TENNESSEE VALLEY AUTHORITY

FORM 10-K
(Annual Report)

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

FORM 10-K

(MARK ONE)
☒ ANNUAL REPORT PURSUANT TO SECTION 13, 15(d), OR 37 OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2008
OR
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-52313

TENNESSEE VALLEY AUTHORITY

(Exact name of registrant as specified in its charter)

A corporate agency of the United States created by an act of Congress *(State or other jurisdiction of incorporation or organization)*	62-0474417 *(IRS Employer Identification No.)*
400 W. Summit Hill Drive Knoxville, Tennessee *(Address of principal executive offices)*	37902 *(Zip Code)*

(865) 632-2101
Registrant's telephone number, including area code

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13, Section 15(d), or Section 37 of the Securities Exchange Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13, 15(d), or 37 of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ☒ No ☐

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☒	Smaller reporting company ☐

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act). Yes ☐ No ☒

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FORWARD -LOOKING INFORMATION

This Annual Report on Form 10-K for the fiscal year ended September 30, 2008 ("Annual Report") contains forward-looking statements relating to future events and future performance. All statements other than those that are purely historical may be forward-looking statements.

In certain cases, forward-looking statements can be identified by the use of words such as "may," "will," "should," "expect," "anticipate," "believe," "intend," "project," "plan," "predict," "assume," "forecast," "estimate," "objective," "possible," "probably," "likely," "potential," or other similar expressions.

Examples of forward-looking statements include, but are not limited to:

- Statements regarding strategic objectives;
- Projections regarding potential rate actions;
- Forecasts of costs of certain asset retirement obligations;
- Estimates regarding power and energy forecasts;
- Expectations about the adequacy of TVA's funding of its pension plans, nuclear decommissioning trust, and asset retirement trust;
- The anticipated results of TVA's Extended Power Uprate project at Browns Ferry Nuclear Plant;
- TVA's plan to reduce the growth in peak demand by up to 1,400 megawatts by the end of 2012;
- TVA's plans to borrow under its credit facility with the U.S. Treasury during 2009;
- TVA's plans to continue using short-term debt to meet current obligations; and
- The anticipated cost and timetable for placing Watts Bar Unit 2 in service.

Although the Tennessee Valley Authority ("TVA") believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things:

- New laws, regulations, and administrative orders, especially those related to:
  - TVA's protected service area,
  - The sole authority of the TVA board of directors to set power rates,
  - Various environmental matters including laws, regulations, and administrative orders restricting emissions and preferring certain fuels or generation sources over others,
  - The licensing, operation, and decommissioning of nuclear generating facilities;
  - TVA's management of the Tennessee River system,
  - TVA's credit rating, and
  - TVA's debt ceiling;
- Loss of customers;
- Performance of TVA's generation and transmission assets;
- Disruption of fuel supplies, which may result from, among other things, weather conditions, production or transportation difficulties, labor challenges, or environmental regulations affecting TVA's fuel suppliers;
- Purchased power price volatility;
- Events at facilities not owned by TVA that affect the supply of water to TVA's generation facilities;
- Compliance with existing or future environmental laws and regulations;
- Significant delays or cost overruns in construction of generation and transmission assets;
- Inability to obtain regulatory approval for the construction of generation assets;
- Significant changes in demand for electricity;
- Legal and administrative proceedings, including awards of damages and amounts paid in settlements;
- Weather conditions, including drought;
- Failure of TVA's transmission facilities or the transmission facilities of other utilities;
- Events at a nuclear facility, even one that is not operated by or licensed to TVA;
- Catastrophic events such as fires, earthquakes, floods, tornadoes, pandemics, wars, terrorist activities, and other similar events, especially if these events occur in or near TVA's service area;
- Reliability of purchased power providers, fuel suppliers, and other counterparties;
- Changes in the market price of commodities such as coal, uranium, natural gas, fuel oil, construction materials, electricity, and emission allowances;
- Changes in the prices of equity securities, debt securities, and other investments;
- Changes in interest rates;
- Creditworthiness of TVA, its counterparties, and its customers;
- Rising pension costs and health care expenses;
- Increases in TVA's financial liability for decommissioning its nuclear facilities and retiring other assets;
- Unplanned contributions to TVA's pension or other postretirement benefit plans or to TVA's nuclear decommissioning trust;

- Limitations on TVA's ability to borrow money;
- Changes in the economy;
- Ineffectiveness of TVA's disclosure controls and procedures and its internal control over financial reporting;
- Changes in accounting standards;
- The loss of TVA's ability to use regulatory accounting;
- Problems attracting and retaining skilled workers;
- Changes in technology;
- Changes in TVA's plans for allocating its financial resources among projects;
- Differences between estimates of revenues and expenses and actual revenues and expenses incurred;
- Volatility in financial markets;
- Changes in the market for TVA securities; and
- Unforeseeable events.

Additionally, other risks that may cause actual results to differ materially from the predicted results are set forth in Item 1A, Risk Factors, and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA's business or cause results to differ materially from those contained in any forward-looking statement.

TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur after the statement is made.

GENERAL INFORMATION

Fiscal Year

Unless otherwise indicated, years (2008, 2007, etc.) in this Annual Report refer to TVA's fiscal years ended September 30. References to years in the biographical information about directors and executive officers in Item 10, Directors, Executive Officers and Corporate Governance are to calendar years.

Notes

References to "Notes" are to the Notes to Financial Statements contained in Item 8, Financial Statements and Supplementary Data in this Annual Report.

Available Information

TVA's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports are made available on TVA's web site, free of charge, as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). TVA's web site is www.tva.gov. Information contained on TVA's web site shall not be deemed to be incorporated into, or to be a part of, this Annual Report. In addition, the public may read and copy any reports or other information that TVA files with the SEC at the SEC's Public Reference Room at 100 F Street N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. TVA's SEC reports are also available to the public without charge from the web site maintained by the SEC at www.sec.gov.

PART I

ITEM 1. BUSINESS

The Corporation

In 1933, President Franklin D. Roosevelt proposed and the U.S. Congress created the Tennessee Valley Authority ("TVA"), a government corporation. TVA was created, among other things, to improve navigation on the Tennessee River, reduce the damage from destructive flood waters within the Tennessee River System and downstream on the lower Ohio and Mississippi Rivers, further the economic development of TVA's service area in the southeastern United States, and sell the electricity generated at the facilities TVA operates.

Today, TVA operates the nation's largest public power system and supplies power in most of Tennessee, northern Alabama, northeastern Mississippi, and southwestern Kentucky and in portions of northern Georgia, western North Carolina, and southwestern Virginia to a population of nearly nine million people. In 2008, the revenues from TVA's power program were $10.4 billion and accounted for virtually all of TVA's revenues.

TVA also manages the Tennessee River and its tributaries — the United States' fifth largest river system — to provide, among other things, year-round navigation, flood damage reduction, and affordable and reliable electricity. Consistent with these primary purposes, TVA also manages the river system to provide recreational opportunities, adequate water supply, improved water quality, and economic development. TVA's management of the Tennessee River and its tributaries will sometimes be referred to as TVA's "stewardship" program in this Annual Report.

Initially, all TVA operations were funded by federal appropriations. Direct appropriations for the TVA power program ended in 1959, and appropriations for TVA's stewardship, economic development, and multipurpose activities ended in 1999. Since 1999, TVA has funded all of its operations almost entirely from the sale of electricity and power system financings.

Strategy

On May 31, 2007, the TVA Board of Directors ("TVA Board") approved the 2007 Strategic Plan ("Strategic Plan"). The Strategic Plan focuses on TVA's performance in the following five broad areas and establishes general guidelines for each area:

Customers : Maintain power reliability, provide competitive rates, and build trust with TVA's customers;

People : Build pride in TVA's performance and reputation;

Financial : Adhere to a set of sound financial guiding principles to improve TVA's fiscal performance;

Assets : Use TVA's assets to meet market demand and deliver public value; and

Operations : Improve performance to be recognized as an industry leader.

See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations – *Executive Summary — 2008 Performance Indicators* for a discussion of the corporate-level metrics that TVA used during 2008 to monitor its progress toward successful implementation of the Strategic Plan.

Service Area

The area in which TVA sells power, its service area, is defined by two pieces of Congressional legislation: the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (as amended, the "TVA Act") and an amendment to the Federal Power Act ("FPA") known as the "anti-cherrypicking provision."

Under the TVA Act, subject to certain minor exceptions, TVA may not, without specific authorization from the U.S. Congress, enter into contracts which would have the effect of making it, or the distributor customers of its power, a source of power supply outside the area for which TVA or its distributor customers were the primary source of power supply on July 1, 1957. This provision is referred to as the "fence" because it bounds TVA's sales activities, essentially limiting TVA to power sales within a defined service area.

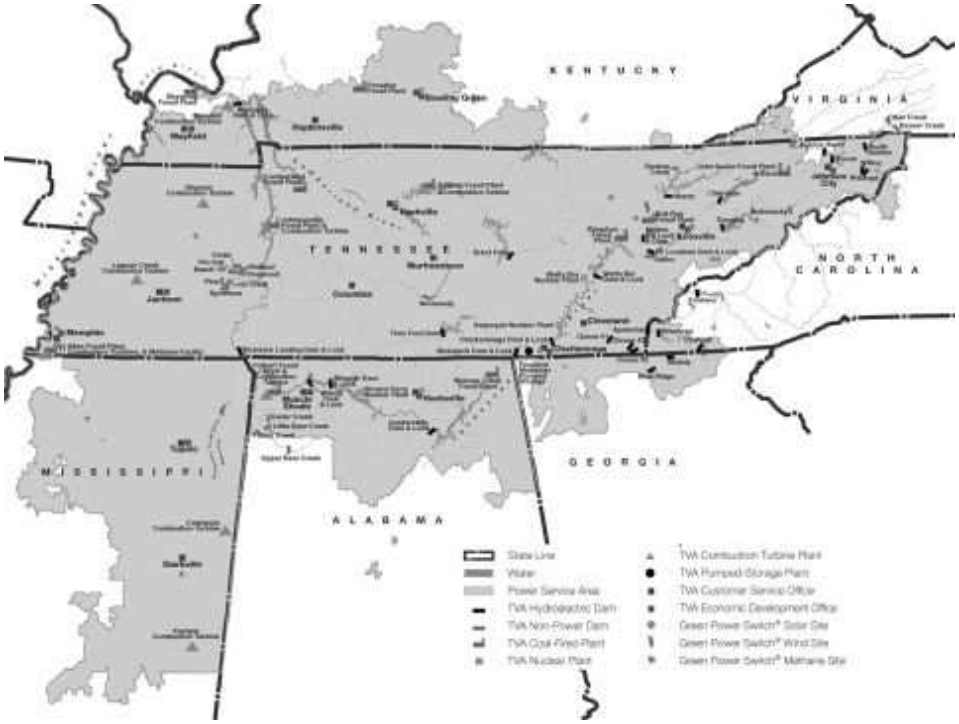
Correspondingly, the FPA, primarily through the anti-cherrypicking provision, prevents the Federal Energy Regulatory Commission ("FERC") from ordering TVA to provide access to its transmission lines to others for the purpose of using TVA's transmission lines to deliver power to customers within substantially all of TVA's defined service area. As a result, the anti-cherrypicking provision reduces TVA's exposure to loss of revenue.

Sales of electricity accounted for substantially all of TVA's operating revenues in 2008, 2007, and 2006, amounting to $10.3 billion, $9.2 billion, and $8.8 billion, respectively. TVA's revenues by state for the last three years are detailed in the table below.

Electricity Sales Revenues by State
For the years ended September 30
(in millions)

	2008	2007	2006
Alabama	$ 1,410	$ 1,264	$ 1,239
Georgia	238	206	226
Kentucky	1,192	1,084	902
Mississippi	923	804	798
North Carolina	50	58	36
Tennessee	6,389	5,740	5,621
Virginia	37	7	5
Subtotal	10,239	9,163	8,827
Sale for resale	13	17	13
Subtotal	10,252	9,180	8,840
Other revenues	130	146	143
Operating revenues	$ 10,382	$ 9,326	$ 8,983

TVA SERVICE AREA



Customers

TVA is primarily a wholesaler of power. TVA sells power at wholesale to distributor customers, consisting of municipalities and cooperatives that resell the power to their customers at a retail rate. TVA also sells power to (1) directly served customers, consisting primarily of federal agencies and customers with large or unusual loads, and (2) exchange power customers (electric systems that border TVA's service area) with which TVA has entered into exchange power arrangements.

Operating revenues by customer type for each of the last three years are set forth in the table below. In this table, sales to industries directly served are included in INDUSTRIES DIRECTLY SERVED , and sales to federal agencies directly served and to exchange power customers are included in FEDERAL AGENCIES AND OTHER .

Operating Revenues by Customer Type
For the years ended September 30
(in millions)

	2008	2007	2006
Municipalities and cooperatives	$ 8,659	$ 7,847	$ 7,659
Industries directly served	1,472	1,221	1,065
Federal agencies and other			
Federal agencies directly served	108	95	103
Off-system sales	13	17	13
Subtotal	10,252	9,180	8,840
Other revenues	130	146	143
Operating revenues	$ 10,382	$ 9,326	$ 8,983

Municipalities and Cooperatives

Revenues from distributor customers accounted for 83.4 percent of TVA's total operating revenues in 2008. At September 30, 2008, TVA had wholesale power contracts with 159 municipalities and cooperatives. All of these contracts require distributor customers to purchase all of their electric power and energy requirements from TVA.

All distributor customers purchase power under one of three basic termination notice arrangements:

- Contracts that require five years' notice to terminate;
- Contracts that require 10 years' notice to terminate; and
- Contracts that require 15 years' notice to terminate.

The number of distributor customers with the contract arrangements described above, the revenues derived from such arrangements in 2008, and the percentage of TVA's 2008 total operating revenues represented by these revenues are summarized in the table below.

TVA Distributor Customer Contracts
As of September 30, 2008

Contract Arrangement	Number of Distributor Customers	Sales to Distributor Customers in 2008	Percentage of Total Operating Revenues in 2008
		(in millions)	
15-Year termination notice	5	$ 93	0.9%
10-Year termination notice	48	2,865	27.6%
5-Year termination notice *	103	5,645	54.4%
Notice given - less than 5 years remaining *	3**	56	0.5%
Total	159	$ 8,659	83.4%

* Ordinarily the distributor customer and TVA have the same termination notice period; however, in contracts with six of the distributor customers with five-year termination notices, TVA has a 10-year termination notice (which becomes a five-year termination notice if TVA loses its discretionary wholesale rate-setting authority). Also, under TVA's contract with Bristol Virginia Utilities, a five-year termination notice may not be given until January 2018.

** One of these contracts, amounting to 0.1% of operating revenues, terminated on November 20, 2008.

TVA's two largest distributor customers — Memphis Light, Gas and Water Division ("MLGW") and Nashville Electric Service ("NES") — have contracts with five-year and 10-year termination notice periods, respectively. Although no single customer accounted for 10 percent or more of TVA's total operating revenues in 2008, sales to MLGW and NES accounted for 8.4 percent and 7.9 percent, respectively.

On January 1, 2008, Bristol Virginia Utilities ("BVU") again became a distributor customer of TVA power. TVA had provided wholesale power to BVU from 1945 to 1997. The contract has a minimum 15-year term, and a five-year termination notice may not be given until January 2018. The rates under this contract are intended to recover the cost of reintegrating BVU into TVA's power supply plan and serving its customer load.

The power contracts between TVA and the distributor customers provide for purchase of power by the distributor customers at the wholesale rates established by the TVA Board, which, beginning with 2007, are adjusted quarterly to reflect changing fuel and purchased power costs. See Item 1, Business — *Rate Actions.*

TVA has a role in regulating the distributor customers since most of the power contracts between TVA and the distributor customers specify the resale rates that distributor customers charge their power customers. These rates are revised from time to time, subject to TVA approval, to reflect changes in costs, including changes in the wholesale cost of power, and are designed to conform to the TVA Act's objective of providing an adequate supply of power at the lowest feasible rates. The distributor customers' resale rates are divided into the classifications of residential, general power, and manufacturing. The general power and manufacturing classifications are further divided into subclassifications according to their load size. In addition, TVA seeks to ensure that the electric system revenues of the distributor customers are used for electric system purposes.

Other Customers

Revenues from industrial customers directly served accounted for 14.2 percent of TVA's total operating revenues in 2008. In 2008, contracts for customers directly served were generally for terms ranging from five to 10 years. These contracts are subject to termination by TVA or the customer upon a minimum notice period that varies according to the customer's contract demand and the period of time service has been provided.

The United States Enrichment Corporation ("USEC") is TVA's largest industrial customer directly served. Sales to USEC for its Paducah, Kentucky, facility represented 5.3 percent of TVA's total operating revenues in 2008. TVA's current contract with USEC expires on May 31, 2012. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities — Credit Risk* . In January 2004, USEC announced its decision to construct a new commercial centrifuge facility in Piketon, Ohio, which is outside TVA's service area. TVA continues to plan for USEC's announced intention to reduce its electricity purchases and believes USEC will reduce its electricity purchases at the Paducah, Kentucky, facility from about 2,000 megawatts at its peak to less than 50 megawatts. Since TVA's need to buy purchased power will decrease with USEC's departure, TVA does not expect its results of operation or cash flows to be to be adversely effected.

Rate Authority

TVA is self-regulated with respect to rates, and the TVA Act gives the TVA Board sole responsibility for establishing the rates TVA charges for power. These rates are not subject to judicial review or to review or approval by any state or federal regulatory body.

Under the TVA Act, TVA is required to charge rates for power which will produce gross revenues sufficient to provide funds for:

- Operation, maintenance, and administration of its power system;
- Payments to states and counties in lieu of taxes ("tax equivalents");
- Debt service on outstanding indebtedness;
- Payments to the U.S. Treasury in repayment of and as a return on the government's appropriation investment in TVA's power facilities (the "Power Facilities Appropriation Investment"); and
- Such additional margin as the TVA Board may consider desirable for investment in power system assets, retirement of outstanding bonds, notes, or other evidences of indebtedness ("Bonds") in advance of maturity, additional reduction of the Power Facilities Appropriation Investment, and other purposes connected with TVA's power business.

In setting TVA's rates, the TVA Board is charged by the TVA Act to have due regard for the primary objectives of the TVA Act, including the objective that power shall be sold at rates as low as are feasible. See Note 1 — *General.*

Revenue Requirements

In setting rates to cover the costs set out in the TVA Act, TVA uses a debt-service coverage ("DSC") methodology to derive annual revenue requirements in a manner similar to that used by other public power entities that also use the DSC rate methodology. The DSC method is essentially a measure of an organization's ability to cover its operating costs and to satisfy its obligations to pay principal and interest on debt. TVA believes this method is appropriate because of TVA's debt-intensive capital structure. This ratemaking approach is particularly suitable for use by highly leveraged enterprises (i.e., enterprises financed primarily, if not entirely, by debt capital).

The revenue requirements (or projected costs) are calculated under the DSC method as the sum of the following components:

- Fuel and purchased power costs;
- Operating and maintenance costs;
- Tax equivalents; and
- Debt service coverage.

Once the revenue requirements (or projected costs) are determined, this amount is compared to the projected revenues for the year in question, at existing rates, to arrive at the shortfall or surplus of revenues as compared to the projected costs. Subject to TVA Board approval, power rates would be adjusted to a level sufficient to produce revenues approximately equal to projected costs. This methodology reflects the cause-and-effect relationship between a regulated entity's costs and the corresponding rates the entity charges for its regulated products and services.

Rate Actions

On August 20, 2008, the TVA Board approved a base rate increase effective October 1, 2008. The increase is related to rising fuel costs that are not recovered by the fuel cost adjustment ("FCA"), continuing effects from drought conditions, as well as TVA's continuing need for investment in generation and transmission facilities, clean air technology, energy efficiency and peak reduction initiatives, and information technology systems. It is anticipated that the increase of the base charges will produce approximately $310 million of additional accrued revenue in 2009, which is expected to have an estimated $275 million cash impact during 2009. The increase, combined with the FCA increase that became effective at the same time, results in an average total increase in wholesale charges of 20 percent from the previously effective charges. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008.*

Fuel Cost Adjustment . As of September 30, 2008, TVA had recognized a regulatory asset of $4 million and a current receivable of $24 million representing deferred fuel and purchased power costs to be recovered through the FCA in future periods. Under TVA's FCA methodology, adjustments to rates are based on the difference between forecasted and baseline (budgeted) costs for the upcoming quarter. Because the FCA adjustments are forward-looking, there is typically a difference between what is collected in rates and FCA-eligible expenses that are actually incurred over the course of the quarter. This difference is added to or deducted from certain accounts on TVA's balance sheet. The higher or lower costs added to or deducted from the balance sheet accounts are then amortized to expense in the periods in which they are to be collected in revenues. This methodology allows better matching of the revenues with associated expenses, although TVA's cash flow can be negatively impacted by this process due to timing of collection of revenues and payments related to fuel and purchased power. The FCA amount implemented in October 2008 was 1.806 cents per kilowatt-hour and was expected to produce an estimated $669 million in revenue during the first quarter of 2009. See Note 1 — *Cost-Based Regulation* and *Accounts Receivable.*

Load and Energy Forecasts

TVA produces a range of forecasts of future load and energy requirements using multiple models driven by historical TVA loads and regional economic forecasts of employment, population, and electricity and gas prices. Numerous factors, such as weather conditions and the health of the regional economy, could cause actual results to differ materially from TVA's forecasts. See *Forward-Looking Information.* TVA believes that new generation sources will be needed to meet load growth under most likely scenarios. See Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Future Challenges.*

Power Supply

General

Power generating facilities operated by TVA at September 30, 2008, included 29 conventional hydroelectric sites, one pumped storage hydroelectric site, 11 coal-fired sites, three nuclear sites, 11 combustion turbine sites, two diesel generator sites, one wind energy site, one digester gas site, one biomass cofiring site, and 15 solar energy sites. In addition, TVA acquires power under power purchase agreements of varying duration as well as short-term contracts of less than 24-hour duration ("spot market").

Generation Facilities

The following table summarizes TVA's net generation in millions of kilowatt-hours by generating source and the percentage of all electric power generated by TVA for the years indicated:

Power Supply from TVA-Operated Generation Facilities
For the years ended September 30
(millions of kWh)

	2008		2007		2006		2005		2004	
Coal-fired	98,752	62%	100,169	64%	99,598	64%	98,361	62%	94,618	61%
Nuclear	51,371	33%	46,441	30%	45,313	29%	45,156	28%	46,003	30%
Hydroelectric	6,685	4%	9,047	6%	9,961	6%	15,723	10%	13,916	9%
Combustion turbine and diesel generators	1,386	1%	705	<1%	613	<1%	595	<1%	278	<1%
Renewable resources *	39	<1%	27	<1%	36	<1%	47	<1%	35	<1%
Total	158,233	100%	156,389	100%	155,521	100%	159,882	100%	154,850	100%

Note:

* Renewable resources for years 2004 through 2006 have been adjusted to remove renewable resources amounts that were acquired under purchased power agreements and included in this table in TVA's 2006 Annual Report on Forms 10-K as amended. These adjustments resulted in reductions in the amount of renewable resources by 13 million kWh for 2004, 14 million kWh for 2005, and 15 million kWh for 2006. Also, for years 2004 through 2006 the following amounts related to TVA's digester gas cofiring site have been reclassified from Coal-fired to Renewable resources: 30 million kWh for 2004, 43 million kWh for 2005, and 32 million kWh for 2006. Renewable resource facilities include a digester gas cofiring site, a biomass cofiring site, a wind energy site, and solar energy sites.

The following table indicates TVA's average fuel expense by generation-type for the years indicated:

Fuel Expense Per kWh
For the years ended September 30
(cents/kWh)

	2008	2007	2006	2005	2004
Coal	2.29	2.13	2.02	1.65	1.48
Natural gas and fuel oil	6.13	7.00	10.65	11.44	9.01
Nuclear	0.50	0.41	0.38	0.39	0.39
Average fuel cost per kWh net thermal generation from all sources	1.72	1.61	1.54	1.30	1.14

Coal-Fired. TVA has 11 coal-fired power sites consisting of 59 units. At September 30, 2008, these facilities accounted for 14,469 megawatts of summer net capability. Net capability is defined as the ability of an electric system, generating unit, or other system component to carry or generate power for a specified time period. TVA's coal-fired units were placed in service between 1951 and 1973. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008* .

Nuclear. TVA has three nuclear sites consisting of six units in operation. At September 30, 2008, these facilities accounted for 6,671 megawatts of summer net capability. For a detailed discussion of TVA's nuclear power program, see Item 1, Business — *Nuclear.* For a discussion of challenges faced by TVA's nuclear power program during 2008, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008.*

Hydroelectric. TVA has 29 conventional hydroelectric sites consisting of 109 units. In addition, TVA has one pumped storage facility consisting of four units. At September 30, 2008, these facilities accounted for 5,503 megawatts of summer net capability. The amount of electricity that TVA is able to generate from its hydroelectric plants depends on a number of factors outside TVA's control, including the amount of precipitation, runoff, initial water levels, and the need for water for competing water management objectives. The amount of electricity generation is also dependent upon the availability of its hydroelectric generation plants, which is in TVA's control. When these factors are unfavorable, TVA must increase its reliance on more expensive generation plants and purchased power. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008 — Weather Conditions* .

