleged antitrust complaints under the General Electricity Law. On March 1, 2004, the Superintendencia of Electricity appealed the Court s decision. The appeal is pending.

In late July 2004, the Corporación Dominicana de Empresas Eléctricas Estatales ( CDEEE ), which is the government entity that currently owns 50% of Empresa Generadora de Electricidad Itabo, S.A. ( Itabo ), filed separate lawsuits in the Dominican Republic against Ede Este, a former subsidiary of AES, and Itabo, an AES affiliate. The lawsuits against Itabo also name the president of Itabo as a defendant. In one of the lawsuits against Itabo, CDEEE requested a rendering of accountability for the accounts of Itabo with regard to all transactions between Itabo and related parties. On November 29, 2004, the Court dismissed the case. CDEEE appealed the dismissal. A hearing was held on May 12, 2005 and Itabo requested the Court to declare the Courts jurisdictional incompetence to decide the matter, in light of the arbitration clause set forth in the contracts executed between Itabo and CDEEE under the Capitalization Process. The Court ordered that the claims be heard on the merits and condemned Itabo for not complying with this request. The Court reserved judgment on Itabo s arguments that the matter should be resolved in an arbitration proceeding. On May 25, 2005, Itabo appealed the May 12 decision and requested a stay of the decision. On October 14, 2005 the Court of Appeals of Santo Domingo upheld Itabo s request of jurisdictional incompetence and remitted the lawsuit to the International Chamber of Commerce ( ICC ) for arbitration. On May 26, 2005, Itabo filed a motion with the United States District Court Southern District New York, seeking relief in aid of the ongoing arbitration. The petition was denied on July 18. Itabo appealed said decision on September 6, 2005. In the other Itabo lawsuit, CDEEE also requested that the court order Itabo to deliver its accounting books and records for the period from September 1999 to July 2004 to CDEEE. At a hearing that was held on March 30, 2005, Itabo submitted that the court did not have jurisdiction to hear the case and that the case should be decided in an arbitration proceeding. On October 11, 2005 the Court upheld Itabo s petition of jurisdictional incompetence and declared that the lawsuit should be decided in an arbitral proceeding. In the Ede Este lawsuit, CDEEE requests a rendering of accountability of the accounts of all Ede Este s commercial and financial operations with affiliate companies since August 5, 1999. On February 9, 2005, Itabo filed a lawsuit against CDEEE and the Fondo Patrimonial para el Desarrollo ( FONPER ) seeking among other relief, to enforce the arbitration/dispute resolution processes set forth in the contracts among the parties. FONPER submitted an answer and asserted a counterclaim on April 21, 2005. CDEEE submitted an answer on April 23, 2005. Itabo answered FONPER s counterclaim on May 12, 2005. On August 25 Itabo filed an amended lawsuit. The Tribunal has been constituted. The arbitration is ongoing.

On February 18, 2004, AES Gener S.A. ( Gener SA ), a subsidiary of the Company, filed a lawsuit in the Federal District Court for the Southern District of New York. Gener SA is co-venturer with Coastal Itabo, Ltd. ( Coastal ) in Itabo, a Dominican Republic electric generation Company. The lawsuit sought to enjoin the efforts initiated by Coastal to hire an alleged independent expert, purportedly pursuant to the Shareholder Agreement between the parties, to perform a valuation of Gener SA s aggregate interests in Itabo. Coastal asserts that Gener SA has committed a material breach under the parties Shareholder Agreement, and therefore, Gener is required if requested by Coastal to sell its aggregate interests in Itabo

to Coastal at a price equal to 75% of the independent expert's valuation. Coastal claims a breach occurred based on alleged violations by Gener SA of purported antitrust laws of the Dominican Republic. Gener SA disputes that any default has occurred. On March 11, 2004, upon motion by Gener SA, the court enjoined the evaluation being performed by the expert and ordered the parties to arbitration. On March 11, 2004, Gener SA commenced arbitration proceedings. The arbitration tribunal has been appointed and the arbitration is ongoing.

Pursuant to the pesification established by the Public Emergency Law and related decrees in Argentina, since the beginning of 2002, the Company's subsidiary TermoAndes has converted its obligations under its gas supply and gas transportation contracts into pesos. In accordance with the Argentine regulations, payments were made in Argentine pesos at a 1:1 exchange rate. Certain gas suppliers (Tecpetrol, Mobil and Compañía General de Combustibles S.A.) which represented 50% of the gas supply contract have objected to the payment in pesos. On January 30, 2004, such gas suppliers filed for arbitration with the ICC requesting the re-dollarization of the gas price. TermoAndes replied on March 10, 2004 with a counter-lawsuit related to (i) the default of suppliers regarding the most favored nation clause, (ii) the unilateral modification of the point of gas injection by the suppliers, (iii) the obligations to supply the contracted quantities and (iv) the ability of TermoAndes to resell the gas not consumed. On May 12, 2004, the plaintiffs responded to TermoAndes' counterclaims. In October 2004, the case was submitted to a court of arbitration for determination of the Terms of Reference. Hearings to show evidence were held in Buenos Aires in June 2005. The arbitration seeks approximately \$12 million for past gas supplies plus interest.