Combustion Turbine Facilities . As of September 30, 2008, TVA operated 93 combustion turbine units, 87 of which are simple cycle and six of which are combined cycle. The simple cycle units provide a maximum of 5,706 megawatts of summer net capability. The six combined cycle units provide a maximum of 1,560 megawatts of summer net capability. Eighty of the simple cycle units are fueled by either natural gas or diesel fuel. The remaining seven simple cycle units as well as the six combined cycle units are fueled by natural gas only. Seventy-six of the simple cycle units are capable of quick-start response allowing full generation capability in approximately 10 minutes. As of September 30, 2008, 24 of the simple cycle combustion turbine units are owned by private entities and leased back to TVA under long-term leases.

Caledonia. TVA entered into an operating lease agreement and various related contracts for the Caledonia combined cycle facility located near Columbus, Mississippi, with a commencement date of July 1, 2007. The lease agreement expires on February 28, 2022. The Caledonia facility consists of three combined cycle units with a summer net capability of 768 megawatts. TVA assumed plant operations on December 10, 2007. The lease agreement also includes an end-of-term purchase option.

Brownsville. In November 2007, the TVA Board approved the purchase of a four-unit, 474 megawatt summer net capability simple cycle, gas-fired, combustion turbine facility at a price of $55 million. TVA agreed to purchase the facility, which is located in Brownsville, Tennessee, from Brownsville Power I, LLC ("Brownsville Power"). Brownsville Power is a wholly owned direct subsidiary of Cinergy Capital & Trading, Inc. The purchase closed April 18, 2008. After the operating systems were evaluated and tested, the units became available for dispatch in June 2008.

Southaven. TVA also agreed to purchase, as part of a bankruptcy auction process, a three-unit, 792-megawatt summer net capability combined cycle, combustion turbine facility located in Southaven, Mississippi, owned by Southaven Power, LLC ("Southaven") for a base purchase price of $461 million. In addition to the purchase price, TVA agreed to pay $5 million to Southaven in connection with the termination of an operation and maintenance agreement held by a Southaven affiliate. The purchase closed May 9, 2008, and the plant was available for immediate operation. On September 30, 2008, Seven States Southaven LLC ("SSSL") purchased an undivided 69.69 percent interest in TVA's Southaven combined cycle, combustion turbine facility. SSSL and TVA have entered into an agreement under which TVA leases SSSL's undivided interest in the Southaven facility and operates the facility through April 30, 2010. See Note 4 — *New Generation* and Note 13 — *Leaseback Obligations.*

Capacity Expansion. TVA is constructing an additional combined cycle facility, Lagoon Creek Combined Cycle, which is currently scheduled to be in service in June 2010 and have a summer net capability of 540 megawatts. Also, engineering and procurement of equipment is underway for the conversion of the Gleason simple cycle site to a combined cycle site. This conversion is expected to add approximately 375 megawatts of summer net capability and to be completed in January 2012. TVA's Brownsville and Gleason simple cycle sites do not currently have firm gas transportation or the ability to burn oil as a back-up fuel; however, TVA has available interruptible gas supply for these sites through May 2012 which is the norm for simple cycle single fuel sites. TVA has entered into a firm gas transportation agreement with a supplier for the periods of June 1, 2012, through May 31, 2022. In addition, TVA plans to acquire combustion turbine units for installation at the New Caledonia facility that it acquired in February 2008. The units are expected to be in simple cycle service in June 2013 and have a summer net capability of 458 megawatts.

Diesel Generators. TVA has two diesel generator plants consisting of nine units. At September 30, 2008, these facilities provided 13 megawatts of summer net capability.

Renewable Resources. TVA has one wind energy site with three wind turbines, one biomass cofiring site, one digester gas cofiring site, and 15 solar energy sites. At September 30, 2008, the digester gas cofiring site provided TVA with about three megawatts of renewable summer net capability. In addition, the wind energy site, the solar energy sites, and the biomass cofiring site provided additional megawatts of capability, but because of the nature of this capability, it is not considered to be summer net capability.

Purchased Power and Other Agreements

TVA acquires power from a variety of power producers through long-term and short-term power purchase agreements as well as through power spot market purchases. During 2008, TVA acquired 41 percent of the power that it purchased on the power spot market, nine percent through short-term power purchase agreements, and 50 percent through long-term power purchase agreements that expire more than one year after September 30, 2008.

At September 30, 2008, TVA's long-term power purchase agreements provided TVA with 2,789 megawatts of summer net capability. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities — Credit Risk* .

A portion of TVA's capability provided by power purchase agreements is provided under contracts that expire between 2010 and 2032, and the most significant of these contracts are discussed below.

- *Calpine Energy Services, L.P.* TVA has contracted with Calpine Energy Services, L.P. ("Calpine") for 720 megawatts of summer net capability from a natural gas-fired generating plant located at Decatur, Alabama. This contract expires on August 31, 2012. In addition, TVA has contracted with Calpine for 500 megawatts of summer net capability from a natural gas-fired generating plant located in Morgan County, Alabama. While this contract was executed on August 11, 2008, it will not go into effect until January 1, 2009. This contract expires on December 31, 2011.

- *Suez Energy Marketing NA, Inc*. TVA has contracted with Suez Energy Marketing NA, Inc. ("Suez") for 650 megawatts of summer net capability from a natural gas-fired generating plant located near Ackerman, Mississippi. TVA's contract with Suez expires on December 31, 2012.

- *Choctaw Generation, L.P.* TVA has contracted with Choctaw Generation, L.P. ("Choctaw") for 440 megawatts of summer net capability from a lignite-fired generating plant in Chester, Mississippi. TVA's contract with Choctaw expires on March 31, 2032. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities — Credit Risk* .

- *Alcoa Power Generating, Inc*. Four hydroelectric plants owned by Alcoa Power Generating, Inc. ("APGI"), formerly known as Tapoco, Inc., are operated in coordination with the TVA system. Under contractual arrangements with APGI which terminate on June 20, 2010, TVA dispatches the electric power generated at these facilities and uses it to partially supply Alcoa's energy needs. TVA's arrangement with APGI provides 347 megawatts of summer net capability.

- *Invenergy TN LLC* . TVA has contracted with Invenergy TN LLC for 27 megawatts of wind energy generation from 15 wind turbine generators located on Buffalo Mountain near Oak Ridge, Tennessee. Because of the nature of wind conditions in the TVA service area, these generators provide energy benefits but are not included in TVA's summer net capability total. TVA's contract with Invenergy TN LLC expires on December 31, 2024.

- *Southeastern Power Administration.* TVA, along with others, contracted with the Southeastern Power Administration ("SEPA") to obtain power from eight U.S. Army Corps of Engineers hydroelectric facilities on the Cumberland River system. The agreement with SEPA can be terminated upon three years' notice, but this notice of termination may not become effective prior to June 30, 2017. The contract originally required SEPA to provide TVA an annual minimum of 1,500 hours of power for each megawatt of TVA's 405 megawatt allocation, and all surplus power from the Cumberland River system. Because hydroelectric production has been reduced at two of the hydroelectric facilities on the Cumberland River system (Wolf Creek and Center Hill Dams) and because of reductions in the summer stream flow on the Cumberland River, SEPA declared "force majeure" on February 25, 2007. SEPA then instituted an emergency operating plan that:

- Eliminates its obligation to provide any affected customer (including TVA) with a minimum amount of power;
- Provides for all affected customers (except TVA) to receive a pro rata share of a portion of the gross hourly generation from the eight Cumberland River hydroelectric facilities;
- Provides for TVA to receive all of the remaining hourly generation (minus station service for those facilities);
- Eliminates the payment of demand charges by customers (including TVA) since there is significantly reduced dependable capacity on the Cumberland River system; and
- Increases the rate charged per kilowatt-hour of energy received by SEPA's customers (including TVA), because SEPA is legally required to charge rates that cover its costs.

It is unclear how long the emergency operating plan will remain in effect.

Under the Public Utility Regulatory Policies Act of 1978, as amended by the Energy Policy Act of 1992 and the Energy Policy Act of 2005, TVA is required to purchase energy from qualifying facilities, cogenerators, and small power producers at TVA's avoided cost of self-generating or purchasing this energy from another source.

During the past five years, TVA supplemented its power generation through power purchases as follows:

Purchased Power *
For the years ended September 30

	2008	2007	2006	2005	2004
Millions of kWh	20,887	22,141	19,019	14,892	14,025
Percent of TVA's Total Power Supply	11.6	12.4	10.9	8.5	8.3

Note

* Purchased power amounts for years 2004, 2005, and 2006 have been adjusted to remove APGI purchases and include them as a credit to power sales.

For more information regarding TVA's power purchase obligations, see Note 15 — *Commitments — Power Purchase Obligations.*

Purchasing power from others will likely remain a part of how TVA meets the power needs of its service area. The Strategic Plan establishes a goal of balancing production capabilities with power supply requirements by promoting the conservation and efficient use of electricity and, when necessary, buying, building, and/or leasing assets or entering into purchased power agreements. Achieving this goal will allow TVA to reduce its reliance on purchased power. Although purchased power volume decreased in 2008, TVA purchased significantly more power than planned due to decreased hydroelectric generation of 26.1 percent as a result of ongoing drought conditions in 2008. Capacity margins in areas surrounding TVA have narrowed over the past three years. However, due to current economic conditions, this trend may flatten or reverse due to lower system loads. A return to normal weather patterns would likely increase hydroelectric generation and reduce reliance on purchased power. See Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — *Challenges During 2008 — Weather Conditions.*

Net Capability

The following table summarizes the summer net capability in megawatts TVA had available as of September 30, 2008:

SUMMER NET CAPABILITY [1]
As of September 30, 2008

Source of Capability	Location	Number of Units	Summer Net Capability [2] (MW)	Date First Unit Placed in Service	Date Last Unit Placed in Service
TVA GENERATING FACILITIES					
Coal-Fired					
Allen	Tennessee	3	735	1959	1959
Bull Run	Tennessee	1	882	1967	1967
Colbert	Alabama	5	1,147	1955	1965
Cumberland	Tennessee	2	2,466	1973	1973
Gallatin	Tennessee	4	964	1956	1959
John Sevier	Tennessee	4	704	1955	1957
Johnsonville	Tennessee	10	1,128	1951	1959
Kingston	Tennessee	9	1,411	1954	1955
Paradise	Kentucky	3	2,201	1963	1970
Shawnee	Kentucky	10	1,323	1953	1956
Widows Creek	Alabama	8	1,508	1952	1965
Total Coal-Fired		59	14,469		
Nuclear					
Browns Ferry	Alabama	3	3,280	1974	1977
Sequoyah	Tennessee	2	2,282	1981	1982
Watts Bar	Tennessee	1	1,109	1996	1996
Total Nuclear		6	6,671		
Hydroelectric					
Conventional Plants	Alabama	36	1,498	1925	1962
	Georgia	2	31	1931	1956
	Kentucky	5	175	1944	1948
	North Carolina	6	383	1940	1956
	Tennessee	60	1,699	1912	1972
Pumped Storage	Tennessee	4	1,717	1978	1979
Total Hydroelectric		113	5,503		
Combustion Turbine [3]					
Allen	Tennessee	20	478	1971	1972
Brownsville	Tennessee	4	474	2008	2008
Caledonia	Mississippi	3	768	2007	2007
Colbert	Alabama	8	384	1972	1972
Gallatin	Tennessee	8	636	1975	2000
Gleason	Tennessee	3	519	2007	2007
Johnsonville	Tennessee	20	1,218	1975	2000
Kemper	Mississippi	4	329	2001	2001
Lagoon Creek	Tennessee	12	1,009	2002	2002
Marshall County	Kentucky	8	659	2007	2007
Southaven	Mississippi	3	792	2008	2008
Total Combustion Turbine		93	7,266		
Diesel Generator					
Meridian	Mississippi	5	9	1998	1998
Albertville	Alabama	4	4	2000	2000
Total Diesel Generators		9	13		
Renewable Resources			3		
Total TVA Generating Facilities			33,925		

POWER PURCHASE AND OTHER AGREEMENTS	2,789
Total Summer Net Capability	**36,714**

Notes

(1) Net capability is defined as the ability of an electric system, generating unit, or other system component to carry or generate power for a specified time period.

(2) TVA estimated total winter net capability at September 30, 2008, to be approximately 37,085 megawatts, including hydroelectric capability of approximately 5,265 megawatts, coal-fired capability of approximately 14,870 megawatts, nuclear power capability of approximately 6,898 megawatts, combustion turbine capability of approximately 7,150 megawatts, diesel generator capability of approximately 13 megawatts, renewable assets capability of approximately three megawatts, and capability from power purchase agreements of approximately 2,886 megawatts. The difference in winter and summer net capability is primarily due to more efficient fossil fuel-fired and nuclear generation performance in cold weather.

(3) See Item 1, Business — *Power Supply — Generation Facilities — Combustion Turbine Facilities* , for a description of TVA-operated combustion turbine facilities.

Energy Efficiency Initiatives

On May 19, 2008, the TVA Board approved staff recommendations for an Energy Efficiency and Demand Response Plan. The plan seeks to slow the current rate of growth in the TVA service area's power demand by providing opportunities for residential, business, and industrial consumer groups to use energy more efficiently. TVA plans to work with the distributor customers to identify energy efficiency opportunities and to reduce peak demand. TVA is also expanding the ways it informs consumers about energy efficiency. In the short term, the plan proposes reducing the growth in peak demand by up to 1,400 megawatts by the end of the 2012.

Renewable and Clean Energy

In May 2008, the TVA Board adopted an Environmental Policy that establishes objectives of reducing load growth and meeting remaining load growth through lower carbon emitting energy sources, including affordable renewables. Clean energy is defined as coming from low and, effectively, zero-carbon emitting supply and demand-side options, including renewables, nuclear, combined heat and power, and energy efficiency.

Renewable energy comes from generation that is sustainable and includes:

- Wind generation;
- Solar generation;
- Landfill methane generation;
- Biomass cofiring;
- Dedicated biomass generation;
- Existing hydroelectric generation; and
- Incremental and low-impact hydroelectric generation.

In April 2000, TVA launched its Green Power Switch ® program. This program allows residential, commercial, and industrial customers to voluntarily buy "kwh blocks" of specific renewable generation (wind, solar, and digester gas). This was the first voluntary certified green pricing program offered in the southeast United States

Renewable and clean energy technologies are often considered collectively. However, they are largely unrelated technologically, each having its own developmental challenges such as intermittency and varying regional availability issues.

Technology advancements will be needed to address some of the operation issues associated with renewable energy, such as energy storage to address intermittency and interconnection technologies to address onsite, non-grid connected renewables and efficiencies.

Most renewable energy resources are geographically specific. Some regions of the Unites States have an abundance of wind and solar resources, whereas other regions have hydroelectric resources. Regional differences and limitations play a primary role in the types and amount of renewable and clean energy developed in areas across the country. Within the area served by TVA (southeast United States), two of the most abundant renewable sources are hydroelectric and biomass. Feasible wind energy in this region is primarily associated with mountain top and ridgeline installations, and the total potential capacity is limited when compared to other parts of the nation where wind energy is more abundant.

As of September 30, 2008, TVA's zero and near-zero carbon emitting sources included:

Zero or Low Carbon Emitting Generation Source	Site/Units	Megawatts
Nuclear generation	6 units	6,671.0
Conventional hydroelectric generation *	109 units	3,786.0
Wind power purchase agreement *	15 units	27.0
Methane gas at Allen Fossil Plant *	2 units	8.0
Biomass cofiring at Colbert Fossil Plant *	4 units	7.0
Landfill methane gas purchase agreements *	2 sites	5.9
Wind generation *	3 units	2.0
Solar photovoltaic *	15 sites	0.3
Total	156 units/sites	10,507.2

*Renewable generation

In May 2008, TVA completed a Renewable and Clean Energy Assessment ("Assessment") which estimated that by 2020 there could be 12,700 million kilowatt-hours of potential renewable resources in the Tennessee Valley. The Assessment determined that TVA's lowest-cost options for additional regional renewables include:

- Completion of the hydroelectric modernization program;
- Additional low level biomass cofiring;
- Additional hydroelectric units at existing dams;
- Landfill gas; and
- Wind.

In 2008, approximately 37 percent of TVA's generation was from clean energy sources. See Item 1, Business — *Environmental Matters — Renewables and Clean Energy*.

Nuclear

Overview

TVA has six operating nuclear units and has resumed construction of one nuclear unit that is scheduled to be placed in service in 2013. Selected statistics of each of these units are included in the table below.

TVA Nuclear Power
As of September 30, 2008

Nuclear Unit	Status	Installed Capacity (MW)	Net Capacity Factor for 2008	Date of Expiration of Operating License	Date of Expiration of Construction Permit
Sequoyah Unit 1	Operating	1,221	85.9	2020	–
Sequoyah Unit 2	Operating	1,221	89.5	2021	–
Browns Ferry Unit 1	Operating	1,150	92.1	2033	–
Browns Ferry Unit 2	Operating	1,190	96.6	2034	–
Browns Ferry Unit 3	Operating	1,190	71.6	2036	–
Watts Bar Unit 1	Operating	1,230	80.2	2035	–
Watts Bar Unit 2	Construction resumed in December 2007	–	–	–	2013

TVA began a significant nuclear plant construction program in 1966 to meet projected system load growth. At the height of its construction program, TVA had 17 units either under construction or in commercial operation at seven plant sites. In 1982, TVA canceled construction of four units because of lower than expected load growth, and TVA canceled four more units in 1984 for similar reasons.

By August 1985, TVA had delayed construction of two units each at Watts Bar and Bellefonte Nuclear Plants and had shut down its three-unit Browns Ferry Nuclear Plant ("Browns Ferry") and two-unit Sequoyah Nuclear Plant ("Sequoyah") because of an increasing number of technical and operational problems. The Nuclear Regulatory Commission ("NRC") required TVA to address program and management deficiencies and to provide its corrective actions to the NRC before restarting any of its licensed nuclear units or requesting a license for Watts Bar Nuclear Plant Unit 1 ("Watts Bar"). After implementing a comprehensive recovery plan, TVA restarted Sequoyah Unit 2 in May 1988 and Sequoyah Unit 1 in November 1988. TVA restarted Browns Ferry Unit 2 in May 1991 and Browns Ferry Unit 3 in November 1995. Construction of Watts Bar Unit 1 was successfully completed, and the unit commenced full power commercial operation in May 1996.

TVA is undertaking an Extended Power Uprate ("EPU") project at Browns Ferry which is expected to increase the amount of electrical generation by increasing the amount of steam produced by the reactors. This project is expected to result in approximately 125 megawatts of additional capability per unit as a result of operating the reactor at 120 percent of the original licensed thermal power. Additional fuel is added to the reactor during each refueling outage to support the increased steam production. The purpose of the EPU project is to complete modifications to the plant required to accommodate the increased steam flows and resulting electrical production. The NRC license for operating the reactor must be modified to allow reactor operation at the higher power level.

In November 2005, TVA canceled the construction of Units 1 and 2 at Bellefonte Nuclear Plant ("Bellefonte"). Two months prior to the cancellation of these units, the Bellefonte site was selected by NuStart Development LLC ("NuStart") as one of two sites for the development of a combined license application for two new reactors using the Westinghouse Advanced Passive 1000 ("AP1000") reactor design. NuStart is an industry consortium composed of 10 utilities and two reactor vendors whose purpose is to satisfactorily demonstrate the new NRC licensing process for advanced design nuclear plants. TVA submitted its combined operating license application ("COLA") to the NRC for Bellefonte Units 3 and 4 in October 2007, and it was accepted for detailed review by the NRC on January 18, 2008. If approved, the license to build and operate the plant would be issued to TVA. The NRC is expected to complete an evaluation of its COLA review schedule in December 2008 prior to making a decision as to the new schedule. The TVA Board has not made a decision to construct a new plant at the Bellefonte site, and TVA continues to evaluate all nuclear generation options at the site. As part of this evaluation, TVA asked the NRC in August 2008 to reinstate the construction permits for its two unfinished nuclear units also at the Bellefonte site. Reinstating the construction permits would allow TVA to place the units in a deferred status again with the NRC and would help TVA clarify the regulatory requirements and continue to evaluate the feasibility of using Bellefonte Units 1 and 2 to meet future base-load power demand.

On June 7, 2008, a joint petition in connection with TVA's COLA for Bellefonte Units 3 and 4 for intervention and a request for a hearing was submitted to the NRC by the Bellefonte Efficiency and Sustainability Team, the Blue Ridge Environmental Defense League, and the Southern Alliance for Clean Energy. The petitioners raised 19 contentions and subsequently added another with respect to TVA's COLA. Following TVA's and NRC's responses opposing the proposed contentions, the Atomic Safety and Licensing Board ("ASLB"), which is presiding over the proceeding, accepted four contentions submitted by two of the petitioners. A hearing on these admitted contentions will be conducted in the future. The admitted contentions involve questions about the estimated costs of the new nuclear plant, the storage of low-level radioactive waste, and the impact of the facility's operations, in particular the plant intake, on aquatic species.

On August 1, 2007, the TVA Board approved completing the construction of Watts Bar Unit 2. Prior to the approval, TVA conducted a detailed scoping, estimating, and planning study to estimate the project's cost, schedule, and risks. Separately, TVA prepared a report evaluating potential environmental impacts as required by the National Environmental Policy Act. TVA has an NRC construction permit for Watts Bar Unit 2 that expires in 2013. TVA will seek an operating license under NRC regulations, and this process will include an opportunity for a public hearing. Completing Watts Bar Unit 2 is expected to take approximately 60 months and cost approximately $2.5 billion, excluding an allowance for funds used during construction ("AFUDC") and the cost of the first core of fuel. When completed, Watts Bar Unit 2 is expected to provide 1,180 megawatts of summer net capability.

Spent Nuclear Fuel

Under the Nuclear Waste Policy Act of 1982, TVA (and other domestic nuclear utility licensees) entered into a contract with the U.S. Department of Energy ("DOE") for the disposal of spent nuclear fuel. Payments to DOE are based upon TVA's nuclear generation and charged to nuclear fuel expense. Although the contracts called for DOE to begin accepting spent nuclear fuel from the utilities by January 31, 1998, DOE announced that it would not begin receiving spent nuclear fuel from any domestic nuclear utility until 2010 at the earliest. TVA, like other nuclear utilities, stores spent nuclear fuel in pools of borated water at its nuclear sites. TVA would have had sufficient space to continue to store spent nuclear fuel in those storage pools at its Sequoyah and Browns Ferry Nuclear Plants indefinitely had DOE begun accepting spent nuclear fuel. DOE's failure to do so in a timely manner required TVA to construct dry cask storage facilities at its Sequoyah and Browns Ferry Nuclear Plants and to purchase special storage containers for the spent nuclear fuel. The Sequoyah and Browns Ferry dry cask storage facilities have been constructed and approved by the NRC and have been in use since 2004 and 2005, respectively, providing storage capacity through 2030 at Sequoyah and 2019 at Browns Ferry. Watts Bar has sufficient storage capacity in its spent fuel pool to last until approximately 2015.

To recover the cost of providing long-term, on-site storage for spent nuclear fuel, TVA filed a breach of contract suit against the United States in the Court of Federal Claims in 2001. In August 2006, the United States paid TVA almost $35 million in damages awarded by the Court of Federal Claims, which partially offset the construction costs of the dry cask storage facilities that TVA incurred through 2004. In September 2008, the United States paid TVA about $10.4 million for on-site spent nuclear fuel storage costs incurred during 2005. Additional claims will be reviewed from time-to-time.

Low-Level Radioactive Waste

Low-level radioactive waste ("radwaste") results from the normal operation of nuclear units and includes such materials as disposable protective clothing, mops, and filters. TVA contracted to dispose of such waste at a Barnwell, South Carolina, disposal facility through June 2008, when that facility closed to radwaste generators located in states that are not members of the Atlantic Interstate Low-Level Radioactive Waste Management Compact ("Atlantic Compact"). None of TVA's nuclear units are located in states that are members of the Atlantic Compact. Since June 2008, TVA has continued its practice of having certain types of radwaste processed and shipped to a disposal facility in Clive, Utah, and TVA is also storing some radwaste at its own facilities. TVA is capable of storing radwaste at its facilities for an extended period of time and has done so in the past.

Nuclear Decommissioning Trust

TVA maintains a nuclear decommissioning trust to provide funding for the ultimate decommissioning of its nuclear power plants. The trust is invested in securities generally designed to achieve a return in line with overall equity market performance. The assets of the trust as of September 30, 2008, totaled $845 million, which is less than the present value of TVA's estimated future nuclear decommissioning costs as computed under the NRC funding requirements and less than the present value of these costs as computed under Statement of Financial Accounting Standards No. 143, *"Accounting for Asset Retirement Obligations."* See Note 15 — *Contingencies — Decommissioning Costs* and Note 18 — *Impact of Recent Financial Market Conditions on Investment Portfolios.* If market conditions do not improve, additional funding may be required.

Nuclear Insurance

The Price-Anderson Act provides a layered framework of protection to compensate for losses arising from a nuclear event. For the first layer, all NRC nuclear plant licensees, including TVA, purchase $300 million of nuclear liability insurance from American Nuclear Insurers for each plant with an operating license. Funds for the second layer, the Secondary Financial Program, would come from an assessment of up to $112 million from the licensees of each of the 104 NRC licensed reactors in the United States. The assessment for any nuclear accident would be limited to $18 million per year per unit. American Nuclear Insurers, under a contract with the NRC, administers the Secondary Financial Program. With its six licensed units, TVA could be required to pay a maximum of $671 million per nuclear incident, but it would have to pay no more than $105 million per incident in any one year. When the contributions of the nuclear plant licensees are added to the insurance proceeds of $300 million, over $12 billion, including a five percent surcharge for legal expenses, would be available. Under the Price-Anderson Act, if the first two layers are exhausted, the U.S. Congress is required to take action to provide additional funds to cover the additional losses.

TVA carries property, decommissioning, and decontamination insurance of $4.6 billion for its licensed nuclear plants, with up to $2.1 billion available for a loss at any one site, to cover the cost of stabilizing or shutting down a reactor after an accident. Some of this insurance, which is purchased from Nuclear Electric Insurance Limited ("NEIL"), may require the payment of retrospective premiums up to a maximum of approximately $72 million.

TVA purchases accidental outage (business interruption) insurance for TVA's nuclear sites from NEIL. In the event that an accident covered by this policy takes a nuclear unit offline or keeps a nuclear unit offline, NEIL will pay TVA, after a waiting period, an indemnity (a set dollar amount per week) up to a maximum indemnity of $490 million per unit. This insurance policy may require the payment of retrospective premiums up to a maximum of approximately $30 million. See Note 15 — *Contingencies — Nuclear Insurance*.

Fuel Supply

General

TVA's consumption of various types of fuel depends largely on the demand for electricity by TVA's customers, the availability of various generating units, and the availability and cost of fuel. The following table indicates TVA's costs for various fuels for the years indicated:

Fuel Purchases for TVA-Owned Facilities
For the years ended September 30
(in millions)

	2008	2007	2006	2005	2004
Coal	$ 2,110	$ 1,922	$ 1,835	$ 1,495	$ 1,254
Natural gas	131	62	60	63	22
Fuel oil	61	22	46	28	17
Uranium	71	121	71	44	16
Total	$ 2,373	$ 2,127	$ 2,012	$ 1,630	$ 1,309

TVA also has tolling agreements under which it buys power production from outside suppliers. Under these tolling agreements, TVA supplies the fuel to the outside supplier, and the outsider supplier converts the fuel into electricity. The following table indicates the cost of fuel supplied by TVA under these agreements and also the average fuel expense per kilowatt-hour for the years indicated:

Natural Gas Purchases for Tolling Plants
For the years ended September 30

	2008	2007	2006	2005	2004
Cost of Fuel (in millions)	$ 457	$ 430	$ 288	$ 159	$ 10
Average Fuel Expense (cents/kWh)	12.26	5.51	6.07	6.21	4.71

Due to rising commodity prices across domestic and international markets, TVA experienced increased costs in short-term markets for natural gas, fuel oil, coal, and electricity during 2008. Market prices for these commodities at September 30, 2008, and 2007, are shown below.

Commodity Pricing Table
As of September 30

Commodity	2008	2007	Percent Increase
Natural Gas (Henry Hub, $/mmBtu)	$ 9.01	$ 6.87	31%
Fuel Oil (Gulf Coast, $/mmBtu)	21.38	12.97	65%
Coal (FOB mine, $/ton)	48.13	29.65	62%
Electricity (Into-TVA, $/MWh)	70.95	58.03	22%

Since September 30, 2008, the market prices for all of these commodities except for coal have fallen. Market prices for these commodities at November 30, 2008, and September 30, 2008, are shown below.

Commodity Pricing Table

Commodity	Prices As of November 30, 2008	Prices As of September 30, 2008	Percent Change
Natural Gas (Henry Hub, $/mmBtu)	$ 6.71	$ 9.01	(26)%
Fuel Oil (Gulf Coast, $/mmBtu)	12.20	21.38	(43)%
Coal (FOB mine $/ton)	58.76	48.13	22 %
Electricity (Into-TVA, $/MWh)			
On-Peak (5 days x 16 hours)	38.00	70.95	(46)%
Off-Peak (5 days x 8 hours)	34.75	38.40	(10)%

Although the FCA provides a mechanism to modify rates on a quarterly basis to recover changing fuel and purchased power costs, there is a lag between the occurrence of a change in fuel and purchased power costs and the reflection of the change in rates. As a result, TVA's cash flows can be negatively affected by the FCA. As of September 30, 2008, TVA had approximately $28 million in deferred fuel and purchased power costs that are expected to be recovered through the FCA in future periods. See Item 1, Business — *Rate Actions.*

Coal

Coal consumption at TVA's coal-fired generating facilities during 2008 was 46.3 million tons. As of September 30, 2008, and 2007, TVA had 26 days and 23 days of system-wide coal supply at full burn, respectively, with a net book value of coal inventory of $303 million and $264 million, respectively.

TVA utilizes both short-term and long-term coal contracts. Long-term coal contracts generally last longer than one year, while short-term contracts are usually for one year or less. During 2008, long-term contracts made up 93 percent of coal purchases and short-term contracts accounted for the remaining seven percent. TVA plans to continue signing contracts of various lengths, terms, and coal quality to meet its expected burn and inventory requirements. During 2008, TVA purchased coal by basin as follows:

- 35 percent from the Illinois Basin;
- 27 percent from the Powder River Basin in Wyoming;
- 21 percent from the Uinta Basin of Utah and Colorado; and
- 17 percent from the Appalachian Basin of Kentucky, Pennsylvania, Tennessee, Virginia, and West Virginia.

Total system coal inventories were at or above target levels for most of 2008. During 2008, 42 percent of TVA's coal supply was delivered by rail, 19 percent was delivered by barge, and 33 percent was delivered by a combination of barge and rail. The remainder was delivered by truck.

Natural Gas and Fuel Oil

During 2008, TVA purchased substantially all of its natural gas requirements from a variety of suppliers under contracts with terms of one year or less. TVA purchases substantially all of its natural gas to operate combustion turbine peaking units and to supply fuel under power purchase agreements in which TVA is the fuel supplier. At September 30, 2008, all but two of TVA's combustion turbine plants were dual fuel capable, and TVA has fuel oil stored on each site for its dual fuel combustion turbines as a backup to natural gas.

During 2008, TVA purchased substantially all of its fuel oil on the spot market. At September 30, 2008, and 2007, the net book value of TVA's natural gas in inventory was $12 million and $3 million, respectively, and the net book value of TVA's fuel oil in inventory was $66 million and $50 million, respectively.

Nuclear Fuel

Converting uranium to nuclear fuel generally involves four stages: the mining and milling of uranium ore to produce uranium concentrates; the conversion of uranium concentrates to uranium hexafluoride gas; enrichment of uranium hexafluoride; and the fabrication of the enriched uranium hexafluoride into usable fuel assemblies. TVA currently has 100 percent of its forward three-year (2009 through 2011) uranium mining and milling requirements either in inventory or under contract for its boiling water reactor units at Browns Ferry Nuclear Plant and has 100 percent of its forward three-year (2009 through 2011) uranium requirements under contract for its pressurized water reactor units at Sequoyah and Watts Bar Nuclear Plants. In addition, TVA has 100 percent of its conversion, enrichment, and fabrication needs under contract through 2011. Beyond 2011, TVA anticipates being able to fill its needs by normal bidding processes for fuel cycle components as market forecasts indicate that the fuel cycle components will be readily available.

TVA, DOE, and some nuclear fuel contractors have entered into agreements that provide for the blending down of surplus DOE highly enriched uranium (uranium that is too highly enriched for use in a nuclear power plant) with other uranium. Under these agreements, the enriched uranium that results from this blending process, which is called blended low enriched uranium ("BLEU"), is fabricated into fuel that can be used in a nuclear power plant. This blended nuclear fuel was first loaded in a Browns Ferry reactor in 2005 and is expected to continue to be used to reload the Browns Ferry reactors through 2014. BLEU fuel was first loaded into Sequoyah Unit 2 in May 2008 and will be loaded again in 2009 and 2011.

Under the terms of an interagency agreement between DOE and TVA, in exchange for supplying highly enriched uranium materials for processing into usable BLEU fuel for TVA, DOE will participate to a degree in the savings generated by TVA's use of this blended nuclear fuel. TVA anticipates these future payments could begin in 2010 and last until 2014. See Note 1 — *Blended Low Enriched Uranium Program* for a more detailed discussion of the BLEU project.

TVA owns all nuclear fuel held for its nuclear plants. As of September 30, 2008, and 2007, the net book value of this nuclear fuel was $722 million and $602 million, respectively.

For a discussion of TVA's plans with respect to spent nuclear fuel storage, see Item 1, Business — *Nuclear — Spent Nuclear Fuel* .

Transmission

The TVA transmission system is one of the largest in North America. TVA's transmission system has interconnections with 13 neighboring electric systems, and delivered more than 176 billion kilowatt-hours of electricity to Tennessee Valley customers in 2008. The TVA Act gives TVA overall responsibility for grid reliability in the TVA service area. To that end, TVA has operated with 99.999 percent reliability over the last nine years in delivering electricity to customers. Any changes to the TVA Act which alter TVA's authority to operate and control the transmission system could negatively impact reliability in the region. See Item 1A, Risk Factors — *Strategic Risks.*

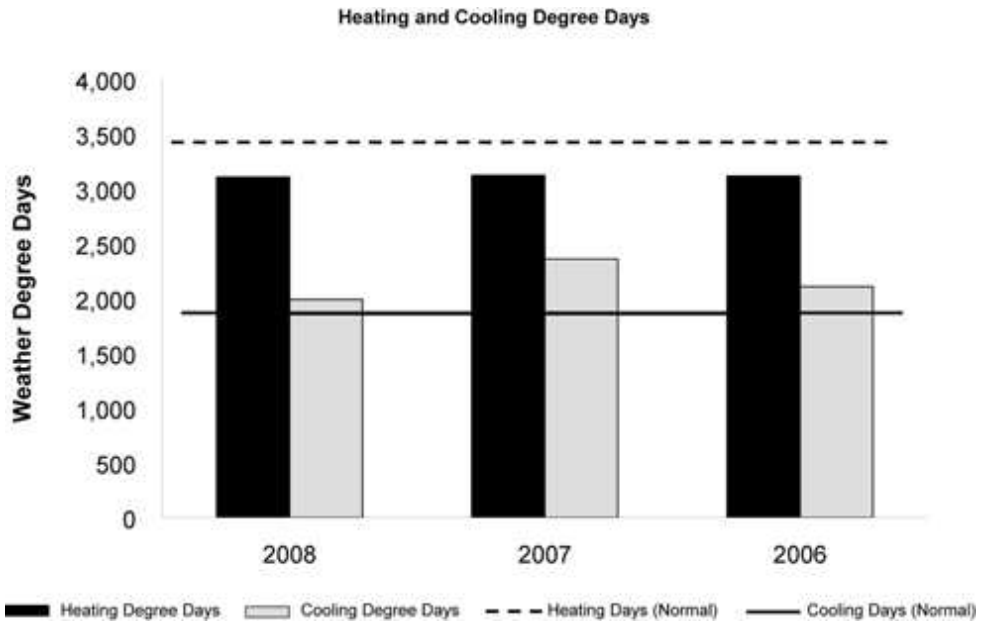
To the extent federal law allows access to the TVA transmission system, the TVA transmission organization offers transmission services to others to transmit power at wholesale in a manner that is comparable to TVA's own use of the transmission system. TVA has also adopted and operates in accordance with a published Standards of Conduct for Transmission Providers and appropriately separates its transmission functions from its marketing functions.

Weather and Seasonality

Weather affects both the demand for and the market prices of electricity. TVA's power system generally peaks in the summer, with a slightly lower peak in the winter. TVA met its highest winter peak demand of 32,027 megawatts on January 25, 2008. See Item 1A, Risk Factors, for a discussion of the potential impact of weather on TVA.

TVA uses weather degree days to measure the impact of weather on TVA's power operations. Weather degree days measure the extent to which average temperatures in the five largest cities in TVA's service area vary from 65 degrees Fahrenheit. TVA calculates weather degree days for Memphis, Nashville, Knoxville, and Chattanooga, Tennessee, and Huntsville, Alabama — the five largest cities in TVA's service area.

During 2008, TVA had 14 less heating degree days and 371 less cooling degree days than in 2007. The graph below shows the number of heating and cooling degree days for 2008, 2007, and 2006 as compared to the normal number of heating and cooling degree days. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008 — Weather Conditions.*



2008 was the ninth driest year in the eastern Tennessee Valley in 119 years of record-keeping with rainfall 76 percent of normal for the year and runoff 47 percent of normal. Largely as a result of this low rainfall and runoff, TVA's hydroelectric production for 2008 was slightly less than 6.7 billion kilowatt-hours, which was 26 percent, 33 percent, and 57 percent lower than 2007, 2006, and 2005, respectively.

The hot weather and low rainfall were also significant factors in causing TVA to reduce output at several generating plants during the period of mid-June through mid-September of 2008. During this period, temperatures on the Tennessee and Cumberland Rivers reached levels at which discharging cooling water from some of TVA's plants into the rivers could have caused the permitted thermal limits for the rivers to be exceeded. While every effort was made to reduce (derate) electrical output during low load periods to reduce financial and operational impacts, some derates were required during higher load daytime hours to meet the permitted temperature limits. These conditions caused TVA to rely more heavily on purchased power and more expensive generation sources such as combustion turbines during 2008. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary —Challenges During 2008 — Weather Conditions* .

Competition

TVA sells electricity in a service area that is largely free of competition from other electric power providers. This service area is defined primarily by two provisions of law: one called the "fence" and one called the "anti-cherrypicking" provision. The fence limits the region in which TVA or distributors of TVA power may provide power. The anti-cherrypicking provision limits the ability of others to use the TVA transmission system for the purpose of serving customers within TVA's service area. Bristol, Virginia, was exempted from the anti-cherrypicking provision.

There have been efforts to erode the protection of the anti-cherrypicking provision. FERC issued an order that would have required TVA to interconnect its transmission system with the transmission system of East Kentucky Power Cooperative, Inc. ("East Kentucky") in what TVA believed was a violation of the anti-cherrypicking provision. See Item 3, Legal Proceedings. Additionally, Senators Jim Bunning and Mitch McConnell introduced the Access to Competitive Power Act of 2007 in the Senate that would, among other things, provide that the anti-cherrypicking provision would not apply with respect to any distributor which provided a termination notice to TVA before December 31, 2006, regardless of whether the notice was later withdrawn or rescinded. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Legislative and Regulatory Matters* . While the FERC action involving East Kentucky is moot and the proposed legislation has not made it to the Senate floor, the events illustrate how the protection to TVA's service area provided by the anti-cherrypicking provision could be called into question and perhaps eliminated at some time in the future.

Research and Development

TVA invests in science and technological innovation to inform decision making and improve operational and environmental performance. TVA's research and development activities are leveraged through partnerships with the Electric Power Research Institute, Department of Energy, Oak Ridge National Laboratory, other utilities, and universities. Examples of ongoing work include projects for energy efficiency, renewables, and clean energy, as well as projects to increase efficiency and reliability of existing generation and transmission assets, reduce fossil fuel plant emissions, reduce energy consumption, and evaluate new and proposed generation options. During 2008, TVA spent $21 million on research and development activities. See Note 1 — *Research and Development Costs.*

Governance

TVA is governed by the TVA Board. The Consolidated Appropriations Act, 2005, amended the TVA Act by restructuring the TVA Board from three full-time members to nine part-time members, at least seven of whom must be legal residents of the TVA service area. TVA Board members are appointed by the President of the United States with the advice and consent of the U.S. Senate. After an initial phase-in period, TVA Board members serve five-year terms, and at least one member's term ends each year. The TVA Board, among other things, establishes broad goals, objectives, and policies for TVA; establishes long-range plans to carry out these goals, objectives, and policies; approves annual budgets; and establishes a compensation plan for employees. To allow TVA to operate more flexibly than a traditional government agency, Congress exempted TVA from some general federal laws that govern other agencies, such as the federal labor relations laws and the civil service laws related to the hiring of federal employees, the procurement of supplies and services, and the acquisition of land. Other federal laws enacted since the creation of TVA have been made applicable to TVA including those related to paying employees overtime, the protection of the environment, cultural resources, and civil rights laws. Information about members of the TVA Board and TVA's executive officers is discussed in Item 10, Directors, Executive Officers and Corporate Governance.

Regulation

Congress

TVA exists pursuant to legislation enacted by Congress and carries on its operations in accordance with this legislation. Congress can enact legislation expanding or reducing TVA's activities, change TVA's structure, and even eliminate TVA. Congress can also enact legislation requiring the sale of some or all of the assets TVA operates or reduce the United States' ownership in TVA. To allow TVA to operate more flexibly than a traditional government agency, Congress exempted TVA from some general federal laws that govern other agencies, such as federal labor relations laws and the civil service laws related to the hiring of federal employees, the procurement of supplies and services, and the acquisition of land. Other federal laws enacted since the creation of TVA have been made applicable to TVA, including those related to paying employees overtime, the protection of the environment, cultural resources, and civil rights.

Securities and Exchange Commission

Section 37 was added to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as part of the Consolidated Appropriations Act, 2005. Section 37 requires TVA to file with the SEC such periodic, current, and supplementary information, documents, and reports as would be required pursuant to section 13 of the Exchange Act if TVA were an issuer of a security registered pursuant to section 12 of the Exchange Act. Section 37 of the Exchange Act exempts TVA from complying with section 10A(m)(3) of the Exchange Act, which requires each member of a listed issuer's audit committee to be an independent member of the board of directors of the issuer. Since TVA is an agency and instrumentality of the United States, securities issued or guaranteed by TVA are "exempted securities" under the Securities Act of 1933, as amended (the "Securities Act"), and may be offered and sold without registration under the Securities Act.

In addition, securities issued or guaranteed by TVA are “exempted securities” and “government securities” under the Exchange Act. TVA is also exempt from sections 14(a)-(d) and 14(f)-(h) of the Exchange Act (which address proxy solicitations) insofar as those sections relate to securities issued by TVA, and transactions in TVA securities are exempt from rules governing tender offers under Regulation 14E of the Exchange Act. Also, since TVA securities are exempted securities under the Securities Act, TVA is exempt from the Trust Indenture Act of 1939 insofar as it relates to securities issued by TVA, and no independent trustee is required for these securities.

Federal Energy Regulatory Commission

Under the FPA, TVA is not a “public utility,” a term which generally includes investor-owned utilities. Therefore, TVA is not subject to the full jurisdiction that FERC exercises over public utilities under the FPA. TVA is, however, an “electric utility” as defined in the FPA and, thus, is directly subject to certain aspects of FERC’s jurisdiction.

- Under section 210 of the FPA, TVA can be ordered to interconnect its transmission facilities with the electrical facilities of qualified generators and other electric utilities that meet certain requirements. It must be found that the requested interconnection is in the public interest and would encourage conservation of energy or capital, optimize efficiency of facilities or resources, or improve reliability. The requirements of section 212 concerning the terms and conditions of interconnection, including reimbursement of costs, must also be met.

- Under section 211 of the FPA, TVA can be ordered to transmit power at wholesale provided that the order does not impair the reliability of the TVA or surrounding systems and likewise meets the applicable requirements of section 212 concerning terms, conditions, and rates for service. Under section 211A of the FPA, TVA is subject to FERC review of the transmission rates and the terms and conditions of service that TVA provides others to ensure comparability of treatment of such service with TVA’s own use of its transmission system. With the exception of wheeling power to Bristol, Virginia, the anti-cherrypicking provision of the FPA precludes TVA from being ordered to wheel another supplier’s power to a customer if the power would be consumed within TVA’s defined service territory.

- Sections 221 and 222 of the FPA, applicable to all market participants, including TVA, prohibit (i) using manipulative or deceptive devices or contrivances in connection with the purchase or sale of power or transmission services subject to FERC’s jurisdiction and (ii) reporting false information on the price of electricity sold at wholesale or the availability of transmission capacity to a federal agency with intent to fraudulently affect the data being compiled by the agency.

- Section 206(e) of the FPA provides FERC with authority to order refunds of excessive prices on short-term sales (transactions lasting 31 days or less) by all market participants, including TVA, in market manipulation and price gouging situations if such sales are under a FERC-approved tariff.

- Section 220 of the FPA provides FERC with authority to issue regulations requiring the reporting, on a timely basis, of information about the availability and prices of wholesale power and transmission service by all market participants, including TVA.

- Under sections 306 and 307 of the FPA, FERC may investigate electric industry practices, including TVA’s operations previously mentioned that are subject to FERC’s jurisdiction.

- Under sections 316 and 316A of the FPA, FERC has authority to impose criminal penalties and civil penalties of up to $1 million a day for each violation on entities subject to the provisions of Part II of the FPA, which includes the above provisions applicable to TVA.

Finally, while not required to do so, TVA has elected to implement various FERC orders and regulations pertaining to public utilities on a voluntary basis to the extent that these are consistent with TVA’s obligations under the TVA Act.

For a discussion of legislation that could change FERC’s ability to regulate TVA, see Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations — *Legislative and Regulatory Matters* .

Nuclear Regulatory Commission

TVA operates its nuclear facilities in a highly regulated environment and is subject to the oversight of the NRC, an independent agency which sets the rules that users of radioactive materials must follow. The NRC has broad authority to impose requirements relating to the licensing, operation, and decommissioning of nuclear generating facilities. In addition, if TVA fails to comply with requirements promulgated by the NRC, the NRC has the authority to impose fines, shut down units, or modify, suspend, or revoke TVA's operating licenses.

Environmental Protection Agency

TVA is subject to regulation by the Environmental Protection Agency ("EPA") in a variety of areas, including air quality control, water quality control, and management and disposal of hazardous wastes. See Item 1, Business — *Environmental Matters.*

States

The Supremacy Clause of the U.S. Constitution prohibits states, without congressional consent, from regulating the manner in which the federal government conducts its activities. As a federal agency, TVA is exempt from regulation, control, and taxation by states except in certain areas such as air and water quality where Congress has given the states limited powers to regulate federal activities.

Other Federal Entities

TVA's activities and records are also subject to review to varying degrees by other federal entities, including TVA's Office of Inspector General and the following agencies: the Government Accountability Office, the Congressional Budget Office, and the Office of Management and Budget.

Payments in Lieu of Taxes

TVA is not subject to federal income taxes, and neither TVA nor its property, franchises, or income is subject to taxation by states or their subdivisions. However, the TVA Act requires TVA to make tax equivalent payments to states and counties in which TVA conducts power operations and in which TVA has acquired properties previously subject to state and local taxation. The total amount of these payments is five percent of gross revenues from the sale of power during the preceding year excluding sales or deliveries to other federal agencies and off-system sales with other utilities, with a provision for minimum payments under certain circumstances. Except for certain direct payments TVA is required to make to counties, distribution of tax equivalent payments within a state is determined by individual state legislation.

Environmental Matters

TVA's power generation activities, like those across the utility industry and in other industrial sectors, are subject to federal, state, and local environmental laws and regulations. Major areas of regulation affecting TVA's activities include air quality control, water quality control, and management and disposal of solid and hazardous wastes. Looking to the future, regulations in all of these areas are expected to become more stringent along with increased emphasis on dealing with climate change, expanding renewable generation alternatives, and encouraging efficient use of electricity.

Due to the increasing level and complexity of environmental requirements and expectations, TVA completed a new high-level environmental policy to align with and execute the direction in the Strategic Plan. The Environmental Policy ("Environmental Policy") was approved by the TVA Board on May 19, 2008, and is intended to be an integrated framework which provides policy-level guidance to carry out TVA's mission of providing cleaner, affordable energy, sustainable economic development, and proactive environmental stewardship. The TVA Environmental Policy sets out environmental objectives and critical success factors in six environmental dimensions: climate change mitigation, air quality improvement, water resource protection and improvement, waste minimization, sustainable land use, and natural resource management.

TVA has incurred, and expects to continue to incur, substantial capital and operating and maintenance costs to comply with evolving environmental requirements primarily associated with, but not limited to, the operation of TVA's 59 coal-fired generating units. It is virtually certain that environmental requirements placed on the operation of TVA's coal-fired and other generating units will continue to become more restrictive. Litigation over emissions from coal-fired generating units is also occurring, including litigation against TVA. See Item 3, Legal Proceedings .

Air Quality Control Developments

Air quality in the United States and in the Tennessee Valley has significantly improved since the enactment of the Clean Air Act ("CAA") in 1970. These air quality improvements are expected to continue as the CAA continues to be implemented and evolve as a result of legislative and regulatory changes. Three substances emitted from coal-fired units — sulfur dioxide ("SO_2"), oxides of nitrogen ("NO_x"), and particulates — have historically been the focus of CAA emission reduction regulatory programs, and these are discussed in more detail below.

Expenditures related to clean air projects aimed at controlling emissions of these substances during 2008 and 2007 were approximately $274 million and $239 million, respectively. These figures include expenditures in 2008 of $9 million to continue to reduce NO_x emissions through the installation of selective non-catalytic reduction ("SNCR") systems, and $240 million for the installation of flue gas desulfurization systems ("scrubbers") to continue to reduce SO_2 emissions. TVA had previously estimated its total capital cost for reducing emissions from its power plants from 1977 through 2010 would reach $5.5 billion, $5.1 billion of which had already been spent as of September 30, 2008. TVA estimates that compliance with future CAA requirements and potential mercury regulations, but not including carbon dioxide ("CO_2"), as discussed below could lead to additional costs of $3.0 billion to $3.7 billion in the decade beginning in 2011. There could be additional material costs if reductions of greenhouse gases, including CO_2, are mandated under the CAA or via legislation, or if future legislative, regulatory, or judicial actions lead to more stringent emission reduction requirements for conventional pollutants. These costs cannot reasonably be predicted at this time.