On or about October 27, 2004, AES Red Oak LLC (Red Oak) was named as a defendant in a lawsuit filed by Raytheon Company (Raytheon) in the Supreme Court of the State of New York, County of New York. The complaint purports to allege claims for breach of contract, fraud, interference with contractual rights and equitable relief concerning alleged issues related to the construction and/or performance of the Red Oak project. The complaint seeks the return from Red Oak of approximately \$30 million that was drawn by Red Oak under a letter of credit that was posted by Raytheon related to the construction and/or performance of the Red Oak project. Raytheon also seeks \$110 million in purported additional expense allegedly incurred by Raytheon in connection with the guaranty and construction agreements entered with Red Oak. In December 2004, Red Oak answered the complaint and filed counterclaims against Raytheon. In January 2005, Raytheon moved for dismissal of Red Oak's counterclaims. In March 2005, the motion to dismiss was withdrawn and a partial motion for summary judgment was filed by Raytheon seeking return of approximately \$16 million of the letter of credit draw. Red Oak submitted its opposition to the partial motion for summary judgment in April. Meanwhile, Raytheon re-filed its motion to dismiss the fraud allegations in the counterclaim. In late April 2005, Red Oak filed its response opposing the renewed motion to dismiss. In December 2005, the Court granted a dismissal of Red Oak's fraud claim. The Court also ordered the return of approximately \$15 million of the letter of credit draw that had yet to be utilized for the performance/construction issues. The parties are conducting discovery. Red Oak expects to defend itself vigorously in the action. Raytheon also filed a related action against Red Oak in the Superior Court of Middlesex County, New Jersey, on May 27, 2005, seeking to foreclose on a construction lien filed against property allegedly owned by Red Oak, in the amount of \$31 million. Red Oak was served with the Complaint in September of 2005, and filed its answer, affirmative defenses, and counterclaim in October of 2005. Raytheon has stated that it wishes to stay the New Jersey action pending the outcome of the New York action. Red Oak has not decided whether it wishes to oppose the lien or consent to a stay.

On January 26, 2005, the City of Redondo Beach, California, sent Williams Power Co., Inc., (Williams) and AES Redondo Beach, LLC (AES Redondo Beach), a subsidiary of the Company, a notice of assessment for utility users' tax (UUT) for the period of May 1998 through September 2004 taxing the natural gas used at AES Redondo's plant to generate electricity during that time period. The

original assessment included alleged amounts owing of \$32.8 million for gas usage and \$38.9 million in interest and penalties. The City lowered the assessment to total \$56.7 million on July 13. An administrative hearing before the City's Tax Administrator was held on July 18-21 to hear Williams and AES Redondo Beach's objections to the assessment. On September 23, the Tax Administrator issued a decision holding AES Redondo Beach and Williams jointly and severally liable for approximately \$56.7 million, over \$20 million of which is interest and penalties. AES Redondo Beach filed with the City Manager of Redondo Beach an appeal of that decision on October 7. Under its Ordinance, the City of Redondo Beach has 45 days to hold the appeal hearing from the date of the filing of the appeal. A hearing on the appeal will likely be scheduled for late January or February 2006. In addition, in July 2005, AES Redondo Beach filed a lawsuit in Los Angeles Superior Court seeking a refund of UUT that was paid from February 2005 through final judgment of that case and an order that the City cannot charge AES Redondo Beach that tax going forward. On August 11, 2005, the City filed a demurrer seeking a dismissal of that lawsuit.

On April 26, 2003 approximately 4,000 gallons of distillate fuel oil spilled as a result of incorrect loading and storage tank valve settings at the Company's gas turbine plant at Condado del Rey, Panama. Remediation efforts were promptly conducted and completed. AES Panama agreed with Autoridad Nacional del Ambiente (ANAM), the Panamanian National Environmental Authority, to pay a fine of \$250 thousand, execute a soil remediation program, present an audit and new environmental management plan for the plant, and present a project to improve the domestic wastewater treatment system of the Condado del Rey neighborhood and the environmental recovery of the Abajo river watershed. As part of recent discussions and in response to a letter received by AES Panama from ANAM on May 25, 2005, clarifying the scope of the watershed project, AES Panama paid the fine on June 6, 2005, and complied with the agreed initiatives. The Company considers this issue to be closed and does not expect that any remaining costs or efforts to be material to our operations or results.

**ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Company held its Annual Meeting of Stockholders on April 28, 2005. The following matters were decided by a vote of the Stockholders.

**ELECTION OF DIRECTORS**

<b>NOMINEE</b>	<b>FOR</b>	<b>AGAINST/ABSTAIN</b>
Richard Darman	563,057,534	13,879,094
Paul T. Hanrahan	563,045,165	13,891,463
Kristina M. Johnson	562,510,474	14,426,154
John A. Koskinen	562,989,646	13,946,982
Philip Lader	562,548,196	14,388,432
John H. McArthur	540,456,971	36,479,657
Sandra O. Moose	562,922,803	14,013,825
Philip A. Odeen	559,949,975	16,986,653
Charles O. Rossotti	563,064,248	13,872,380
Sven Sandstrom	563,012,951	13,923,677
Roger W. Sant	543,298,212	33,638,416



Ratification of Deloitte and Touche, LLP, Auditors of The AES Corporation: 565,353,088 votes for, 8,333,302 votes against and 3,250,238 votes withheld.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

- 31.1 Certification of principal executive officer required by Rule 13a-14(a) of the Exchange Act.
- 31.2 Certification of principal financial officer required by Rule 13a-14(a) of the Exchange Act.
- 32.1 Certification of principal executive officer required by Rule 13a-14(b) or 15d-14(b) of the Exchange Act.
- 32.2 Certification of principal financial officer required by Rule 13a-14(b) or 15d-14(b) of the Exchange Act.

58

---

**SIGNATURES**

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

Date: January 19, 2006

THE AES CORPORATION  
(Registrant)

By:

/s/ BARRY J. SHARP  
Name: Barry J. Sharp  
Title: *Executive Vice President and  
Chief Financial Officer*

59

---