On July 11, 2008, the U.S. Court of Appeals for the D.C. Circuit ("D.C. Circuit") issued a decision in *State of North Carolina vs. EPA* that vacated the Clean Air Interstate Rule ("CAIR") in its entirety and directed the EPA to promulgate a new rule that is consistent with the D.C. Circuit opinion. EPA promulgated CAIR in 2005 and the rule required significant additional utility SO_2 and NO_x emission reductions to address ozone and fine particulate matter attainment issues in 28 eastern states, including all of TVA's operating area, and the District of Columbia. The requirements of CAIR formed the basis for TVA's (and much of the utility industry's) planning with regard to air emission controls beginning in 2009 and continuing well into the next decade. In the absence of CAIR, the uncertainty regarding compliance requirements, methods, and timelines may result in increased capital expenditures and operating expenses. In addition, it is unclear whether the petitions for a re-hearing or review of this decision will be granted by the D.C. Circuit, which could prolong the uncertainty of the regulatory landscape.

In the absence of CAIR, other requirements of the CAA, such as achievement of ozone and fine particulate ambient air quality standards, requirements relating to regional haze, and control of interstate transport of air pollution (Section 126 petitions), will continue to drive installation of additional controls on electric generating units across the industry, including at TVA. As discussed in more detail below, TVA will continue its previously announced emissions reduction program, including completion of scrubber installations for SO_2 control at Bull Run, Kingston, and John Sevier Fossil Plants, and annual operation of the 21 selective catalytic reduction ("SCR") and other NO_x controls beginning in October 2008.

On February 8, 2008, the D.C. Circuit vacated the EPA's decision to remove coal and oil-fired Electric Generating Units from the list of stationary sources whose hazardous air pollutant ("HAP") emissions are subject to Maximum Achievable Control Technology ("MACT") standards under section 112 of the CAA. The D.C. Circuit also vacated and remanded the Clean Air Mercury Rule ("CAMR") which set mercury limits via a cap-and-trade program. Unless the D.C. Circuit's ruling is reversed, or EPA is able to determine that mercury emissions are adequately controlled in accordance with the D.C. Circuit's remand instructions, EPA will have to regulate mercury emissions from utilities under section 112(d) of the CAA, setting MACT standards for emissions based on command and control type requirements. The cost to comply with the MACT standards is not known, but is expected to be higher than the cost would have been to comply with CAMR. Regardless of the status of the EPA's regulatory program for mercury, TVA will continue to reduce mercury emissions from its coal-fired power plants. Over the next five years, mercury emissions from its coal-fired plants are expected to continue to decline, primarily as a result of the co-benefits received from the controls TVA is installing to reduce SO_2 and NO_x emissions.

The D.C. Circuit's recent decisions with regard to CAIR and CAMR may also have the effect of reviving interest in Congress in adopting multi-pollutant control legislation focused on the electric power sector. Among other things, such an approach could seek to establish coordinated caps for power plant emissions of mercury, SO_2, NO_x, and CO_2. The legislative and regulatory landscape is continuing to change for these and other issues and the outcome cannot be predicted accurately at this time.

Sulfur Dioxide. Utility SO_2 emissions are currently regulated under the Federal Acid Rain Program and state programs designed to meet the National Ambient Air Quality Standards ("NAAQS") for SO_2 and fine particulate matter. Looking forward, these programs, as well as implementation of the regional haze program, will result in additional regulation of SO_2 emissions.

Through calendar year 2007, TVA had reduced its SO_2 emissions by 84 percent from the peak 1977 level by switching to lower-sulfur coals, continuing to operate an Atmospheric Fluidized Bed Combustion ("AFBC") unit at its Shawnee Fossil Plant, operating existing scrubbers on six larger units, and installing and operating a scrubber on an additional large unit at Paradise Fossil Plant. TVA is constructing a scrubber at Bull Run Fossil Plant, which is scheduled to begin operation in 2009, and two scrubbers at its Kingston Fossil Plant, which are scheduled to begin operation in 2010. In April 2008, the TVA Board approved construction of additional flue gas desulfurization equipment at the four-unit John Sevier Fossil Plant in east Tennessee ("John Sevier"), which is expected to begin operation in 2012. Additionally, TVA has switched, or plans to switch, to lower-sulfur coal at several additional units in the next few years. It is likely that additional emission reduction measures will have to be undertaken in addition to these announced actions to achieve compliance with requirements yet to be adopted. Such measures will also help to meet the goal identified in TVA's Environmental Policy to reduce emissions by continuing to install emission reduction equipment and new technology with the aim of controlling over 80 percent of fossil generation in the next 10 years.

Nitrogen Oxides. Utility NO_x emissions continue to be regulated under state programs to achieve and maintain EPA's NAAQS for ozone and fine particles, the Federal Acid Rain Program, and the regional haze program. On March 12, 2008, EPA issued final rules adopting new, more stringent NAAQS for ozone. EPA lowered the primary standard, created to protect public health with an adequate margin of safety, from 0.084 parts per million ("ppm") to 0.075 ppm. EPA also promulgated a new secondary standard, mainly created to protect vegetation. The form and level of the secondary standard are the same as the primary standard.

In 2009, states will have to recommend to EPA those counties proposed to be designated as "non-attainment" counties under the new standards, and in 2010, EPA is expected to finalize attainment designations using 2006 to 2008 monitoring data. States must submit plans to EPA no later than 2013 that demonstrate attainment with the standard. Areas must reach attainment by deadlines that vary (2013 to 2030) depending on the severity of the ozone problem.

Based on 2005-2007 monitoring data, virtually all of the larger cities in the Tennessee Valley area and their associated Metropolitan Statistical Areas, as well as those rural counties where ozone monitors are present, will likely be designated as non-attainment areas under the new standard.

Non-attainment designation can impact industrial development and expansion since new businesses tend to avoid non-attainment areas, and expansion of existing businesses becomes more difficult. Non-attainment can have serious repercussions for counties by increasing costs to industry, delaying the air permitting process, and restricting expansion of existing sources. Consumers are also likely to be affected as a result of the institution of vehicle inspection and fuel restriction programs. Non-attainment can also impact transportation planning since loss of federal highway funds can occur unless projects demonstrate "conformity" with the new standards.

TVA contributes to ambient ozone levels primarily as a result of NO_x emissions from fossil-fired power plants. As a result of its emission reduction program, TVA's summertime NO_x emissions have declined substantially. Since 1995, TVA has reduced its NO_x emissions during the summer (when ozone levels increase) by 82 percent by installing various controls, including low-NO_x burners and/or combustion controls, on 58 of its 59 coal-fired units and installing SCRs on 21 of the largest units. (The AFBC unit at Shawnee Fossil Plant is inherently low NO_x emitting.)

In 2005, TVA installed SNCR systems, which generally have lower NO_x removal capabilities than SCRs, on two units, Johnsonville Unit 1 and Shawnee Unit 1, to demonstrate long-term technology capability, and continues to operate the SNCR at Johnsonville Unit 1 in West Tennessee. In 2007, TVA began operating the High Energy Reagent Technology ("HERT") system on Unit 1 at John Sevier, and on Unit 4 at Johnsonville Fossil Plant ("Johnsonville"). HERT is similar to SNCR technology but has higher removal capabilities. Similar HERT equipment is planned for installation on the other three John Sevier units and Johnsonville Units 2 and 3 by May 2009, and TVA has announced plans to install SCRs at John Sevier by 2015.

TVA's NO_x emission reduction program is expected to continue to depend primarily on SCRs, but will also incorporate some mix of SNCRs and/or HERTs as TVA gains more experience with these technologies. These plans may change depending on the timing and severity of future regulatory developments affecting power plant emissions. In October 2008, TVA began operating this NO_x control equipment year round (except for maintenance outages).

An increase in the number of counties in the Tennessee Valley designated as non-attainment areas is likely to focus additional regulatory attention on all NO_x emission sources, including TVA sources.

Particulates/Opacity. Coarse particulates (defined as particles of 10 micrometers or larger), which include fly ash, have long been regulated by states to meet EPA's NAAQS for particulate matter. All of TVA's coal-fired units have been equipped with mechanical collectors, electrostatic precipitators, scrubbers, or baghouses, which have reduced particulate emissions from the TVA system by more than 99 percent compared to uncontrolled units. In 1997, EPA issued separate NAAQS for even smaller particles with a size of up to 2.5 micrometers ("fine particles" or "$PM_{2.5}$"). Counties and parts of counties in the Knoxville and Chattanooga, Tennessee, metropolitan areas have been designated as non-attainment areas under the 1997 standard.

In September 2006, EPA revised the 1997 standards. The 2006 revisions tighten the 24-hour fine particle standard and retain the 1997 annual fine particle standard. EPA also decided to retain the existing 24-hour standard for coarse particles, but revoked the related annual standard. On August 19, 2008, EPA sent letters to state and tribal representatives responding to their initial recommendations for areas meeting and not meeting the 24-hour national ambient air quality standards for $PM_{2.5}$. States and tribes now have the opportunity to comment on EPA's modifications to their recommendations and to provide new information and analyses to EPA if appropriate. Several counties and parts of counties in the Tennessee Valley that include or are close to TVA coal-fired generating plants are included in this preliminary designation. Particular areas of concern to TVA are the Kentucky counties of Muhlenberg and McCracken, the Tennessee counties of Humphreys, Montgomery, and Stewart, and the counties in the Knoxville area. EPA has announced plans to make final designations in December 2008 using air quality monitoring data from 2005, 2006, and 2007. TVA will continue efforts to reduce emissions and engage regional and national stakeholders to further understand and improve regional air quality. TVA's continued installations of scrubbers for SO_2 control and SCRs and other technologies for NO_x control as described above are expected to continue to reduce fine particle levels.

Issues regarding utility compliance with state opacity requirements are also increasing. Opacity measures the denseness (or color) of power plant plumes and has traditionally been used by states as a means of monitoring good maintenance and operation of particulate control equipment. Under some conditions, retrofitting a unit with additional equipment to better control SO_2 and NO_x emissions can adversely affect opacity performance, and TVA and other utilities are addressing this issue. There are also disputes and lawsuits over the role of continuous opacity monitors in determining compliance with opacity limitations, and TVA has received an adverse decision in one such lawsuit. See Item 3, Legal Proceedings.

Climate Change. In 1995, TVA was the first utility in the nation to participate in "Climate Challenge," a DOE-sponsored voluntary greenhouse gas reduction program. Over the past decade, TVA has reduced, avoided, or sequestered over 305 million tons of CO_2 under this program. TVA also participates in the President's Climate VISION program which calls on the electric utility sector, along with other industry sectors, to help meet a national goal of reducing the greenhouse intensity of the U.S. economy by 18 percent from 2002 to 2012.

TVA has taken and is continuing to take significant voluntary steps that will reduce the carbon intensity of its electric generation, including the recovery of Browns Ferry Unit 1, planned power up-rates of Browns Ferry Units 1, 2 and 3 (which will increase the generating capability of the units resulting in additional avoided emissions of CO_2), the completion of Watts Bar Unit 2, and the completion of the hydroelectric modernization program. TVA has also filed with the NRC a combined operating license application for two advanced nuclear reactors at the Bellefonte Nuclear Plant near Hollywood, Alabama, and requested that the NRC reinstate the construction permit for Bellefonte Nuclear Units 1 and 2, although no decision has been made to complete those units or to build the new reactors. TVA is also committed to increasing its renewable energy by adding regional renewable energy sources to its generation portfolio.

In addition, TVA is a member of the Southeast Regional Carbon Sequestration Partnership and is working with the Electric Power Research Institute and other electric utilities on projects investigating technologies for CO_2 capture and geologic storage, as well as carbon sequestration via reforestation. Legislation was introduced in the last Congress to require reductions of CO_2 that, if enacted, could have resulted in significant additional costs for TVA and other utilities with coal-fired generation. In general, any carbon legislation will result in some level of increase in the price of electricity to consumers, regardless of form, severity, and timing of the legislation, and TVA's analyses of previous versions of several proposed climate bills indicate that the price increases could be substantial. These analyses also show that TVA's existing coal-fired generating assets will continue to play an important role in meeting the energy needs of the Tennessee Valley. TVA expects that the next Congress and Administration will again take up the issue of climate change and is incorporating the possibility of mandatory carbon reductions and a renewable portfolio standard into its long range planning. TVA will continue to monitor legislative and regulatory developments related to CO_2 and a renewable portfolio standard to assess any potential financial and operational impacts as information becomes available. Looking ahead, TVA's Environmental Policy contains a Climate Change Mitigation objective to stop the growth in volume of emissions and reduce the rate of carbon emissions by 2020.

In addition to legislative activity, climate change issues are the subject of a number of lawsuits, including lawsuits against TVA. See Item 3, Legal Proceedings. On November 29, 2006, the U.S. Supreme Court heard the case of *Massachusetts v. EPA* , concerning whether EPA has the authority and duty to regulate CO_2 emissions under the CAA. On April 2, 2007, the Supreme Court found that greenhouse gases, including CO_2 , are pollutants under the CAA, and that EPA thus does have the authority to regulate these gases. The Supreme Court also concluded that EPA's refusal to regulate these pollutants was based on impermissible reasons, and remanded the case to EPA to make a judgment regarding endangerment (either that greenhouse gases do, or do not, pose a threat to health and welfare) with respect to certain mobile sources. While this case focused on CO_2 emissions from motor vehicles, it sets a precedent for regulation in other industrial sectors, such as the electric utility industry.

In July 2008, EPA issued an Advance Notice of Proposed Rulemaking ("ANPR") that addressed essentially all regulatory proceedings before EPA in which greenhouse gas emissions and climate change are issues, including consideration of greenhouse gas emissions in establishing new source performance standards and resolving pending appeals of new source review permit applications. The ANPR sought comments on the framework and direction of EPA's actions to regulate greenhouse gas emissions from a wide range of facilities, including electric generating facilities. The ANPR outlines issues to be addressed in new legislation that may be required in order to regulate greenhouse gas emissions. Regulatory options that may be considered in such legislation include, but are not limited to, the enactment of a cap-and-trade policy and development and deployment of alternative fuels, renewable energy resources, and energy conservation. Whether climate change legislation will be enacted during the 2009 to 2010 legislative session, and if so its potential impacts, cannot be assessed at this time. Any such legislation, or similar regulatory action by EPA under the CAA or otherwise, would probably have a significant impact on fossil-fueled generation facilities.

States are also becoming more active in the regulation of emissions that are believed to be contributing to global climate change. Several northeastern states have formed the Regional Greenhouse Gas Initiative, which is in the process of being implemented, and California passed a bill capping greenhouse gas emissions in the state. Other states are considering a variety of actions. North Carolina is studying initiatives aimed at climate change under the provisions of the state's Clean Smokestacks Act of 2002. This act required the State Division of Air Quality to study potential control of CO_2 emissions from coal-fired utility plants and other stationary sources. This has also prompted efforts to develop a climate action plan for North Carolina.

Renewables and Clean Energy

In light of increasing national focus on renewable and clean energy and TVA's desire to reduce its environmental footprint, on May 19, 2008, the TVA Board approved guiding principles for an Energy Efficiency and Demand Response Plan and a Renewable and Clean Energy Assessment.

The Energy Efficiency and Demand Response Plan seeks to slow the current rate of growth in the region's power demand by providing opportunities for residential, business, and industrial consumer groups to use energy more efficiently. In the short term, the plan proposes reducing the growth in peak demand by up to 1,400 megawatts by the end of the 2012 fiscal year.

The Renewable and Clean Energy Assessment strives to add clean energy resources to TVA's generating mix to help reduce carbon emissions while minimizing costs and maintaining a reliable power supply. The assessment proposes to review TVA's generation mix and identify a road map for pursuing additional renewable and clean energy supply in the region, and recommends consideration of different sources of renewable energy and a reduction in carbon intensity in TVA's generation mix, along with additional energy conservation by everyone who uses electricity.

Water Quality Control Developments

In the second phase of a three-part rulemaking to minimize the adverse impacts from cooling water intake structures on fish and shellfish, as required under Section 316(b) of the Clean Water Act ("CWA"), EPA promulgated a final rule for existing power producing facilities ("Phase II Rule") that became effective on September 7, 2004. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit (the "Second Circuit") remanded the Phase II Rule, holding, among other things, that costs cannot be compared to benefits in picking the best technology available ("BTA") to minimize the adverse environmental impacts of intake structures. The Utility Water Act Group, Entergy Corporation, and PSEG Fossil LLC filed a petition seeking review of the decision by the U.S. Supreme Court. TVA and the attorneys general of several states, including Alabama, Kentucky, and Tennessee, supported this petition. On April 14, 2008, the U.S. Supreme Court granted the petition, limiting its review to one issue: "Whether Section 316(b) of the CWA authorizes EPA to compare costs with benefits in determining the 'best technology available for minimizing adverse environmental impact' at cooling water intake structures." The Department of Justice and industry petitioners will defend the EPA rule supporting the concept that costs under the rule should be limited to those that are "not significantly greater than" the benefits to be derived. The case has been argued before the U.S. Supreme Court. TVA is unable to predict the outcome.

On July 9, 2007, EPA suspended all but one provision of the Phase II Rule until the agency resolves the issues raised by the Second Circuit's remand. The provision that was retained requires permitting authorities to apply, in the interim, Best Professional Judgment ("BPJ") controls for existing facilities. BPJ controls are those that reflect the best technology available for minimizing the adverse environmental impacts of intake structures. The use of BPJ controls reflects a return to the regulatory process that was used by permitting authorities to regulate the impact of intake structures prior to the promulgation of the Phase II Rule.

All of the intakes at TVA's existing coal and nuclear generating facilities were subject to the Phase II Rule. Given the uncertainty over the ultimate outcome of the appellate process and what the changes in the final rule as ultimately issued by EPA will be, the impacts of the eventual rulemaking are uncertain at this time.

Section 303d of the CWA requires states to develop and report to EPA on a two-year cycle a list of waters that are "impaired" or are expected to not meet water quality standards in the next two years and need additional pollution controls. The Tennessee Department of Environment and Conservation ("TDEC") placed a portion of Barkley Reservoir downstream of TVA's Cumberland Fossil Plant on its 2008 list of impaired streams (the "303d List"). This section of Barkley Reservoir had not been listed previously. The reservoir conditions in 2007, especially for temperature and dissolved oxygen, changed significantly due primarily to reduced flows in the Cumberland River resulting from emergency dam repairs on the Wolf Creek and Center Hill Dams coupled with the most severe drought on record in the region. The lower flows made less water available to dissipate the heated discharge from Cumberland Fossil Plant and resulted in increased river temperatures. The prospect of continued reduced flows through the Cumberland River system during the period required to complete the necessary repairs to Wolf Creek and Center Hill Dams may impact the generation of electricity from TVA's Cumberland and Gallatin Fossil Plants. Placing this section of Barkley reservoir on the 303d List could also impact the thermal limits imposed by the State of Tennessee when the discharge permit for Cumberland Fossil Plant is renewed in 2010, or earlier if the state or EPA determines that additional actions are required to protect the aquatic environment below the plant. TVA is working with the U.S. Army Corps of Engineers and TDEC to minimize the impacts to TVA's generating plants and improve the conditions observed in the river in 2007. TVA began operating temporary cooling towers at Cumberland Fossil Plant to reduce the temperature of the water discharged to the river.

EPA, and many states, are taking increased interest in evaluating the potential effects of thermal discharges from steam-electric generating facilities. TVA is working with states and EPA Region IV to demonstrate that the data collected by TVA in the vicinity of its facilities is sufficient to meet the requirements for assessing the impacts of thermal discharges on the aquatic environment.

In March 2007, TDEC adopted a lower, more conservative threshold (0.3 ppm) for issuing precautionary advisories for fish consumption due to mercury. Adoption of the lower threshold resulted in the issuance of several new precautionary fish consumption advisories in April 2007 for all or parts of five TVA reservoirs (Norris, Cherokee, South Holston, Watauga, and Tellico) and parts of four rivers in the Tennessee Valley (Buffalo, Emory, Hiwassee, and Holston) as well as the Loosahatchie, Wolf, and Mississippi Rivers in Tennessee that are not in the Tennessee River watershed.

As part of the 2007 advisory determinations, TDEC also identified several water bodies where more data were needed to determine if advisories were necessary. State agencies have since collected fish from those water bodies and decided several of them needed advisories to protect public health. The new Precautionary Advisory list for 2008 includes one additional TVA reservoir (Beech) and three additional river segments in the Tennessee River watershed (French Broad, Sequatchie, and Duck). Also, existing advisories for several reservoirs and rivers were expanded to include mercury as a chemical of concern and/or to include more kinds of fish.

TDEC's announcement of additional Precautionary Advisories for several Tennessee water bodies does not mean that mercury levels in fish are increasing, but is more reflective of the effect of the lowered threshold values for issuing a precautionary consumption advisory. TVA has been monitoring mercury levels in fish and sediments in TVA reservoirs for the last 35 years, and TVA's data were provided to TDEC as a part of its review process. TVA's data show significant reductions in mercury concentrations in fish from the reservoirs with known industrial discharges that have now ceased. Other than those areas historically impacted by industrial discharges, mercury concentrations in fish have tended to fluctuate through time with no discernible trend in fish from most reservoirs. Despite increased burning of coal for electricity generation, current and historic data records indicate that mercury concentrations in reservoir sediments have remained stable or declined.

One of the results of the major reductions in atmospheric emissions resulting from the clean air expenditures discussed above is that wastewaters at TVA coal-fired facilities and across the utility industry may be changing because of waste streams from air quality control technologies. Varying amounts of ammonia or similar compounds used as a necessary component of SCR and SNCR operations may end up in facility wastewater ponds that may discharge through outfalls regulated under the CWA. Operation of scrubbers for SO_2 control also results in additional amounts of pollutants being introduced into facility wastewater treatment ponds. EPA is currently collecting information to determine if the national Steam Electric Point Source Effluent Guidelines ("Effluent Guidelines") under the CWA need to be revised. If the Effluent Guidelines are revised, potentially more restrictive discharge limitations for existing parameters or the addition of new parameters could result in additional wastewater treatment expenses to meet requirements of the CWA. These costs cannot be accurately predicted at this time, but TVA is involved in and closely monitoring EPA's data collection activities and the progress of the Effluent Guidelines review process. On the state level, new numeric nutrient criteria development and implementation (an EPA requirement) may require additional treatment costs to reduce nitrogen concentrations being added to the waste treatment ponds as a result of the operation of air pollution control equipment. TVA is closely monitoring the development and implementation of numeric nutrient criteria, particularly by the states in TVA's service area and is encouraging regulatory agencies in the Valley states to incorporate water quality trading regulations into their water quality standards.

As is the case across the utility industry and in other industrial sectors, TVA is also facing more stringent requirements related to protection of wetlands, reductions in storm water impacts from construction activities, water quality degradation, new water quality criteria, and laboratory analytical methods. TVA is also following litigation related to the use of herbicides, water transfers, and releases from dams. TVA is not facing any substantive requirements related to non-compliance with existing CWA regulations.

Hazardous Substance Response, Oil Cleanup, and Similar Environmental Work

Liability for releases and cleanup of hazardous substances is primarily regulated under the federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), and other federal and parallel state statutes. In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances over the years. TVA is aware of alleged hazardous-substance releases at 10 non-TVA areas for which it may have some liability. TVA has reached agreements with EPA to settle its liability at two of the non-TVA areas for a total of less than $23,000. There have been no recent assertions of TVA liability for five of the non-TVA areas, and there is little or no known evidence that TVA contributed any significant quantity of hazardous substances to these five sites. There is evidence that TVA sent some materials to the remaining three non-TVA areas: the David Witherspoon site in Knoxville, Tennessee, the Ward Transformer site in Raleigh, North Carolina, and the General Waste Products site in Evansville, Indiana. As discussed below, TVA is not able to estimate its liability related to these sites at this time.

The Witherspoon site is contaminated with radionuclides, polychlorinated biphenyls ("PCBs"), and metals. DOE has admitted to being the main contributor of materials to the Witherspoon site and is currently performing clean up activities. DOE claims that TVA sent equipment to be recycled at this facility, and there is some supporting evidence for the claim. However, TVA believes it sent only a relatively small amount of equipment and that none of it was radioactive. DOE has asked TVA to "cooperate" in completing the cleanup, but it has not provided to TVA any evidence of TVA's percentage share of the contamination.

The Ward Transformer site is contaminated by PCBs from electrical equipment. EPA and a working group of potentially responsible parties (the "PRP Work Group") have provided documentation showing that TVA sent a limited amount of equipment containing PCBs to the site in 1974. The PRP Work Group is cleaning up on-site contamination in accordance with an agreement with EPA. The cleanup effort has been divided into four areas: two phases of soil cleanup; cleanup of off-site contamination in the downstream drainage basin; and supplemental groundwater remediation. The first phase of soil cleanup is underway, and the high-end cost estimate for this work is about $66 million. There are no reliable estimates for the second phase of soil cleanup or the supplemental groundwater remediation. EPA has selected a cleanup plan for the down stream drainage basin with a present-worth cost estimate of $6.1 million. TVA understands that EPA has incurred approximately $3 million in past response costs, and the PRP Work Group has reimbursed EPA approximately $725,000 of those costs. The PRP Work Group plans to propose a cost allocation schedule which it will use as the basis for offering settlements to PRPs for the first phase of soil cleanup. It plans to sue PRPs who do not settle. There also may be natural resource damages liability at this site, but TVA is not aware of any estimated amount for any such damages. TVA has a potential defense that it only sent useful equipment to Ward and thus is not liable for arranging for disposal of a hazardous substance at the site.

General Waste Products was a scrap metal salvage yard that operated from the 1930s until 1998. The original defendants in a CERCLA action have filed a third party complaint against TVA and others seeking cost contribution for cleanup of contamination from lead batteries and PCB transformers at the facility. There is evidence that TVA sent scrap metal to the facility, but TVA has not found any records indicating that it sent batteries or PCB equipment. There are two cleanup sites at the facility. TVA has been informed that the first site has been cleaned up at a cost of $3.2 million, and cleanup estimates for the second site range from $2 million to $7 million. TVA's allocated share of the cleanup costs, if any, is expected to be relatively small.

TVA operations at some TVA facilities have resulted in oil spills and other contamination TVA plans to address, and TVA expects to incur costs of about $15 million for environmental work related to decommissioning of the Watts Bar Fossil Plant.

As of September 30, 2008, TVA's estimated liability for cleanup and similar environmental work for those sites for which sufficient information is available to develop a cost estimate (primarily the TVA sites) is approximately $18 million on a non-discounted basis, including the Watts Bar Fossil Plant work, and is included in OTHER LIABILITIES on the Balance Sheet.

Coal-Combustion Wastes

In accordance with a regulatory determination by EPA in May 2000, coal-combustion and certain related wastes disposed of in landfills and surface impoundments are not regulated as hazardous waste. In conjunction with this determination, EPA committed to developing non-hazardous management standards for these wastes. These standards are likely to include increased groundwater monitoring, more stringent siting requirements, and closure of existing waste-management facilities not meeting minimum standards. On August 29, 2007, EPA issued a Notice of Data Availability ("NODA") in which it requested public comment on whether the additional information mentioned in the notice should affect EPA's decisions as it continues to follow up on its commitment to develop management standards for coal-combustion wastes. Although TVA did not comment on the NODA, the Utility Solid Waste Activity Group, of which TVA is a member, did file extensive comments with EPA regarding the risk assessment method that EPA chose to support the NODA.

Employee Relations

On September 30, 2008, TVA had 11,584 employees, of whom 5,010 were trades and labor employees. Under the TVA Act, TVA is required to pay trades and labor workers hired by TVA or its contractors the prevailing rate of wages. This rate is the rate of wages for work of a similar nature prevailing in the vicinity where the work is being performed. Neither the federal labor relations laws covering most private sector employers nor those covering most federal agencies apply to TVA. However, the TVA Board has a long-standing policy of acknowledging and dealing with recognized representatives of its employees, and that policy is reflected in long-term agreements to recognize the unions (or their successors) that represent TVA employees. Federal law prohibits TVA employees from engaging in strikes against TVA.

ITEM 1A. RISK FACTORS

The risk factors described below, as well as the other information included in this Annual Report, should be carefully considered. Risks and uncertainties described in these risk factors could cause future results to differ materially from historical results as well as from the results predicted in forward-looking statements. Although the risk factors described below are the ones that TVA management considers significant, additional risk factors that are not presently known to TVA management or that TVA management presently considers insignificant may also impair TVA's business operations. Although TVA has the authority to set its own rates and thus mitigate some risks by increasing rates, it is possible that partially or completely eliminating one or more of these risks through rate increases might adversely affect TVA commercially or politically. Accordingly, the occurrence of any of the following could have a material adverse effect on TVA's cash flows, results of operations, and financial condition.

For ease of reference, the risk factors are presented in four categories: strategic risks, operational risks, financial risks, and risks related to TVA securities.

Strategic Risks

New laws, regulations, and administrative orders may negatively affect TVA's cash flows, results of operations, and financial condition, as well as the way TVA conducts its business.

Although it is difficult to predict exactly how any new laws, regulations, and administrative orders would impact TVA, some of the possible effects are described below.

- ***TVA could lose its protected service territory.***

  TVA's service area is primarily defined by two provisions of law.

  – The TVA Act provides that, subject to certain minor exceptions, neither TVA nor its distributor customers may be a source of power supply outside of TVA's defined service area. This provision is often called the "fence" since it limits TVA's sales activities to a specified service area.

  – The Federal Power Act prevents FERC from ordering TVA to provide others with access to its transmission lines for the purpose of delivering power to customers within TVA's defined service area, except to those customers residing in Bristol, Virginia. This provision is often called the "anti-cherrypicking provision" since it prevents competitors from "cherrypicking" TVA's customers.

  If Congress were to eliminate or reduce the coverage of the anti-cherrypicking provision, TVA could more easily lose customers, and the loss of these customers could adversely affect TVA's cash flows, results of operations, and financial condition. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Legislative and Regulatory Matters — Proposed Legislation.*

- ***The TVA Board could lose its sole authority to set rates for electricity.***

  Under the TVA Act, the TVA Board has the sole authority to set the rates that TVA charges for electricity, and these rates are not subject to review. The loss of this authority could have material adverse effects on TVA including, but not limited to, the following:

  – TVA might be unable to set rates at a level sufficient to generate adequate revenues to service its financial obligations, properly operate and maintain its power assets, and provide for reinvestment in its power program; and

  – TVA might become subject to additional regulatory oversight that could impede TVA's ability to manage its business.

- ***TVA could become subject to increased environmental regulation.***

  There is a risk that new environmental laws and regulations could become applicable to TVA or the facilities it operates and that existing environmental regulations could be revised or reinterpreted in a way that adversely affects TVA. For example, proposals in Congress that would regulate CO_2 and other greenhouse gases could require TVA to incur significantly increased costs. Any such developments could require TVA to make significant capital expenditures, increase TVA's operating and maintenance costs, require TVA to pay a carbon penalty, or even lead to TVA's closing certain facilities. See Item 1, Business — *Environmental Matters* .

- ***TVA could become subject to Renewable Energy Portfolio Standards.***

  TVA is not currently obligated to provide a percentage of the power it sells from renewable sources but might be required to do so in the future. In such a case, TVA would either have to build additional facilities that use renewable resources to produce the power itself or purchase renewable power from other companies. Such developments could require TVA to make significant capital expenditures, increase its purchased power costs, or make changes in how it operates its facilities. See Item 1, Business — *Renewable and Clean Energy* .

- ***The NRC could impose significant restrictions or requirements on TVA.***

  The NRC has broad authority to impose requirements relating to the licensing, operation, and decommissioning of nuclear generation facilities. If the NRC modifies existing requirements or imposes new requirements, TVA could be required to make substantial capital expenditures at its nuclear plants or make substantial contributions to its nuclear decommissioning trust. In addition, if TVA fails to comply with requirements promulgated by the NRC, the NRC has the authority to impose fines, shut down units, or modify, suspend, or revoke TVA's operating licenses. See Item 1, Business — *Nuclear*.

- ***TVA could lose responsibility for managing the Tennessee River system.***

  TVA's management of the Tennessee River system is important to effective operation of the power system. TVA's ability to integrate management of the Tennessee River system with power system operations increases power system reliability and reduces costs. Restrictions on how TVA manages the Tennessee River system could negatively affect TVA's operations.

- ***Congress could take actions that lead to a downgrade of TVA's credit rating.***

  TVA's rated securities are currently rated "Aaa" by Moody's Investors Service and "AAA" by Standard and Poor's and Fitch Ratings, which are the highest ratings assigned by these rating agencies. TVA's credit ratings are not based solely on its underlying business or financial condition, which by themselves may not be commensurate with a triple-A rating. TVA's current ratings are based to a large extent on the body of legislation that defines TVA's business structure. Key characteristics of TVA's business defined by legislation include (1) the TVA Board's ratemaking authority, (2) the current competitive environment, which is defined by the fence and the anti-cherrypicking provision, and (3) TVA's status as a corporate agency and instrumentality of the United States. Accordingly, if Congress takes any action that effectively alters any of these characteristics, TVA's credit ratings could be downgraded.

- ***TVA's debt ceiling could become more restrictive.***

  The TVA Act provides that TVA can issue bonds, notes, and other evidences of indebtedness ("Bonds") in an amount not to exceed $30 billion outstanding at any time. If Congress either lowers the debt ceiling or broadens the types of financial instruments that are covered by the debt ceiling, TVA might not be able to raise enough capital to, among other things, service its financial obligations, properly operate and maintain its power assets, and provide for reinvestment in its power program.

- ***TVA may lose some of its customers.***

  As of September 30, 2008, three distributor customers had notices in effect terminating their power contracts with TVA. Although sales to these three distributor customers generated only 0.5 percent of TVA's total operating revenues in 2008, the loss of additional customers could have a material adverse effect on TVA's cash flows, results of operations, and financial condition. See Item 1, Business — *Customers — Municipalities and Cooperatives* and *Other Customers.*

Operational Risks

TVA's generation and transmission assets may not operate as planned.

Many of TVA's generation and transmission assets have been operating since the 1950s or earlier and have been in nearly constant service since they were completed. If these assets fail to operate as planned, TVA, among other things:

- Might have to invest a significant amount of resources to repair or replace the assets;
- Might be unable to operate the assets for a significant period of time;
- Might have to purchase replacement power on the open market;
- Might not be able to meet its contractual obligations to deliver power; and
- Might have to remediate collateral damage caused by a failure of the assets.

In addition, the failure of TVA's assets to perform as planned could cause health, safety, and environmental problems and even result in such events as the failure of a dam or a nuclear accident. Any of these potential outcomes could negatively affect TVA's cash flows, results of operations, and financial condition. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008.*

TVA's fuel supplies might be disrupted.

TVA purchases coal, uranium, fuel oil, and natural gas from a number of suppliers. Disruption in the acquisition or delivery of fuel may result from a variety of factors, including, but not limited to, weather, production or transportation difficulties, labor challenges, or environmental regulations affecting TVA's fuel suppliers. These disruptions could adversely affect TVA's ability to operate its facilities and could require TVA to acquire power at higher prices on the spot market, purchase more expensive alternative fuels, or operate higher cost plants, thereby adversely affecting TVA's cash flows, results of operations, and financial condition.

Compliance with existing and future environmental laws and regulations may affect TVA's operations in unexpected ways.

TVA is subject to risks from existing federal, state, and local environmental laws and regulations including, but not limited to, the following:

- Compliance with existing environmental laws and regulations may cost TVA more than it anticipates.
- At some of TVA's older facilities, it may be uneconomical for TVA to install the necessary equipment to comply with future environmental laws, which may cause TVA to shut down those facilities.
- TVA may be responsible for on-site liabilities associated with the environmental condition of facilities that it has acquired or developed, regardless of when the liabilities arose and whether they are known or unknown.
- TVA may be unable to obtain or maintain all required environmental regulatory approvals. If there is a delay in obtaining any required environmental regulatory approvals or if TVA fails to obtain, maintain, or comply with any such approval, TVA may be unable to operate its facilities or may have to pay fines or penalties.

See Item 1, Business — *Environmental Matters.*

Compliance with environmental laws and regulations relating to carbon dioxide and other greenhouse gases may affect TVA's operations in unexpected ways.

Future compliance may be required resulting from the regulation of carbon dioxide and other greenhouse gases. Any future legislative or regulatory actions to address global climate change may be materially adverse to TVA's financial position or results of operations. The cost impact of legislation or regulation to address global climate change would depend on the specific legislation or regulation enacted, which cannot be determined at this time. See Item 1, Business — *Environmental Matters* .

TVA is the sole power provider for customers within its service area, and if demand for power in TVA's service area increases, TVA is contractually obligated to take steps to meet this increased demand.

If demand for power in TVA's service area increases, TVA may need to meet this increased demand by purchasing power from other sources, building new generation and transmission facilities, or purchasing existing generation and transmission facilities. Purchasing power from external sources, as well as acquiring or building new generation and transmission facilities, could negatively affect TVA's cash flows, results of operations, and financial condition.

Purchased power prices may be highly volatile, and providers of purchased power may fail to perform under their contracts with TVA.

TVA acquires a portion of its electricity needs through purchased power arrangements. The price for purchased power has been volatile in recent years, and the price that TVA pays for purchased power may increase significantly in the future. In addition, if one of TVA's purchased power suppliers fails to perform under the terms of its contract with TVA, TVA might have to purchase replacement power on the spot market, perhaps at a significantly higher price than TVA was entitled to pay under the contract. In some circumstances, TVA may not be able to recover this difference from the supplier. Moreover, if TVA is unable to acquire enough purchased power or enough replacement power on the spot market and does not have enough reserve generation capacity available to offset the loss of power from the purchased power supplier, TVA might not be able to supply enough power to meet the demand, resulting in power curtailments or even blackouts. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities — Credit Risk — Credit of Other Counterparties.*

TVA's ability to supply power and its customers' demands for power are influenced by weather conditions.

Extreme temperatures may increase the demand for power and require TVA to purchase power at high prices in order to meet the demand from customers, while unusually mild weather may result in decreased demand for power and lead to reduced electricity sales. In addition, in periods of low rainfall or drought, TVA's low-cost hydroelectric generation may be reduced, requiring TVA to purchase power or use more costly means of producing power. Furthermore, high river water temperatures in the summer may limit TVA's ability to use water from the Tennessee or Cumberland River system for cooling at its generating facilities, thereby limiting TVA's ability to operate its generating facilities. See Item 1, Business — *Weather and Seasonality* and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008 — Weather Conditions* .

TVA may incur delays and additional costs in power plant construction and may be unable to obtain necessary regulatory approval.

TVA has begun the process of completing the construction of Watts Bar Nuclear Unit 2 and may need to construct more generating facilities in the future. The completion of such facilities involves substantial risks of delays and overruns in the cost of labor and materials. In addition, completion may require regulatory approval, as in the case of Watts Bar Nuclear Unit 2. If TVA does not obtain the necessary regulatory approval, is otherwise unable to complete the development or construction of a facility, decides to cancel construction of a facility, or incurs delays or cost overruns in connection with constructing a facility, TVA's cash flows, financial condition, and results of operations could be negatively affected. In addition, if construction projects are not completed according to specifications, TVA may suffer, among other things, reduced plant efficiency and higher operating costs. See Item 1, Business — *Nuclear* .

TVA may face problems attracting and retaining skilled workers.

As TVA employees retire and TVA faces competition for skilled workers, TVA may face problems attracting and retaining skilled workers to, among other things, operate and maintain TVA's generation and transmission facilities and complete large construction projects such as Watts Bar Nuclear Unit 2.

TVA is involved in various legal and administrative proceedings whose outcomes may affect TVA's finances and operations.

TVA is involved in various legal and administrative proceedings and is likely to become involved in other legal proceedings in the future in the ordinary course of business. Although TVA cannot predict the outcome of the individual matters in which TVA is involved or will become involved, the resolution of these matters could require TVA to make expenditures in excess of established reserves and in amounts that could have a material adverse effect on TVA's cash flows, results of operations, and financial condition. Similarly, resolution could require TVA to change its business practices or procedures, which could also have a material adverse effect on TVA's cash flows, results of operations, and financial condition. See Item 3, Legal Proceedings.

TVA's transmission reliability could be affected by problems at other utilities or TVA facilities.

TVA's transmission facilities are directly interconnected with the transmission facilities of neighboring utilities and are thus part of an interstate power transmission grid. Accordingly, problems at other utilities, or at TVA's own facilities, may cause interruptions in TVA's transmission service. If TVA were to suffer a transmission service interruption, TVA's cash flows, results of operations, and financial condition could be negatively affected.

Events at non-TVA facilities which affect the supply of water to TVA's generation facilities may interfere with TVA's ability to generate power.

TVA's coal-fired and nuclear generation facilities depend on water from the river systems near which they are located for cooling water and for water to convert into steam to drive turbines. While TVA manages the Tennessee River and large portions of its tributary system in order to provide much of this necessary water, the U.S. Army Corps of Engineers operates and manages other bodies of water upon which some TVA facilities rely. Events at these non-TVA managed bodies of water or their associated hydroelectric facilities may interfere with the flow of water and may result in TVA having insufficient water to meet the needs of its plants. In such scenarios, TVA may be required to reduce generation at its affected facilities to levels compatible with the available supply of water. See Item 1, Business — *Power Supply* and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008* .

An incident at any nuclear facility, even one that is not owned by or licensed to TVA, could result in increased expenses and oversight.

A nuclear incident at a TVA facility could have significant consequences including loss of life, damage to the environment, damage to or loss of the facility, and damage to non-TVA property. Any nuclear incident, even at a facility that is not owned by or licensed to TVA, has the potential to impact TVA adversely by obligating TVA to pay up to $105 million per year and a total of $671 million per nuclear incident under the Price-Anderson Act. In addition, a nuclear incident could negatively affect TVA by, among other things, obligating TVA to pay retrospective premiums, reducing the availability of insurance, increasing the costs of operating nuclear units, or leading to increased regulation or restriction on the construction, operation, and decommissioning of nuclear facilities.

Catastrophic events could affect TVA's ability to supply electricity or reduce demand for electricity.

TVA could be adversely affected by catastrophic events such as fires, earthquakes, floods, tornadoes, wars, terrorist activities, pandemics, and other similar events. These events, the frequency and severity of which are unpredictable, could negatively affect TVA's cash flows, results of operations, and financial condition by, among other things, limiting TVA's ability to generate and transmit power, reducing the demand for power, disrupting fuel or other supplies, leading to an economic downturn, or creating instability in the financial markets.

Demand for electricity supplied by TVA could be reduced by changes in technology.

Research and development activities are ongoing to improve existing and alternative technologies to produce electricity, including gas turbines, fuel cells, microturbines, and solar cells. It is possible that advances in these or other alternative technologies could reduce the costs of electricity production from alternative technologies to a level that will enable these technologies to compete effectively with traditional power plants like TVA's. To the extent these technologies become a more cost-effective option for certain customers, TVA's sales to these customers could be reduced, thereby negatively affecting TVA's cash flows, results of operations, and financial condition. In addition, demand for electricity may be affected by the implementation of time-of-use rates. Depending on design features, time-of-use rates may affect timing and volatility of cash flow. Metering or related technology changes may impact the features and penetration of time-of-use rates.

Financial Risks

TVA is subject to a variety of market risks that could negatively affect TVA's cash flows, results of operations, and financial position.

TVA is subject to a variety of market risks, including, but not limited to, commodity price risk, investment price risk, interest rate risk, and credit risk.

- *Commodity Price Risk.* Prices of commodities critical to TVA's operations, including coal, uranium, natural gas, fuel oil, construction materials, emission allowances, and electricity, have been extremely volatile in recent years. If TVA fails to effectively manage its commodity price risk, TVA's rates could increase and thereby cause customers to look for alternative power suppliers.

- *Investment Price Risk.* TVA is exposed to investment price risk in its nuclear decommissioning trust, its asset retirement trust, and its pension fund. If the value of the investments held in the nuclear decommissioning trust or the pension fund decreases significantly, TVA could be required to make substantial unplanned contributions to these funds, which would negatively affect TVA's cash flows, results of operations, and financial condition.

- *Interest Rate Risk.* Changes in interest rates could negatively affect TVA's cash flows, results of operations, and financial condition by increasing the amount of interest that TVA pays on new bonds that it issues, decreasing the return that TVA receives on its short-term investments, decreasing the value of the investments in TVA's pension fund and trusts, and increasing the losses on the mark-to-market valuation of certain derivative transactions into which TVA has entered.

- *Credit Risk.* TVA is exposed to the risk that its counterparties will not be able to perform their contractual obligations. If TVA's counterparties fail to perform their obligations, TVA's cash flows, results of operations, and financial condition could be adversely affected. In addition, the failure of a counterparty to perform could make it difficult for TVA to perform its obligations, particularly if the counterparty is a supplier of electricity or fuel to TVA.

For more information regarding market risks, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities* , and for a discussion of the impact on TVA of recent developments in the commodity, investment, interest rate, and credit markets, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008* and *Liquidity and Capital Resources —- Sources of Liquidity.*

TVA and owners of TVA securities could be impacted by a downgrade of TVA's credit rating.

A downgrade in TVA's credit rating could have material adverse effects on TVA's cash flows, results of operations, and financial condition as well as on investors in TVA securities. Among other things, a downgrade could have the following effects:

- A downgrade would increase TVA's interest expense by increasing the interest rates that TVA pays on new Bonds that it issues. An increase in TVA's interest expense would reduce the amount of cash available for other purposes, which could result in the need to increase borrowings, to reduce other expenses or capital investments, or to increase power rates.

- A significant downgrade could result in TVA's having to post collateral under certain physical and financial contracts that contain rating triggers.

- A downgrade below a contractual threshold could prevent TVA from borrowing under two credit facilities totaling $2.25 billion.

- A downgrade could lower the price of TVA securities in the secondary market.

See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Liquidity and Capital Resources.*

TVA may have to make significant unplanned contributions to fund its pension and other postretirement benefit plans.

TVA's costs of providing pension benefits and other postretirement benefits depend upon a number of factors, including, but not limited to:

- Provisions of the pension and postretirement benefit plans;
- Changing employee demographics;
- Rates of increase in compensation levels;
- Rates of return on plan assets;
- Discount rates used in determining future benefit obligations;
- Rates of increase in health care costs;
- Levels of interest rates used to measure the required minimum funding levels of the plans;
- Future government regulation; and
- Contributions made to the plans.

Any number of these factors could increase TVA's costs of providing pension and other postretirement benefits and require TVA to make significant unplanned contributions to the plans. Such contributions would negatively affect TVA's cash flows, results of operations, and financial condition. For a discussion of the impact of the recent turmoil in the financial markets on TVA's pension fund, including the funded status and recent performance of the fund, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008 — Investment Performance.*

TVA may have to make significant unplanned contributions to its nuclear decommissioning trust.

TVA maintains a nuclear decommissioning trust for the purpose of providing funds to decommission its nuclear facilities. The decommissioning trust is invested in securities generally designed to achieve a return in line with overall equity market performance. TVA might have to make significant unplanned contributions to the trust if, among other things:

- The value of the investments in the trust declines significantly;
- The laws or regulations regarding nuclear decommissioning change the decommissioning funding requirements;
- The assumed real rate of return on plan assets, which is currently five percent, is lowered by the TVA Board;
- Changes in technology and experience related to decommissioning cause decommissioning cost estimates to increase significantly; or
- TVA is required to decommission a nuclear plant sooner than it anticipates.

If TVA makes unplanned contributions to the trust, the contributions would negatively affect TVA's cash flows, results of operations, and financial condition. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Challenges During 2008 — Investment Performance.*

TVA may be unable to meet its current cash requirements if its access to the debt markets is limited.

TVA's cash management policy is to use cash provided by operations together with proceeds from power program borrowings to fund TVA's current cash requirements. In addition, TVA has access to a $150 million credit facility with the U.S. Treasury and $2.25 billion of credit facilities with a national bank. In light of TVA's cash management policy, it is critical that TVA continue to have access to the debt markets in order to meet its cash requirements. The importance of having access to the debt markets is underscored by the fact that TVA, unlike many utilities, relies almost entirely on the debt markets to raise capital since it is not authorized to issue equity securities. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Liquidity and Capital Resources.*

Approaching or reaching its debt ceiling could limit TVA's ability to carry out its business.

At September 30, 2008, TVA had approximately $22.7 billion of Bonds outstanding (not including noncash items of foreign currency valuation loss of $138 million and net discount on sale of bonds of $199 million). TVA has a statutorily imposed ceiling of $30 billion on outstanding Bonds. Approaching or reaching this debt ceiling could adversely affect TVA's business by limiting TVA's ability to borrow money and increasing the cost of servicing TVA's debt. In addition, approaching or reaching this debt ceiling could lead to increased legislative or regulatory oversight of TVA's activities.

TVA's cash flows, results of operations, and financial condition could be negatively affected by economic downturns.

Sustained downturns or weakness in the economy in TVA's service area or other parts of the United States could reduce overall demand for power and thus reduce TVA's power sales and cash flows, especially as TVA's industrial customers reduce their operations and thus their consumption of power. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — Future Challenges.*

TVA's financial control system cannot guarantee that all control issues and instances of fraud or errors will be detected.

No financial control system, no matter how well designed and operated, can provide absolute assurance that the objectives of the control system are met, and no evaluation of financial controls can provide absolute assurance that all control issues and instances of fraud or errors can be detected. The design of any system of financial controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. For an assessment as of September 30, 2008, of TVA's disclosure controls and procedures (which were deemed ineffective) and TVA's internal controls and procedures (which were deemed effective) as well as a discussion of the remediation during the fourth quarter of 2008 of a material internal control weakness related to TVA's estimate of unbilled revenue, see Item 9A, Controls and Procedures.

TVA could lose the ability to use regulatory accounting and be required to write off a significant amount of regulatory assets.

TVA is able to use regulatory accounting because it satisfies the requirements set forth in Statement of Financial Accounting Standards ("SFAS") No. 71, *"Accounting for the Effects of Certain Types of Regulation."* Accordingly, TVA records as assets certain costs that would not be recorded as assets under generally accepted accounting principles for non-regulated entities. As of September 30, 2008, TVA had $6.9 billion of regulatory assets. If TVA loses its ability to use regulatory accounting, TVA could be required to write-off its regulatory assets. Any asset write-offs would be required to be recognized in earnings in the period in which regulatory accounting under SFAS No. 71 ceased to apply to TVA.

Risks Related to TVA Securities

Payment of principal and interest on TVA securities is not guaranteed by the United States.

Although TVA is a corporate agency and instrumentality of the United States government, TVA securities are not backed by the full faith and credit of the United States. Principal and interest on TVA securities are payable solely from TVA's net power proceeds. Net power proceeds are defined as the remainder of TVA's gross power revenues after deducting the costs of operating, maintaining, and administering its power properties and payments to states and counties in lieu of taxes, but before deducting depreciation accruals or other charges representing the amortization of capital expenditures, plus the net proceeds from the sale or other disposition of any power facility or interest therein.

The trading market for TVA securities might be limited.

All of TVA's Bonds are listed on the New York Stock Exchange except for TVA's discount notes, which have maturities of less than one year, and the power bonds issued under TVA's electronotes ® program, which is TVA's medium-term retail notes program. In addition, some of TVA's Bonds are listed on foreign stock exchanges. Although many of TVA's Bonds are listed on stock exchanges, there can be no assurances that any market will develop or continue to exist for any Bonds. Additionally, no assurances can be made as to the ability of the holders of Bonds to sell their Bonds or the price at which holders will be able to sell their Bonds. Future trading prices of Bonds will depend on many factors, including prevailing interest rates, the then-current ratings assigned to the Bonds, the amount of Bonds outstanding, the time remaining until the maturity of the Bonds, the redemption features of the Bonds, the market for similar securities, and the level, direction, and volatility of interest rates generally.

If a particular series of Bonds is offered through underwriters, those underwriters may attempt to make a market in the Bonds. The underwriters would not be obligated to do so, however, and could terminate any market-making activity at any time without notice.

In addition, legal limitations may affect the ability of banks and others to invest in Bonds. For example, national banks may purchase TVA Bonds for their own accounts in an amount not to exceed 10 percent of unimpaired capital and surplus. Also, TVA Bonds are "obligations of a corporation which is an instrumentality of the United States" within the meaning of section 7701(a)(19)(C)(ii) of the Internal Revenue Code for purposes of the 60 percent of assets limitation applicable to U.S. building and loan associations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

TVA holds personal property in its own name but holds real property as agent for the United States of America. TVA may acquire real property by negotiated purchase or by eminent domain.

Generating Properties

At September 30, 2008, generating assets operated by TVA consisted of 59 coal-fired units, six nuclear units, 109 conventional hydroelectric units, four pumped storage units, 93 combustion turbine units, three combined cycle units, nine diesel generator units, one digester gas site, one biomass cofiring site, one wind energy site, and 15 solar energy sites. See Item 1, Business — *Power Supply* for a chart that indicates the location, capability, and in-service dates for each of these properties. Construction on Watts Bar Unit 2 commenced in December 2007. Completing Watts Bar Unit 2 is expected to take 60 months. TVA added seven combustion turbine units in 2008 and subsequently sold an undivided 69.69 percent interest in three of the combined cycle, combustion turbine units it had acquired. It now operates these three units under a lease agreement. See Item 1, Business — *Power Supply — Generation Facilities — Combustion Turbine Facilities*.

Twenty-four of TVA's simple cycle combustion turbines are subject to leaseback arrangements. For more information regarding these arrangements, see Note 13 — *Leaseback Obligations.*

Transmission Properties

TVA's transmission system interconnects with systems of surrounding utilities and consists primarily of the following assets:

- Approximately 15,860 circuit miles of transmission lines (primarily 500 kilovolt and 161 kilovolt lines);
- 487 transmission substations, power switchyards, and switching stations; and
- 64 individual interchange and 1,006 customer connection points.

In 2003, TVA entered into a leaseback of certain qualified technological equipment and other software related to TVA's transmission system. For more information regarding this transaction, see Note 13 — *Leaseback Obligations.*

Natural Resource Stewardship Properties

TVA operates and maintains 49 dams, and TVA manages the following natural resource stewardship properties:

- 11,000 miles of reservoir shoreline;
- 293,000 acres of reservoir land;
- 650,000 surface acres of water; and
- Over 100 public recreation facilities.

As part of its stewardship responsibilities, TVA approval is required to be obtained before construction of any obstruction affecting navigation, flood control, or public lands can be constructed in or along the Tennessee River and its tributaries.

Buildings

TVA has a variety of buildings throughout its service area in addition to the buildings located at its generation and transmission facilities, including office buildings, customer service centers, power service centers, warehouses, visitor centers, and crew quarters. The most significant of these buildings is the Knoxville Office Complex. TVA also leases buildings when it deems appropriate, including its Chattanooga Office Complex, which consists of approximately 1.2 million square feet of office space. The initial term of TVA's lease of approximately 1.05 million square feet of the Chattanooga Office Complex expires on January 1, 2011. On February 8, 2008, TVA finalized an agreement to purchase this portion of the Chattanooga Office Complex upon the expiration of the existing lease term on January 1, 2011. The purchase price is $22 million, payable on January 3, 2011. See Note 4 — *Asset Acquisitions and Dispositions.* The lease on the Monteagle Place the remaining portion of the Chattanooga Office Complex (approximately 131,979 square feet) expires on September 30, 2012. TVA also owns a significant number of buildings in Muscle Shoals, Alabama, and is currently evaluating strategies for long-term solutions to further reduce its Muscle Shoals portfolio.

Disposal of Property

Under the TVA Act, TVA has broad authority to dispose of personal property but only limited authority to dispose of real property. TVA’s primary sources of authority to dispose of real property are briefly described below:

- Under Section 31 of the TVA Act, TVA has authority to dispose of surplus real property at a public auction.
- Under Section 4(k) of the TVA Act, TVA can dispose of real property for certain specified purposes, including to provide replacement lands for certain entities whose lands were flooded or destroyed by dam or reservoir construction and to grant easements and rights-of-way upon which are located transmission or distribution lines.
- Under Section 15d(g) of the TVA Act, TVA can dispose of real property in connection with the construction of generating plants or other facilities under certain circumstances.
- Under 40 U.S.C. § 1314, TVA has authority to grant easements for rights-of-way and other purposes.

In addition, the Basic Tennessee Valley Authority Power Bond Resolution adopted by the TVA Board on October 6, 1960, as amended on September 28, 1976, October 17, 1989, and March 25, 1992, prohibits TVA from mortgaging any part of its power properties and from disposing of all or any substantial portion of these properties unless TVA provides for a continuance of the interest, principal, and sinking fund payments due and to become due on all outstanding Bonds, or for the retirement of such Bonds.

ITEM 3. LEGAL PROCEEDINGS

TVA is subject to various legal proceedings and claims that have arisen in the ordinary course of business. These proceedings and claims include the matters discussed below. In accordance with SFAS No. 5, *“Accounting for Contingencies,”* TVA had accrued approximately $46 million and $3 million with respect to the proceedings described below as of September 30, 2008 and 2007, respectively, as well as approximately $5 million and $4 million as of September 30, 2008, and 2007, respectively, with respect to other proceedings that have arisen in the normal course of TVA’s business. TVA recognized $20 million, $4 million, and $24 million in 2008, 2007, and 2006, respectively, of expense by increasing accruals related to legal proceedings. No assurance can be given that TVA will not be subject to significant additional claims and liabilities. If actual liabilities significantly exceed the estimates made, TVA’s results of operations, liquidity, and financial condition could be materially adversely affected.

Global Warming Cases, Southern District of New York . On July 21, 2004, two lawsuits were filed against TVA in the United States District Court for the Southern District of New York alleging that global warming is a public nuisance and that CO_2 emissions from fossil-fuel electric generating facilities should be ordered abated because they contribute to causing the nuisance. The first case was filed by various states (California, Connecticut, Iowa, New Jersey, New York, Rhode Island, Vermont, and Wisconsin) and the City of New York against TVA and other power companies. The second case, which alleges both public and private nuisance, was filed against the same defendants by Open Space Institute, Inc., Open Space Conservancy, Inc., and the Audubon Society of New Hampshire. The plaintiffs do not seek monetary damages, but instead seek a court order requiring each defendant to cap its CO_2 emissions and then reduce these emissions by an unspecified percentage each year for at least a decade. In September 2005, the district court dismissed both lawsuits because they raised political questions that should not be decided by the courts. The plaintiffs appealed to the United States Court of Appeals for the Second Circuit ("Second Circuit"). Oral argument was held before the Second Circuit on June 7, 2006. On June 21, 2007, the Second Circuit directed the parties to submit letter briefs by July 6, 2007, addressing the impact of the Supreme Court's decision in *Massachusetts v. EPA* , 127 S.Ct. 1438 (2007), on the issues raised by the parties. On July 6, 2007, the defendants jointly submitted their letter brief. The Second Circuit is deliberating on its decision.

Case Involving Alleged Violations of the New Source Review Regulations at Bull Run Fossil Plant . The National Parks Conservation Association, Inc. ("NPCA"), and the Sierra Club, Inc. ("Sierra Club") filed suit against TVA on February 13, 2001, in the United States District Court for the Eastern District of Tennessee, alleging that TVA did not comply with the new source review ("NSR") requirements of the CAA when TVA repaired its Bull Run Fossil Plant ("Bull Run"), a coal-fired electric generating facility located in Anderson County, Tennessee. In March 2005, the district court granted TVA's motion to dismiss the lawsuit on statute of limitation grounds. The plaintiffs' motion for reconsideration was denied, and they appealed to the United States Court of Appeals for the Sixth Circuit ("Sixth Circuit"). Friend of the court briefs supporting the plaintiffs' appeal were filed by New York, Connecticut, Illinois, Iowa, Maryland, New Hampshire, New Jersey, New Mexico, Rhode Island, Kentucky, Massachusetts, and Pennsylvania. Several Ohio utilities filed a friend of the court brief supporting TVA. A panel of three judges issued a decision reversing the district court's dismissal on March 2, 2007. TVA's request that the full Sixth Circuit rehear the appeal was denied. The district court trial previously scheduled for September 2, 2008, was postponed, and the district court instead heard oral arguments on the parties' motions for summary judgment on that date. The trial has not yet been rescheduled. TVA is already installing or has installed the control equipment that the plaintiffs seek to require TVA to install in this case, and it is unlikely that an adverse decision will result in substantial additional costs to TVA at Bull Run. An adverse decision, however, could lead to additional litigation and could cause TVA to change its emission control strategy and increase costs. It is uncertain whether there would be significant increased costs to TVA.

Case Involving Opacity at Colbert Fossil Plant . On September 16, 2002, the Sierra Club and the Alabama Environmental Council filed a lawsuit in the United States District Court for the Northern District of Alabama alleging that TVA violated CAA opacity limits applicable to Colbert Fossil Plant ("Colbert") between July 1, 1997, and June 30, 2002. The plaintiffs seek a court order that could require TVA to incur substantial additional costs for environmental controls and pay civil penalties of up to approximately $250 million. After the court dismissed the complaint (finding that the challenged emissions were within Alabama's two percent de minimis rule, which provided a safe harbor if nonexempt opacity monitor readings over 20 percent did not occur more than two percent of the time each quarter), the plaintiffs appealed the district court's decision to the United States Court of Appeals for the Eleventh Circuit ("Eleventh Circuit"). On November 22, 2005, the Eleventh Circuit affirmed the district court's dismissal of the claims for civil penalties but held that the Alabama de minimis rule was not applicable because Alabama had not yet obtained Environmental Protection Agency ("EPA") approval of that rule. The case was remanded to the district court for further proceedings. On April 5, 2007, the plaintiffs moved for summary judgment. TVA opposed the motion and moved to stay the proceedings. On April 12, 2007, EPA proposed to approve Alabama's de minimis rule subject to certain changes. On July 16, 2007, the district court denied TVA's motion to stay the proceedings pending approval of Alabama's de minimis rule. Oral argument on the plaintiffs' motion for summary judgment was held on August 16, 2007. On August 27, 2007, the district court granted the plaintiffs' motion for summary judgment, finding that TVA had violated the CAA at Colbert. The district court held that, while TVA had achieved 99 percent compliance on Colbert Units 1-4 and 99.5 percent compliance at Colbert Unit 5, TVA had exceeded the 20 percent opacity limit (measured in six-minute intervals) more than 3,350 times between January 3, 2000, and September 30, 2002. The district court ordered TVA to submit a proposed remediation plan, which TVA did on October 26, 2007. The plaintiffs responded to TVA's proposed plan, and the district court held a hearing on the plan on December 15, 2008. EPA has approved Alabama's de minimis rule, which will become effective in 2009.

In addition to Colbert, TVA has another coal-fired power plant in Alabama, Widows Creek Fossil Plant ("Widows Creek"), which has a summer net capability of 1,508 megawatts. Since the operation of Widows Creek must meet the same opacity requirements, this plant may be affected by the decision in this case. The recently approved de minimis rule change helps reduce the chances of an adverse effect on Widows Creek from the district court decision.

Case Brought by North Carolina Alleging Public Nuisance . On January 30, 2006, North Carolina filed suit against TVA in the United States District Court for the Western District of North Carolina alleging that TVA's operation of its coal-fired power plants in the States of Tennessee, Alabama, and Kentucky constitute public nuisances. North Carolina is asking the court to impose caps on emissions of certain pollutants from TVA's coal-fired plants that North Carolina considers to be equivalent to caps on emissions imposed by North Carolina law on North Carolina's two largest electric utilities. The imposition of such caps could require TVA to install more pollution controls on a faster schedule than required by federal law. The trial in this case was completed on July 30, 2008. The parties submitted their post-trial filings on September 15, 2008, and a decision will follow at a later time.

Case Arising out of Hurricane Katrina . In April 2006, TVA was added as a defendant to a class action lawsuit brought in the United States District Court for the Southern District of Mississippi by 14 residents of Mississippi allegedly injured by Hurricane Katrina. The plaintiffs sued seven large oil companies and an oil company trade association, three large chemical companies and a chemical trade association, and 31 large companies involved in the mining and/or burning of coal, including TVA and other utilities. The plaintiffs allege that the defendants' greenhouse gas emissions contributed to global warming and were a proximate and direct cause of Hurricane Katrina's increased destructive force. The plaintiffs are seeking monetary damages among other relief. TVA has moved to dismiss the complaint on grounds that TVA's operation of its coal-fired plants is not subject to tort liability due to the discretionary function doctrine. The district court dismissed the case on the grounds that the plaintiffs lacked standing. The plaintiffs appealed the dismissal to the United States Court of Appeals for the Fifth Circuit, and oral argument was held before a three judge panel in July 2008. A judge on the panel subsequently recused himself from the case, and the case was reargued during the week of November 3, 2008.

East Kentucky Power Cooperative Transmission Case . In April 2003, Warren Rural Electric Cooperative Corporation ("Warren") notified TVA that it was terminating its power contract with TVA. Warren then entered into an arrangement with East Kentucky Power Cooperative ("East Kentucky") under which Warren would become a member of East Kentucky, and East Kentucky would supply power to Warren after its power contract with TVA expires in 2009. East Kentucky asked to interconnect its transmission system with the TVA transmission system in three places that are currently delivery points through which TVA supplies power to Warren. TVA did not agree and East Kentucky asked FERC to order TVA to provide the interconnections. In January 2006, FERC issued a final order directing TVA to interconnect its transmission facilities with East Kentucky's system at three locations. TVA appealed the FERC order in the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") seeking review of this order on the grounds that this order violated the anti-cherrypicking provision. On January 10, 2007, TVA and Warren executed an agreement under which Warren rescinded its notice of termination. FERC terminated the proceeding but did not vacate its previous order. On January 17, 2008, TVA filed an unopposed motion to dismiss the D.C. Circuit appeal as moot. The D.C. Circuit dismissed the case on January 29, 2008 .

Case Involving AREVA Fuel Fabrication . On November 9, 2005, TVA received two invoices totaling $76 million from Framatome ANP Inc., which subsequently changed its name to AREVA NP Inc. ("AREVA"). AREVA asserted that it was the successor to the contract between TVA and Babcock and Wilcox Company ("B&W") under which B&W would provide fuel fabrication services for TVA's Bellefonte Nuclear Plant. AREVA's invoices were based upon the premise that the contract required TVA to buy more fuel fabrication services from B&W than TVA actually purchased. In September 2006, TVA received a formal claim from AREVA which requested a Contracting Officer's decision pursuant to the Contract Disputes Act of 1978 and reduced the amount sought to $26 million. On April 13, 2007, the Contracting Officer issued a final decision denying the claim. On April 19, 2007, AREVA filed suit in the United States District Court for the Eastern District of Tennessee, reasserting the $26 million claim and alleging that the contract required TVA to purchase certain amounts of fuel and/or to pay a cancellation fee. TVA filed its answer to the complaint on June 15, 2007. AREVA subsequently raised its claim to $48 million. Trial on the question of liability was scheduled to begin on September 22, 2008, but has been reset for April 20, 2009. A second trial on the question of damages will be held later, if necessary. TVA and AREVA have negotiated the terms of a settlement agreement. This agreement is contingent on approval by the TVA Board. The parties have scheduled a meeting with an independent third-party on December 16, 2008, to review the proposed settlement agreement.

Notification of Potential Liability for Ward Transformer Site . The Ward Transformer site is contaminated by PCBs from electrical equipment. EPA and a working group of potentially responsible parties (the "PRP Work Group") have provided documentation showing that TVA sent a limited amount of equipment containing PCBs to the site in 1974. The PRP Work Group is cleaning up on-site contamination in accordance with an agreement with EPA. The cleanup effort has been divided into four areas: two phases of soil cleanup; cleanup of off-site contamination in the downstream drainage basin; and supplemental groundwater remediation. The first phase of soil cleanup is underway, and the high-end cost estimate for this work is about $66 million. There are no reliable estimates for the second phase of soil and cleanup or the supplemental groundwater remediation, although EPA has selected a cleanup plan for the downstream drainage basin with a present worth cost estimate of $6 million. TVA understands that EPA has incurred approximately $3 million in past response costs, and the PRP Work Group has reimbursed EPA approximately $725,000 of those costs. The PRP Work Group plans to propose a cost allocation schedule which it will use as the basis for offering settlements to PRPs for the first phase of soil cleanup. It plans to sue PRPs who do not settle. There also may be natural resource damages liability at this site, but TVA is not aware of any estimated amount for any such damages. TVA has a potential defense that it only sent useful equipment to Ward and thus is not liable for arranging for disposal of a hazardous substance at the site.

Case Involving the General Waste Products Sites . In July 2008, a third-party complaint under CERCLA was filed against TVA in the District Court for the Southern District of Indiana, alleging that TVA, and several other defendants, disposed of hazardous materials at the General Waste Products sites in Evansville, Indiana. TVA was named in the complaint based on allegations that TVA arranged for the disposal of contaminated materials at the sites. The other third-party defendants are General Waste Products, General Electric Company, Indianapolis Power and Light, National Tire and Battery, Old Ben Coal Co., Solar Sources Inc., Whirlpool, White County Coal, PSI, Tell City Electric Department, Frontier Kemper, Speed Queen, Allan Trockman (the former operator of the site), and the City of Evansville. This action was brought by the Evansville Greenway PRP Group, a group of entities who are currently being sued in the underlying case for disposing of hazardous materials at the sites, in order to require the third-party defendants to contribute to, or pay for, the remediation of the sites. The complaint also includes a claim under state law against the defendants for the release of hazardous materials. TVA filed its answer to the complaint on October 29, 2008.

Completion of Browns Ferry Unit 1, Team Incentive Fee Pool Claims . Under the contracts for the restart of TVA's Browns Ferry Unit 1, TVA and two engineering and construction contractors, Bechtel Power Corporation ("Bechtel") and Stone & Webster Construction, Inc. ("Stone and Webster"), are to share in a team incentive fee pool funded from cost savings based on underruns in the budgets for their respective work scopes. The contracts provide that the fee pool could not exceed $100 million regardless of the actual savings involved, and the savings would be allocated as follows: 90 percent of the first $40 million would be given to the contractors, and any amount over $40 million would be split equally among TVA and the two contractors. Thus, if the maximum cost savings of $100 million had been attained, each contractor's payment from this pool would have been $38 million, for a total payout under both contracts of $76 million with the remaining $24 million being credited to TVA. The contractors have taken the position that they should each receive the maximum payment. In 2008, Bechtel agreed to settle its team incentive fee claim for a payment of $15 million, conditioned upon Bechtel receiving an additional payment equal to any amount over $15 million that Stone and Webster receives in resolution of its team incentive fee claim. TVA and Stone and Webster mediated the team incentive fee claim (as well as other claims) in May 2008 and discussions with Stone and Webster are continuing . On August 20, 2008, the TVA Board approved a proposed settlement with Stone and Webster, contingent on Stone and Webster agreeing to certain conditions. Stone and Webster has not agreed to the conditions. It is reasonably possible that TVA could incur some potential liability in excess of the amount previously calculated by TVA, and TVA has created a reserve for the additional amount.

Paradise Fossil Plant Clean Air Act Permit . On December 21, 2007, the Sierra Club, the Center for Biological Diversity, Kentucky Heartwood, and Hilary Lambert filed a petition with EPA raising objections to the conditions of TVA's current CAA permit at the Paradise Fossil Plant ("Paradise"). Among other things, the petitioners allege that activities at Paradise triggered the NSR requirements for NO_x and that the monitoring of opacity at Units 1 and 2 of the plant is deficient. The current permit continues to remain in effect. It is unclear whether or how the plant's permit might be modified as a result of this proceeding.

Employment Proceedings . TVA is engaged in various administrative and legal proceedings arising from employment disputes. These matters are governed by federal law and involve issues typical of those encountered in the ordinary course of business of a utility. They may include allegations of discrimination or retaliation (including retaliation for raising nuclear safety or environmental concerns), wrongful termination, and failure to pay overtime under the Fair Labor Standards Act. Adverse outcomes in these proceedings would not normally be material to TVA's results of operations, liquidity, and financial condition, although it is possible that some outcomes could require TVA to change how it handles certain personnel matters or operates its plants.

Information Request from EPA . On April 25, 2008, TVA received a request from EPA under section 114 of the CAA requesting extensive information about projects at and the operations of 14 of TVA's 59 coal-fired units. These 14 units are located in the States of Alabama, Kentucky, and Tennessee. This request for information is similar to but broader than section 114 requests that other companies have received during EPA's NSR enforcement initiative. TVA has responded to this request. EPA's request could be the first step in an administrative proceeding against TVA that could then result in litigation in the courts.

Notice of Violation at Widows Creek Unit 7 . On July 16, 2007, TVA received a Notice of Violation ("NOV") from EPA alleging that TVA failed to properly maintain ductwork at Widows Creek Unit 7 and other violations. TVA repaired the ductwork in 2005. While the NOV does not set out an administrative penalty, it is likely that EPA may seek a monetary sanction through giving up emission allowances, paying an administrative penalty, or both. TVA and the State of Alabama entered into an agreed order in which TVA agreed to pay the state $100,000. TVA is unable to estimate the amount of potential monetary sanctions from EPA for which TVA may be liable in connection with the NOV.

Administrative Proceeding Regarding Bellefonte Nuclear Plant Units 3 and 4 . TVA submitted its COLA to NRC for Bellefonte Nuclear Plant ("Bellefonte") Units 3 and 4 in October 2007. If approved, the license to build and operate the plant would be issued to TVA. Obtaining the necessary license would give TVA more certainty about the cost and schedule of a nuclear option for future decisions. The COLA for two AP1000 reactors at Bellefonte was officially docketed by NRC on January 18, 2008, indicating the NRC found it complete and technically sufficient to support NRC's more detailed reviews.

On June 6, 2008, a joint petition for intervention and a request for a hearing submitted to the NRC by the Bellefonte Efficiency and Sustainability Team, the Blue Ridge Environmental Defense League, and the Southern Alliance for Clean Energy. The petition raised 19 potential contentions with respect to TVA's COLA. Both TVA and the NRC staff opposed the admission of the petitioners' proposed contentions, and, as a result, the admission of the petitioners as parties to the proceeding. Additionally, TVA opposed the admission of one of the petitioners to the proceeding on the grounds that it lacked standing. The Atomic Safety and Licensing Board presiding over the proceeding subsequently denied standing to one of the petitioners and accepted four of the 19 contentions submitted by the remaining two petitioners. A hearing on these admitted contentions will be conducted in the future. The admitted contentions involve questions about the estimated costs of the new nuclear plant, the storage of low-level radioactive waste, and the impact of the facility's operations, in particular the plant intake, on aquatic species. Other COLA applicants have received similar petitions raising similar potential contentions.

The TVA Board has not made a decision to construct new plant units at the Bellefonte site, and TVA continues to evaluate all nuclear generation options at the site.

Significant Litigation to Which TVA Is Not a Party . On April 2, 2007, the Supreme Court issued an opinion in the case of *United States v. Duke Energy*, vacating the ruling of the United States Court of Appeals for the Fourth Circuit ("Fourth Circuit") in favor of Duke Energy and against EPA in EPA's NSR enforcement case against Duke Energy. The NSR regulations apply primarily to the construction of new plants but can apply to existing plants if a maintenance project (1) is "non-routine" and (2) increases emissions. The Supreme Court held that under EPA's Prevention of Significant Deterioration regulations, increases in annual emissions should be used for the test, not hourly emissions as utilities, including TVA, have argued should be the standard. Annual emissions can increase when a project improves the reliability of plant operations and, depending on the time period over which emission changes are calculated, it is possible to argue that almost all reliability projects increase annual emissions. Neither the Supreme Court nor the Fourth Circuit addressed what the "routine" project test should be. The United States District Court for the Middle District of North Carolina had ruled for Duke Energy on this issue, holding that "routine" must take into account what is routine in the industry and not just what is routine at a particular plant or unit as EPA has argued. EPA did not appeal this ruling. On October 5, 2007, EPA filed a motion with the United States District Court for the Middle District of North Carolina asking that court to vacate its entire prior ruling, including the portion relating to the test for "routine" projects.

TVA is currently involved in an NSR case involving Bull Run, which is discussed in more detail above. The Supreme Court's rejection of the hourly standard for emissions testing could undermine one of TVA's defenses in the Bull Run case, although TVA has other available defenses. Environmental groups and North Carolina have given TVA notice in the past that they may sue TVA for alleged NSR violations at a number of TVA units. The Supreme Court's decision could encourage such suits, which are likely to involve units where emission control systems such as scrubbers and selective catalytic reduction systems are not installed, under construction, or planned to be installed in the relatively near term.

Significant Litigation to Which TVA Is Not a Party, Case Involving North Carolina's Petition to EPA . In 2005, North Carolina petitioned EPA under Section 126 of the CAA to impose additional emission reduction requirements for SO_2 and NO_x on coal-fired power plants in 13 states, including the states where TVA's coal-fired power plants are located. In March 2006, EPA denied the North Carolina petition primarily on the basis that CAIR remedies the problem. In June 2006, North Carolina filed a petition for review of EPA's decision with the D.C. Circuit. On October 1, 2007, TVA filed a friend of the court brief in support of EPA's decision to deny North Carolina's Section 126 petition. The D.C. Circuit ordered the parties, including TVA, to file new briefs in the case and to address what should happen if the court vacates CAIR.

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

Not applicable.

PART II

IT EM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Not applicable.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data for the years 2004 through 2008 should be read in conjunction with the audited financial statements and notes thereto (collectively, the "Financial Statements") presented in Item 8, Financial Statements and Supplementary Data. Certain reclassifications have been made to the 2004, 2005, 2006, and 2007 financial statement presentation to conform to the 2008 presentation.

Statements of Income Data
For the years ended September 30
(in millions)

	2008	2007	2006	2005	2004
Operating revenues [1, 7]	$ 10,382	$ 9,326	$ 8,983	$ 7,792[7]	$ 7,525[7]
Revenue capitalized during pre-commercial plant operations	–	(57)	–	–	–
Operating expenses [6, 8]	(8,198) [2]	(7,726) [2]	(7,560) [2]	(6,455) [2, 7]	(5,833) [3, 7]
Operating income	2,184	1,543	1,423	1,337	1,692
Other income, net [1, 4, 6, 7]	9	71	78	57[7]	64[7]
Unrealized gain (loss) on derivative contracts, net	–	41	(15)	3	(7)
Net interest expense [4, 8]	(1,376)	(1,232)	(1,264)	(1,312) [8]	(1,363) [8]
Cumulative effect of accounting changes	–	–	(109) [5]	–	–
Net income	$ 817	$ 423	$ 113	$ 85	$ 386

Notes

(1) Prior to 2007, TVA reported certain revenue not directly associated with revenue derived from electric operations as OTHER REVENUE . This income of $10 million, $12 million, and $8 million for 2006, 2005, and 2004, respectively, has been reclassified from OTHER REVENUE to OTHER INCOME . Additionally, certain items not directly associated with the sale of electricity were previously reported as S ALES OF ELECTRICITY . This revenue of $22 million, $23 million, and $22 million for 2006, 2005, and 2004, respectively, has been reclassified from S ALES OF ELECTRICITY to OTHER REVENUE .

(2) During 2008, 2007, 2006, and 2005, TVA recognized a total of $9 million, $21 million, $14 million, and $24 million, respectively, in impairment losses related to its PROPERTY, PLANT, AND EQUIPMENT . The 2008 LOSS ON ASSET IMPAIRMENT included a $4 million write-off due to project and technology changes from a wet scrubber to a dry scrubber at John Sevier Fossil Plant, a $4 million write-off of limestone grinding equipment purchased for the Bull Run Fossil Plant when the decision was made to purchase limestone in the pre-ground state, as well as approximately $1 million in write-offs of other C ONSTRUCTION WORK IN PROGRESS assets. The 2007 LOSS ON ASSET IMPAIRMENT included a $17 million write-down of a scrubber project at Colbert and write-downs of $4 million related to other CONSTRUCTION IN PROGRESS assets. The 2006 LOSS ON ASSET IMPAIRMENT included write-downs of $12 million on certain CONSTRUCTION IN PROGRESS assets related to new pollution-control and other technologies that had not been proven effective and a re-evaluation of other projects due to funding limitations and a $2 million write-down on one of two buildings in TVA's Knoxville Office Complex based on TVA's plans to sell or lease the East Tower of the Knoxville Office Complex. The 2005 LOSS ON ASSET IMPAIRMENT included a $16 million write-down on certain CONSTRUCTION IN PROGRESS assets related to new pollution-control and other technologies that had not been proven effective and a re-evaluation of other projects due to funding limitations and an $8 million write-down on one of two buildings in TVA's Knoxville Office Complex based on TVA's plans to sell or lease the East Tower of the Knoxville Office Complex.

(3) During 2004, TVA was notified by a supplier that it would not proceed with manufacturing of fuel cells to be installed in the partially completed Regenesys energy storage plant in Columbus, Mississippi. Accordingly, TVA recognized a net $20 million loss on the cancellation of the Regenesys project.

(4) Prior to 2006, TVA reported short-term investment interest income with interest expense. Interest income of $19 million and $6 million for 2005 and 2004, respectively, has been reclassified from INTEREST EXPENSE, NET to OTHER INCOME, NET.

(5) During 2006, TVA adopted FIN No. 47, " *Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143* ," which resulted in a cumulative effect charge to income of $109 million and an increase in accumulated depreciation of $20 million. See Note 5.

(6) TVA has certain service organizations which provide maintenance and testing services to customers both inside and outside of TVA. For 2006 and 2005, the excess of cost recovery over actual cost and services provided to TVA organizations of $12 million and $12 million,

respectively, has been reclassified from OTHER INCOME to OPERATING EXPENSE .

(7) Certain items previously reported as revenue under OTHER REVENUE were reclassified as OTHER INCOME . These items were not directly associated with revenue derived from electric operations but are associated with the operation of service organizations which provide environmental and maintenance and testing services. Previously reported revenue from these items of approximately $5 million and $13 million for 2005 and 2004, respectively, are now included in OTHER INCOME . Additionally, certain OTHER REVENUE related to income derived from electric operations was recorded net of related expenses. Expenses of $15 million and $13 million for 2005 and 2004, respectively, have been reclassified from OTHER REVENUE to operating expenses.

(8) Subsequent to 2005, certain financing charges related to leaseback obligations were recorded as OPERATING AND MAINTENANCE expense. Beginning with 2006, these financing charges are classified as interest expense. Previously reported financing charges of approximately $51 million and $53 million for 2005 and 2004, respectively, are now included in INTEREST ON DEBT AND LEASEBACK OBLIGATIONS .

Balance Sheets Data
At September 30
(in millions)

	2008	2007	2006	2005	2004
Assets					
Current assets [1]	$ 2,503	$ 2,436	$ 2,513	$ 2,176	$ 2,295
Property, plant, and equipment, net	25,779	24,832	24,421	23,888	23,699
Investment funds	956	1,169	972	858	744
Regulatory and other long-term assets	7,899	5,295	6,402	7,551	7,451
Total assets	$ 37,137	$ 33,732	$ 34,308	$ 34,473	$ 34,189
Liabilities and proprietary capital					
Current liabilities [1]	$ 4,252	$ 3,429	$ 5,229	$ 6,724	$ 5,420
Regulatory and other liabilities	8,918	6,400	7,052	7,606	7,168
Long-term debt, net	20,404	21,099	19,544	17,751	19,337
Total liabilities	33,574	30,928	31,825	32,081	31,925
Retained earnings	2,571	1,763	1,349	1,244	1,162
Other proprietary capital	992	1,041	1,134	1,148	1,102
Total proprietary capital	3,563	2,804	2,483	2,392	2,264
Total liabilities and proprietary capital	$ 37,137	$ 33,732	$ 34,308	$ 34,473	$ 34,189

Notes

(1) In 2006, TVA began to apply certain customer advances previously reported as CURRENT LIABILITIES as a reduction to ACCOUNTS RECEIVABLE . The advances were $93 million in 2005 and $91 million in 2004. A reduction occurred to both CURRENT ASSETS and CURRENT LIABILITIES for the same amount.

Financial Obligations
As of September 30
(in millions)

	2008	2007	2006	2005	2004
Net long-term debt, excluding current maturities	$ 20,404	$ 21,099	$ 19,544	$ 17,751	$ 19,337
Other long-term obligations					
Capital leases *	92	104	128	150	138
Leaseback obligations	1,353	1,072	1,108	1,143	1,178
Energy prepayment obligations	1,033	1,138	1,244	1,350	1,455
Total other long-term obligations	2,478	2,314	2,480	2,643	2,771
Total long-term obligations	22,882	23,413	22,024	20,394	22,108
Discount notes	185	1,422	2,376	2,469	1,924
Current maturities of long-term debt, net	2,030	90	985	2,693	2,000
Total short-term obligations	2,215	1,512	3,361	5,162	3,924
Total financial obligations	$ 25,097	$ 24,925	$ 25,385	$ 25,556	$ 26,032

Note

* Included in ACCRUED LIABILITIES and OTHER LIABILITIES on the Balance Sheets.

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

(Dollars in millions except where noted)

Bu siness Overview

Distinguishing Features of TVA's Business

TVA operates the nation's largest public power system. In 2008, TVA provided electricity to 52 large industrial customers, six federal customers, and 159 distributor customers that serve nearly nine million people in seven southeastern states. TVA generates almost all of its revenues from the sale of electricity, and in 2008 revenues from the sale of electricity totaled $10.3 billion. As a wholly-owned agency and instrumentality of the United States, however, TVA is different from other electric utilities in a number of ways. A few of the more distinguishing features are discussed below.

Defined Service Area. TVA has a defined service area established by federal law. Subject to certain minor exceptions, TVA may not, without an act of Congress, enter into contracts which would have the effect of making it or the distributor customers of its power a source of power supply outside the area for which TVA or its distributor customers were the primary source of power supply on July 1, 1957. This statutory provision is referred to as the "fence" because it bounds TVA's sales activities, essentially limiting TVA to power sales within a defined service area. Correspondingly, however, the possibility of sales by others into TVA's service area is significantly limited. The Federal Power Act, primarily through its anti-cherrypicking provision, prevents FERC from ordering TVA to provide access to its transmission lines to others for the purpose of delivering power to customers within its service area except for customers in Bristol, Virginia.

Rate Authority. Typically, a utility is regulated by a public utility commission, which approves the rates the utility may charge. TVA, however, is self-regulated with respect to rates. The TVA Act gives the TVA Board sole responsibility for establishing the rates TVA charges for power. These rates are not subject to judicial review or review or approval by any state or federal regulatory body. In setting TVA's rates, however, the TVA Board is charged by the TVA Act to have due regard for the objective that power be sold at rates as low as are feasible.

Funding. TVA's operations were originally funded primarily with appropriations from Congress. In 1959, however, Congress passed legislation that required TVA's power program to be self-financing from power revenues and proceeds from power program financings. Until 1999, TVA continued to receive some appropriations for certain multipurpose activities and for its stewardship activities. Since 1999, however, TVA has not received any appropriations from Congress for any activities and has funded essential stewardship activities primarily with power revenues in accordance with a statutory directive from Congress.

TVA, unlike investor-owned power companies, is not authorized to raise capital by issuing equity securities. TVA relies primarily on cash from operations and proceeds from power program borrowings to fund its operations. The TVA Act authorizes TVA to issue bonds, notes, and other evidences of indebtedness (collectively, "Bonds") in an amount not to exceed $30 billion at any time. From time to time, draft legislation is introduced in Congress that would expand the types of financial obligations that count towards TVA's $30 billion debt ceiling. Under this draft legislation, long-term obligations that finance capital assets would also count toward the debt ceiling, including leaseback arrangements and power prepayment agreements with original terms exceeding one year. If Congress decides to broaden the type of financial instruments that are covered by the debt ceiling or to lower the debt ceiling, TVA might not be able to raise enough capital to, among other things, service its then-existing financial obligations, properly operate and maintain its power assets, and provide for reinvestment in its power program. At September 30, 2008, TVA had approximately $22.7 billion of Bonds outstanding (not including noncash items of foreign currency valuation loss of $138 million and net discount on sale of bonds of $199 million). For additional information regarding TVA's sources of funding, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Liquidity and Capital Resources — Sources of Liquidity.*

Stewardship Activities. TVA's mission includes managing the United States' fifth largest river system — the Tennessee River, its tributaries, and public lands along the shoreline — to provide, among other things, year-round navigation, flood damage reduction, affordable and reliable electricity, and, consistent with these primary purposes, recreational opportunities, adequate water supply, improved water quality, and economic development. There are 49 dams that comprise TVA's integrated reservoir system. The reservoir system provides 800 miles of commercially navigable waterway and also provides significant flood reduction benefits both within the Tennessee River system and downstream on the lower Ohio and Mississippi Rivers. The reservoir system also provides a water supply for residential and industrial customers, as well as cooling water for some of TVA's coal-fired and nuclear power plants. TVA's Environmental Policy (approved in May 2008) provides objectives for an integrated approach to TVA's multi-faceted mission by providing cleaner, reliable, and still affordable energy, supporting sustainable economic growth, and engaging in proactive environmental stewardship. The Environmental Policy provides additional direction in several environmental stewardship areas, including water resource protection and improvements, sustainable land use, and natural resource management. TVA also manages 293,000 acres of reservoir lands for natural resource protection, recreation, and other purposes.

Economic Development Activities . Since its beginnings in 1933, part of TVA's mission has been to promote the development of the Tennessee Valley. TVA works with its distributor customers, regional, state and local agencies, and communities to showcase the advantages available to businesses locating or expanding in TVA's seven-state service area. These efforts have resulted in new investments and quality jobs that benefit Tennessee Valley residents.

At its October 30, 2008 meeting, the TVA Board approved a new economic development initiative, the Valley Investment Initiative. Under the Valley Investment Initiative, TVA and distributors of TVA power will provide an incentive award to existing companies in TVA's seven-state service area that demonstrate a multi-year commitment to sustained capital investment, the creation of quality jobs, compatible and efficient power use, and a commitment to remain in the TVA region.

To monitor its progress in accomplishing its economic development mission, the TVA Board uses an economic development index performance measure. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary — 2008 Performance Indicators* . This measure tracks the number of jobs added and/or retained in the Tennessee Valley, the amount of capital investment in the Valley, and the impact of the retained and added jobs on the economic vitality of the Valley. These three metrics represent the influence TVA has on sustainable economic growth in the Valley.

Executive Summary

Challenges During 2008

TVA faced several challenges during 2008 that impacted its cash flows, results of operations, and financial condition. The most significant of these challenges related to investment performance, weather conditions, higher commodity prices, asset performance, and water supply and temperature.

Investment Performance. The performance of debt, equity, and other markets in 2008 negatively impacted the asset values of investments held in TVA's pension and decommissioning trust funds. During 2008, the investments in the TVA Retirement System declined in value $1,429 million, or 19 percent. As of September 30, 2008, the TVA retirement system was approximately 80 percent funded. From October 1, 2008, to November 30, 2008, the investments in the TVA Retirement System declined in value an additional $1,138 million, or 18 percent. Because of these declines, TVA may be required to make additional contributions to the TVA Retirement System in the future.

During 2008, the nuclear decommissioning trust portfolio declined in value $241 million, or 22 percent. As of September 30, 2008, TVA's nuclear decommissioning trust funding was 98 percent of the estimated present value of the funding requirements established by the Nuclear Regulatory Commission ("NRC"). From October 1, 2008, to November 30, 2008, the nuclear decommissioning trust portfolio declined in value an estimated additional $206 million, or 24 percent.

TVA will submit its biennial funding status report to NRC in March 2009. Based on the status of the funding requirement at that time, TVA anticipates it may make contributions to the decommissioning trust fund or provide other methods of decommissioning funding assurance necessary to match projected decommissioning fund balances. TVA is monitoring the monetary value of its nuclear decommissioning trust fund in light of recent market performance and believes that, over the long term before cessation of nuclear plant operations and commencement of decommissioning activities, adequate funds from investments will be available to support decommissioning.

During 2008, TVA's asset retirement trust portfolio, which is invested entirely in fixed income funds, increased in value $1.4 million, or 3.5 percent. From October 1, 2008, to November 30, 2008, the asset retirement trust portfolio increased in value an additional $155 thousand, or 0.19 percent.

TVA's investment policies are based on the objective of meeting long-term obligations, and the allocation of investments is based on the assumption of encountering distressed market conditions from time to time. TVA does not anticipate making significant changes in its basic investment policies as a result of current market conditions. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities — Investment Price Risk.*

Weather Conditions. 2008 was the ninth driest year in the eastern Tennessee Valley in 119 years of record-keeping. Rainfall in the eastern Tennessee Valley was 76 percent of normal for the year, and runoff was 47 percent of normal. Largely as a result of this low rainfall and runoff, TVA's hydroelectric production for 2008 was slightly less than 6.7 billion kilowatt-hours, which was 26 percent, 33 percent, and 57 percent lower than in 2007, 2006, and 2005, respectively. Because of the lower hydroelectric production, TVA had to rely more heavily on purchased power and more expensive generation sources such as combustion turbines during 2008.

Higher Commodity Prices. Due to rising commodity prices across domestic and international markets, TVA experienced increased costs in short-term markets for natural gas, fuel oil, coal, and electricity during 2008. The market prices for these commodities at September 30, 2008, increased 31 percent, 65 percent, 62 percent, and 22 percent, respectively, as compared to the market prices at September 30, 2007. Market prices for these commodities at September 30, 2008, and 2007, are shown in the table below.

Commodity Pricing Table
As of September 30, 2008

Commodity	2008	2007	Percent Change
Natural Gas (Henry Hub, $/mmBtu)	$ 9.01	$ 6.87	31%
Fuel Oil (Gulf Coast, $/mmBtu)	21.38	12.97	65%
Coal (FOB mine, $/ton)	48.13	29.65	62%
Electricity (Into-TVA, $/MWh)	70.95	58.03	22%

Since September 30, 2008, the market prices for some of these commodities have fallen.

Although the FCA provides a mechanism to regularly alter rates to reflect changing fuel and purchased power costs, there is a lag between the occurrence of a change in fuel and purchased power costs and the reflection of the change in rates. As a result, TVA's cash flows can be negatively affected by the FCA. As of September 30, 2008, TVA had $28 million in deferred fuel and purchased power costs that are expected to be recovered through the FCA in future periods. See Item 1, Business — *Rate Actions.*

Performance of Assets. Although TVA's generation and transmission assets performed well overall in meeting the peak demands during the summer of 2008, TVA faced hard spots in its operations related to large generating unit outages.

- Browns Ferry Unit 1 experienced five unplanned reactor shutdowns in the first five months after restart in June 2007.
- A planned outage at Sequoyah Nuclear Plant Unit 1 was extended 16 days due to the identification and repair of damage in the main generator during the scheduled outage.
- Browns Ferry Nuclear Plant Unit 3 experienced an unplanned automatic shutdown due to a main generator trip. As it was recovering from this generator trip, a secondary problem was discovered which required repairs and extended the duration of this outage 21 days.
- The duration of a planned outage scheduled at Watts Bar Nuclear Plant Unit 1 was extended nine days due to emergent issues and complications associated with completion of identified outage work.
- Fossil generation was 2.2 percent less than planned during 2008 primarily due to a 35-day extension of a planned outage on Colbert Fossil Plant Unit 5 and increased forced outage rates at Bull Run Fossil Plant and Widows Creek Fossil Plant Unit 7.

See Item 7, Management's Discussion and Analysis and Results of Operations — *Results of Operations — Operating Expenses* .

Challenges Related to Water Supply and Water Temperature. TVA faces challenges related to water supply and water temperature on the Cumberland River system and on the Tennessee River system. On the Cumberland River system, the U.S. Army Corps of Engineers ("Corps") operates hydroelectric facilities and TVA operates fossil plants. TVA also operates hydroelectric facilities, fossil plants, and nuclear plants on the Tennessee River system.

Cumberland River Challenges. The Corps operates eight hydroelectric facilities on the Cumberland River which fall under the SEPA agreement with TVA. Of these facilities, Wolf Creek and Center Hill Dams are in need of emergency repairs. The need to repair the dams coupled with the drought has resulted in less water flow and above normal water temperatures. TVA has been impacted in two ways.

First, SEPA's emergency operating plan reduced the amount of power TVA received from SEPA due to the drought and the need to repair the Wolf Creek and Center Hill Dams. It is likely that an easing of the drought will not eliminate the need for the emergency operating plans in the future because it is unclear how long it will take the Corps to repair these facilities.

Second, during the summer of 2008, reduced flow through the Cumberland River system, combined with higher than normal upstream river temperatures, forced TVA to reduce ("derate") the power output of its Cumberland and Gallatin Fossil Plants to remain in compliance with discharge temperature limits contained in the plants' discharge permits. To mitigate the derates, TVA installed and commenced operation of temporary cooling towers at its Cumberland Fossil Plant in July 2008. Operation of the cooling towers reduced Cumberland Fossil Plant's output by slightly less than one percent; however, no derates were experienced at the plant after the cooling towers began operating. Output from Gallatin Fossil Plant on the Cumberland River was reduced by approximately three percent, primarily during off-peak hours, to avoid exceeding thermal limits. Summer derates continue to remain a possibility in the future, especially until the Wolf Creek and Center Hill Dams are repaired and normal water flow is restored on the Cumberland River.

Tennessee River System Challenges . Due to the drought, there has been significantly less rainfall and runoff in the Tennessee River system. The result was that less water was available for cooling purposes, and the water that was available was higher in temperature. During the summer of 2008, temperatures on the Tennessee River reached levels that required nearly constant use of cooling towers at Sequoyah and Browns Ferry Nuclear Plants to keep the permitted thermal limits for the river from being exceeded. Using the cooling towers required a substantial amount of power that TVA would have otherwise sold. After Browns Ferry lost the use of cooling towers due to equipment malfunction in early August 2008, TVA temporarily reduced power output on all three units to 50 percent of capacity to avoid exceeding permitted thermal limits. While every effort was made to take derates during low load periods to reduce financial and operational impacts, some derates were required during higher load daytime hours to meet the permitted temperature limits.

2008 Performance Indicators

TVA quantifies the results of its operations in accordance with its Strategic Plan, which outlines the policy-level direction for TVA and lists corporate-level metrics to be used in monitoring progress toward successful implementation of the plan. The Strategic Plan focuses on TVA's performance in the following five broad areas and establishes general guidelines for each area:

Customers :	Maintain power reliability, provide competitive rates, and build trust with TVA's customers;
People :	Build pride in TVA's performance and reputation;
Financial :	Adhere to a set of sound financial guiding principles to improve TVA's fiscal performance;
Assets :	Use TVA's assets to meet market demand and deliver public value; and
Operations :	Improve performance to be recognized as an industry leader.

The Strategic Plan also outlines the policy-level direction for TVA and lists corporate-level metrics to be used in monitoring progress toward successful implementation of the plan. These metrics encompass aspects of TVA's mission in energy, the environment, and economic development and may change from time to time.

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2008 Performance Indicators

	Performance Measure	Description
Customer	TVA's Delivered Cost of Power	
	Excluding FCA Costs	Measures cost per MWh sold (excluding FCA costs). Addresses the highest customer priority of "low cost and reliable power" and emphasizes controlling costs and increasing output.
	FCA Costs	Measures TVA's FCA expenses per MWh sold. Includes eligible expenses recovered through FCA mechanism (fuel, purchased power, emission allowance, and reagents). Encourages TVA to take actions to lower the overall cost of fuel, purchased power, and other eligible FCA costs.
	Economic Development Index	Measures the effectiveness of TVA's sustainable economic development efforts by focusing on jobs growth in the Tennessee Valley, the quality of those jobs, and partnership investments in the TVA service area.
	Participation in Energy Efficiency & Peak Shaving Initiatives	Measures the percent of TVA customers that are participating in demand-side management programs (new and existing) such as energyright © New Homes or Heat Pumps.
	Customer Satisfaction Survey	Measures distributors' and directly served customers' satisfaction with TVA in a variety of areas including wholesale/retail supplier, performance of local TVA customer service staff, and power quality and reliability of transmission service, pricing, contracts, and power supply mix.
	Connection Point Interruptions	Measures reliability from the customer perspective by focusing on interruptions of power, including momentary, caused by the transmission system at connection points.
People	Cultural Health Index	Survey of TVA employees includes questions relating to the workforce environment, safety, Winning Behaviors, and Winning Performance. CHI assesses employee alignment, capability, and engagement as an overall gauge of cultural health.
	Safe Workplace	Measures TVA employee and staff augmentation safety related to the number of Occupational Safety and Health Administration recordable injuries per 200,000 hours worked. Includes fatality, day time restricted duty/job transfer, medical treatment, loss of consciousness, and other significant work-related injury/illness.
Financial	Debt-like Obligations/Asset Value	Measures TVA's debt-like obligations as a percent of total assets. Includes debt, lease obligations, and prepaid energy obligations. Focuses on achieving a more flexible cost structure.
	Earnings/Asset Value	Measures income statement earnings before interest, depreciation, amortization, and taxes divided by total assets. Emphasizes effective cost management and productivity by focusing on TVA's return on assets.
	Non-fuel O&M	Measures all non-fuel operations and maintenance costs per MWh sales. Emphasizes competitiveness by focusing on the most controllable component of TVA's total costs.
Asset/Operations	Key Environmental Metrics	Measures impact of TVA's operations on the environment by focusing on key environmental footprint metrics. Includes weighted summation of: NO_x + SO_2 + CO_2 + Clean Water Act Nonconformances + Oil Spills to Water + Reportable Quantity Releases + Notices of Violation + Office Recyclables.
	Megawatt Demand Reduction (MW Reduced)	Measures level of demand reduction for electricity (MW) through the efficient use of electricity. Promotes conservation through the construction of site-built homes that exceed minimum efficiency

	standards.
Equivalent Availability Factor	Measures the actual available generation from all TVA generating assets in a given period compared to maximum potential availability. Focuses on the generation component of the highest customer priority, "low cost and reliable power."

Future Challenges

TVA faces several challenges that may impact its cash flows, results of operations, and financial condition in the future. The most significant of these challenges are discussed below.

Meeting the Power Needs in TVA's Service Area. Demand for power in TVA's service area had grown at an average of two percent per year from 2001 to 2007. During 2008, demand increased only about 0.2 percent, however, for 2009, TVA has forecasted relatively flat load and sales growth as compared to 2008. This forecast is due in part to expected tighter economic conditions. Although there are many drivers that can contribute to lower sales growth and lower load, such as energy efficiency and more efficient industrial and mechanical equipment, loads are dependent on the economic conditions in TVA's service area. As economic conditions have deteriorated, TVA has experienced roughly a two percent reduction in expected sales in early 2009 and anticipates that the energy sales for the remainder of 2009 will be lower than expected in the 2009 budget. TVA is not anticipating conditions to improve significantly in the near future but continues to monitor and react to these trends.

Despite the recent reduction in power sales, TVA still projects that demand for power in its service area will increase over the long-term and plans to meet the need for additional power through a variety of means:

- *New Generation.* TVA intends to add new generation assets. This intention was reflected in TVA's decision to complete the construction of Watts Bar Unit 2. The completion of Watts Bar Unit 2 is scheduled to occur in 2013 and cost approximately $2.5 billion. TVA plans to consider other opportunities to add new generation from time to time. Market conditions, like the volatility of the price of construction materials and the potential shortage of skilled craft labor, may add uncertainties to the cost and schedule of new construction.

- *Distributor-Owned Generation.* Under interim agreements dated September 30, 2008, TVA and Seven States Power Corporation ("SSPC"), a non-profit organization comprised of the majority of TVA distributor customers (who are also members of the Tennessee Valley Public Power Association), took the first steps in joint power plant ownership in the Tennessee Valley. (See Item 1 Business — *Power Supply — Generation Facilities,* Note 4 — *New Generation* , and Note 13 — *Leaseback Obligations* ,)

- *Power Purchases.* Purchasing power from others will likely remain a part of how TVA meets the power needs of its service area. The Strategic Plan establishes a goal of balancing production capabilities with power supply requirements by promoting the conservation and efficient use of electricity and, when necessary, buying, building, and/or leasing assets or entering into purchased power agreements. Achieving this goal will allow TVA to reduce its reliance on purchased power.

Non-Fuel Operating and Maintenance Costs. TVA has established two significant goals relating to non-fuel operating and maintenance costs.

- Achieving non-fuel operating and maintenance spending performance that ranks in the top quartile in the electric utility industry by managing these costs over the next three years; and after that time.

- Maintaining spending performance within the top quartile by keeping the rate of increase in these costs in line with the top quartile in the industry.

Meeting these goals will significantly affect TVA's ability to add new generation assets.

Future Contributions to TVA Investment Funds . TVA's nuclear decommissioning trust and pension funds have been adversely affected by the recent turmoil in the financial markets. If market conditions do not recover quickly enough or continue to deteriorate, TVA may be required to make contributions to these investment funds in excess of the amounts TVA is currently planning to contribute for the foreseeable future.

Performance of Generation Assets. Although TVA's generation and transmission assets performed extremely well overall in meeting the peak demands during the summer of 2008, TVA was adversely affected by the failure of some assets to operate as planned during times of high demand. As a result, TVA had to operate higher cost units or purchase power in the higher cost energy spot market. See Item 1, Business — *Power Supply.* TVA is likely to face similar problems in the future since many of TVA's generation assets have been operating since the 1950s or earlier and have been in nearly constant service since they were completed. In addition, if drought conditions continue, TVA will have limited availability to operate its hydroelectric generating assets, which are its least expensive units to operate.

Bonds and Other Financial Obligations. As of September 30, 2008, TVA had $22.7 billion of Bonds outstanding (not including noncash items of foreign currency valuation loss of $138 million and net discount on sale of bonds of $199 million). The amount of TVA's Bonds outstanding has been reduced by about $5 billion since September 30, 1996, when the end of year balance of outstanding Bonds peaked. Since that time, however, TVA has entered into energy prepayment transactions that resulted in $1.6 billion in prepayment obligations and certain leaseback transactions that resulted in $1.3 billion in obligations. The amount of prepayment and leaseback obligations outstanding at September 30, 2008, was $2.4 billion. Payments on these Bonds and obligations do not change with the amount of power sold, and if competition increases, TVA's obligations to make these payments could limit its ability to adjust to market pressures. While prudent management of Bonds and other financial obligations will remain an important strategic consideration in the future, increased capital commitments may make it difficult for TVA to continue its trend of reducing these obligations.

Environmental Regulation. TVA expects to see increased environmental regulation in the future, including but not limited to the regulation of mercury and the emission of greenhouse gases such as CO_2. TVA has considered, and intends to continue considering, fuel mix in making decisions about additional generation. The restart of Browns Ferry Unit 1, the decision to complete the construction of Watts Bar Unit 2, and TVA's filing of a combined operating license application for two new units at the Bellefonte Nuclear Plant ("Bellefonte"), as well as TVA's request to reactivate the construction permit for the existing Bellefonte units (although no decision to construct any units at Bellefonte has been made), are examples of TVA's decisions to pursue or consider generation sources that do not emit greenhouse gases. The nature or level of future regulation of greenhouse gases is unclear at this time. Accordingly, the costs associated with such regulation are currently unknown but could be substantial. TVA would have to recover such costs in rates or pursue some other action which, among other options, might include removing some coal-fired units from service.

Renewable Portfolio. Under most proposed legislation, renewable power generation resources include solar, wind, incremental hydroelectric, biomass, and landfill gas. Generating power with renewable sources instead of coal-fired plants could help reduce the carbon intensity of TVA's generation. Power generated using renewable sources, with current technologies, may not be economically competitive compared to existing power generation assets. Technology advancements will be needed to address some of the operational issues associated with renewable energy, such as energy storage to address intermittency and interconnection technologies to address onsite, non-grid connected renewables and efficiencies.

Most renewable energy resources are geographically specific. Some regions of the United States have an abundance of wind and solar resources, whereas other regions have hydroelectric resources. Regional differences and limitations play a primary role in the types and amount of renewable and clean energy developed across the country. Within the area served by TVA (southeast United States), two of the most abundant renewable resources are hydroelectric and biomass. Feasible wind energy in this region is primarily associated with mountain top and ridgeline installations, and the total potential capacity is limited when compared to other parts of the nation where wind energy is more abundant. If TVA is required to increase its use of renewable resources and the cost of doing so is greater than the costs of other sources of generation, TVA's costs may increase, and, as a result, TVA may be forced to raise rates.

Liquidity and Capital Resources

Sources of Liquidity

TVA's current liabilities exceed current assets because of continued use of short-term debt to fund cash needs as well as scheduled maturities of long-term debt. To meet short-term cash needs and contingencies, TVA depends on various sources of liquidity. TVA's primary sources of liquidity are cash on hand and cash from operations and proceeds from the issuance of short-term and long-term debt.

Financial markets experienced extreme volatility in 2008, and have continued to experience extreme volatility into 2009 amid negative developments in housing and mortgage-related activities, weakness of major financial institutions, government actions, and negative economic developments. These conditions have resulted in disruptions in credit and lending activities, particularly in the short-term credit markets through which corporate institutions borrow and lend to each other. Disruptions in the short-term credit markets have the potential to impact TVA because TVA uses short-term debt to meet working capital needs, and because it typically invests its cash holdings in the short-term debt securities of other institutions.

TVA has not experienced difficulty in issuing short-term debt, or in refunding maturing debt, despite the disruptions in the credit markets. Throughout the period, TVA has experienced strong demand for its short-term discount notes, and has been able to issue discount notes at competitive rates.

Other than issuing electronotes ®, which are retail notes and are generally smaller in size than TVA's other long-term debt, TVA has not sought to issue long-term debt since June 2008. Despite conditions in the credit markets, however, TVA believes it would be able to issue long-term debt if needed.

Management expects continued demand for TVA short-term debt securities. Along with the short-term debt program, management expects operating cash flows, cash on hand, and access to credit facilities to continue to provide more than adequate liquidity for TVA for the foreseeable future.

Management is not able to anticipate the long-term impacts of recent financial market turmoil on TVA, the financial markets in which TVA participates, or the economy of the Tennessee Valley. Management closely monitors conditions in the markets in which TVA conducts business and the financial health of companies with which it does business, and will continue to monitor these conditions in the future in an effort to be proactive in maintaining financial health.

The majority of TVA's balance of cash on hand is typically invested in short-term investments. During 2008, TVA's average daily balance of cash and cash equivalents on hand was $357 million. The daily balance of cash and cash equivalents maintained is based on near-term expectations for cash expenditures and funding needs. Under the current market conditions, TVA has placed more of its short-term investments in U.S. Treasury securities and less in commercial paper money market funds.

In addition to cash on hand, cash from operations, and proceeds from the issuance of short-term and long-term debt, TVA's sources of liquidity include a $150 million credit facility with the U.S. Treasury, two credit facilities totaling $2.25 billion with a national bank, and occasional proceeds from other financing arrangements including call monetization transactions, sales of assets, and sales of receivables and loans. Each of these sources of liquidity is discussed below.

Summary Cash Flows. A major source of TVA's liquidity is operating cash flows resulting from the generation and sales of electricity. A summary of cash flow components for the years ended September 30 follows:

Summary Cash Flows
For the years ended September 30

	2008	2007	2006
Cash provided by (used in):			
Operating activities	$ 1,957	$ 1,788	$ 1,985
Investing activities	(2,299)	(1,686)	(1,698)
Financing activities	390	(473)	(289)
Net (decrease) increase in cash and cash equivalents	$ 48	$ (371)	$ (2)

Issuance of Debt. The TVA Act authorizes TVA to issue Bonds in an amount not to exceed $30 billion outstanding at any time. At September 30, 2008, TVA had only two types of Bonds outstanding: power bonds and discount notes. Power bonds have maturities of between one and 50 years, and discount notes have maturities of less than one year. Power bonds and discount notes rank on parity and have first priority of payment out of net power proceeds. Net power proceeds are defined as the remainder of TVA's gross power revenues after deducting the costs of operating, maintaining, and administering its power properties and payments to states and counties in lieu of taxes, but before deducting depreciation accruals or other charges representing the amortization of capital expenditures, plus the net proceeds from the sale or other disposition of any power facility or interest therein. See Note 11 — *General* .

Power bonds and discount notes are both issued pursuant to section 15d of the TVA Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution adopted by the TVA Board on October 6, 1960, as amended on September 28, 1976, October 17, 1989, and March 25, 1992 (the "Basic Resolution"). The TVA Act and the Basic Resolution each contain two bond tests: the rate test and the bondholder protection test.

Under the rate test, TVA must charge rates for power which will produce gross revenues sufficient to provide funds for:

- Operation, maintenance, and administration of its power system;
- Payments to states and counties in lieu of taxes;
- Debt service on outstanding Bonds;
- Payments to the U.S. Treasury as a repayment of and a return on the Power Facilities Appropriation Investment; and
- Such additional margin as the TVA Board may consider desirable for investment in power system assets, retirement of outstanding Bonds in advance of maturity, additional reduction of the Power Facilities Appropriation Investment, and other purposes connected with TVA's power business, having due regard for the primary objectives of the TVA Act, including the objective that power shall be sold at rates as low as are feasible.

Under the bondholder protection test, TVA must, in successive five-year periods, use an amount of net power proceeds at least equal to the sum of:

- The depreciation accruals and other charges representing the amortization of capital expenditures, and
- The net proceeds from any disposition of power facilities,

for either

- The reduction of its capital obligations (including Bonds and the Power Facilities Appropriation Investment), or
- Investment in power assets.

TVA must next meet the bondholder protection test for the five-year period ending September 30, 2010.

As discussed above, TVA uses proceeds from the issuance of discount notes, in addition to other sources of liquidity, to fund working capital requirements. During 2008, 2007, and 2006, the average outstanding balance of discount notes was $767 million, $2.3 billion, and $2.0 billion, respectively, and the weighted average interest rate on discount notes was 3.71 percent, 5.17 percent, and 4.47 percent, respectively. At September 30, 2008, $185 million of discount notes were outstanding with a weighted average interest rate of 1.26 percent. The discount notes are not listed on any stock exchange.

TVA issues power bonds primarily to refinance previously-issued power bonds as they mature. During 2008 and 2007, TVA issued $2.1 billion and $1.0 billion of power bonds, respectively, and redeemed $689 million and $470 million of power bonds, respectively. At September 30, 2008, outstanding power bonds (including current maturities of long-term debt) consisted of the following:

Outstanding Power Bonds
As of September 30, 2008

CUSIP or Other Identifier	Maturity	Coupon Rate	Principal Amount [1]	Stock Exchange Listings
electronotes®	03/15/2009 - 01/15/2028	3.200% - 5.625% [2]	$ 910	None
880591DB5	11/13/2008	5.375%	2,000	New York, Hong Kong, Luxembourg, Singapore
880591DN9	01/18/2011	5.625%	1,000	New York, Luxembourg
880591DL3	05/23/2012	7.140%	29	New York
880591DT6	05/23/2012	6.790%	1,486	New York
880591CW0	03/15/2013	6.000%	1,359	New York, Hong Kong, Luxembourg, Singapore
880591DW9	08/01/2013	4.750%	940	New York, Luxembourg
880591DY5	06/15/2015	4.375%	1,000	New York, Luxembourg
880591DS8	12/15/2016	4.875%	524	New York
880591EA6	07/18/2017	5.500%	1,000	New York, Luxembourg
880591CU4	12/15/2017	6.250%	650	New York
880591EC2	04/01/2018	4.500%	1,000	New York, Luxembourg
880591DC3	06/07/2021	5.805% [3]	356	New York, Luxembourg
880591CJ9	11/01/2025	6.750%	1,350	New York, Hong Kong, Luxembourg, Singapore
880591300	06/01/2028	5.460%	350	New York
880591409	05/01/2029	5.174%	298	New York
880591DM1	05/01/2030	7.125%	1,000	New York, Luxembourg
880591DP4	06/07/2032	6.587% [3]	445	New York, Luxembourg
880591DV1	07/15/2033	4.700%	472	New York, Luxembourg
880591DX7	06/15/2035	4.650%	436	New York
880591CK6	04/01/2036	5.980%	121	New York
880591CS9	04/01/2036	5.880%	1,500	New York
880591CP5	01/15/2038	6.150%	1,000	New York
880591ED0	06/15/2038	5.500%	500	New York
880591BL5	04/15/2042	8.250%	1,000	New York
880591DU3	06/07/2043	4.962% [3]	267	New York, Luxembourg
880591CF7	07/15/2045	6.235%	140	New York
880591EB4	01/15/2048	4.875%	500	New York, Luxembourg
880591DZ2	04/01/2056	5.375%	1,000	New York
Subtotal			**22,633**	
Unamortized discounts, premiums, and other			(199)	
Total outstanding power bonds, net			**$ 22,434**	

Notes

(1) The above table includes net exchange losses from currency transactions of $138 million at September 30, 2008.
(2) The weighted average interest rate of TVA's outstanding electronotes ® was 4.83 percent at September 30, 2008.
(3) The coupon rate represents TVA's effective interest rate.

As of September 30, 2008, all of TVA's Bonds were rated by at least one rating agency except for two issues of power bonds and TVA's discount notes. TVA's rated Bonds are currently rated "Aaa" by Moody's Investors Service and/or "AAA" by Standard & Poor's and/or Fitch Ratings, which are the highest ratings assigned by these agencies. The ratings are not recommendations to buy, sell, or hold any TVA securities and may be subject to revision or withdrawal at any time by the rating agencies. Ratings are assigned independently, and each should be evaluated as such.

For additional information about TVA debt issuance activity and debt instruments issued and outstanding as of September 30, 2008 and 2007, including identifiers, rates, maturities, outstanding principal amounts, and redemption features, see Note 11.

$150 Million Note with U.S.Treasury. TVA has access to financing arrangements with the U.S. Treasury, whereby the U.S. Treasury is authorized to accept an interim obligation with maturity of one year or less in an aggregate amount outstanding not to exceed $150 million. Interest accrues daily at a rate determined by the U.S. Secretary of the Treasury each month based on the average of outstanding obligations of the United States with maturities of one year or less. During 2008, 2007, and 2006, the daily average amounts outstanding were approximately $74 million, $132 million, and $131 million, respectively. The outstanding balances were repaid quarterly. In 2009, TVA and the U.S. Treasury replaced the $150 million note under which TVA previously borrowed from the U.S. Treasury with a memorandum of understanding under which TVA will have a $150 million credit facility. There are no fees other than interest on borrowings under the credit facility. TVA plans to use the U.S. Treasury credit facility as a source of liquidity, but not as a primary source of liquidity, in 2009. See Note 9 — *Payments to U.S. Treasury* and Note 11 — *Short-Term Debt.*

Credit Facilities. TVA has short-term funding available in the form of two short-term revolving credit facilities, one of which is a $1.25 billion facility that matures on May 13, 2009, and the other of which is a $1 billion facility that matures on November 9, 2009. See Note 18 — *Credit Facility Agreements* . The interest rate on any borrowing under both of these facilities is variable and based on market factors and the rating of TVA's senior unsecured long-term non-credit enhanced debt. TVA is required to pay an unused facility fee on the portion of the total $2.25 billion against which TVA has not borrowed. The fee may fluctuate depending on the non-enhanced credit ratings on TVA's senior unsecured long-term debt. There were no outstanding borrowings under the facilities at September 30, 2008. TVA anticipates renewing each credit facility as it matures. TVA anticipates that when it renews the second credit facility in May 2009, the amount of this facility will also be reduced.

Call Monetization Transactions. From time to time TVA has entered into swaption transactions to monetize the value of call provisions on certain of its Bond issues. A swaption essentially grants a third party the right to enter into a swap agreement with TVA under which TVA receives a floating rate of interest and pays the third party a fixed rate of interest equal to the interest rate on the Bond issue whose call provision TVA monetized. Through September 30, 2008, TVA has entered into four swaption transactions that generated proceeds of $261 million.

- In 2003, TVA monetized the call provisions on a $1 billion Bond issue and a $476 million Bond issue by entering into swaption agreements with a third party in exchange for $175 million and $81 million, respectively.

- In 2005, TVA monetized the call provisions on two Bond issues ($42 million total par value) by entering into swaption agreements with a third party in exchange for $5 million.

For more information regarding TVA's call monetization transactions, see Note 10 — *Swaptions and Related Interest Rate Swaps.*

Sale of Interest in TVA Generating Facility. On September 30, 2008, TVA obtained approximately $325 million in proceeds from selling a 69.69 percent undivided interest in its three-unit, 792-megawatt summer net capability, combined cycle combustion turbine facility located in Southaven, Mississippi. Seven States Power Corporation ("SSPC"), the purchaser, through its wholly-owned subsidiary, Seven States Southaven, LLC ("SSSL"), has the ability to acquire up to a 90 percent undivided interest in the facility and may increase its ownership in the facility up to this amount on or prior to May 9, 2009. Because of TVA's continued ownership interest in the facility as well as buy-back provisions, the transaction did not qualify as a sale and accordingly has been recorded as a leaseback obligation. See Note 4 — *Asset Acquisitions and Dispositions* .

Sales of Receivables/Loans. From time to time TVA obtains proceeds from selling receivables and loans. During 2008, TVA sold $2 million of receivables at par such that TVA did not recognize a gain or loss on the sale. These were receivables from a power customer related to energy conservation projects. The proceeds from the sale of these receivables are included within the Cash Flow Statement under the caption CASH FLOWS FROM INVESTING ACTIVITIES .

During 2007, TVA sold $2 million of receivables at par such that TVA did not recognize a gain or loss on the sale. These were receivables from a power customer related to the construction of a substation. The proceeds from the sale of these receivables are included within the Cash Flow Statement under the caption CASH FLOWS FROM INVESTING ACTIVITIES .

TVA did not retain any claim on these receivables and loans sold, and they are no longer reported on TVA's Balance Sheets. For more information regarding TVA's sales of receivables and loans, see Note 1 — *Sales of Receivables/Loans* .

2008 Compared to 2007

Net cash provided by operating activities increased from $1,788 million in 2007 to $1,957 million in 2008. This $169 million increase primarily resulted from:

- An increase in cash from operating revenues of $1,109 million resulting primarily from increases in revenue from municipalities and cooperatives and industries directly served, in both cases, from higher average rates and the FCA and, in the case of industries directly served, higher volume.

This increase was partially offset by:

- An increase in cash paid for fuel and purchased power of $376 million due to higher volume and increased market prices for purchased power;
- An increase in cash paid for interest of $147 million;
- An increase in cash used by changes in working capital of $115 million resulting primarily from an $88 million decrease in accounts payable and accrued liabilities in 2008 compared to a $103 million increase in 2007 and a $40 million larger increase in inventories and other, net, partially offset by an $85 million smaller increase in accounts receivable and a $31 million larger increase in interest payable;
- An increase in pension contributions of $85 million;
- Cash provided by deferred items of $5 million in 2008 compared to $61 million of cash provided by deferred items in 2007. This change is primarily due to funds collected in rates in 2007 that were used to fund future generation. See Note 1 — *Reserve for Future Generation* ;
- An increase in cash paid for refueling outage costs of $54 million;
- An increase in tax equivalent payments of $40 million; and
- An increase in cash outlays for routine and recurring operating costs of $25 million.

Net cash used in investing activities increased from $1,686 million in 2007 to $2,299 million in 2008. This $613 million increase resulted primarily from:

- An increase in expenditures for capital projects of $484 million primarily due to the purchase of a three-unit, 792-megawatt combined cycle, combustion turbine facility located in Southaven, Mississippi;
- A $119 million increase in expenditures for the enrichment and fabrication of nuclear fuel related to a buildup of fuel for strategic inventory purposes; and
- A $23 million decrease in cash from collateral deposits. See Note 1 — *Restricted Cash and Investments.*

Net cash used by financing activities was $473 million in 2007 as compared to net cash provided by financing activities of $390 million in 2008. The $863 million change was primarily the result of:

- An increase in long-term debt issues as a result of the issuance of $2,105 million of long-term debt; and
- Proceeds of $325 million from the sale/leaseback of the Southaven facility.

These items were partially offset by:

- The net redemption of $1,237 million of short-term debt in 2008 as compared to the net redemption of $955 million of short-term debt in 2007; and
- An increase in redemptions and repurchases of long-term debt of $219 million, with long-term debt of $689 million retired in 2008.

2007 Compared to 2006

Net cash provided by operating activities decreased from $1,985 million in 2006 to $1,788 million in 2007. This $197 million decrease primarily resulted from:

- An increase in cash paid for fuel and purchased power of $249 million due to higher volume of fuel and purchased power needed to replace hydroelectric generation as well as increased market prices for fuel;
- An increase in cash outlays for routine and recurring operating costs of $108 million;
- An increase in tax equivalent payments of $76 million; and
- An increase in expenditures for nuclear refueling outages of $24 million due to three planned outages in 2007 compared to two planned outages in the prior year.

These items were partially offset by:

- A decrease of $154 million in cash used by changes in working capital resulting primarily from a smaller increase in the accounts receivable balance of $142 million and a larger increase in accounts payable and accrued liabilities of $9 million;
- Cash provided by deferred items of $61 million in 2007 compared to a $35 million net use of cash in 2006. This change is primarily due to funds collected in rates during 2007 that were used to fund future generation. See Note 1— *Reserve for Future Generation* ; and
- A decrease in cash paid for interest of $33 million in 2007.

Cash used in investing activities decreased from $1,698 million in 2006 to $1,686 million in 2007. This $12 million decrease resulted primarily from:

- A source of cash from collateral deposits in 2007 of $48 million as compared to a net use of cash of $91 million in 2006. See Note 1 — *Restricted Cash and Investments* ; and
- A decrease in expenditures for the enrichment and fabrication of nuclear fuel of $74 million related to the restart of Browns Ferry Unit 1 in 2007.

These items were partially offset by:

- An increase in expenditures of $111 million to acquire the Gleason and Marshall County combustion turbine facilities in 2007;
- A $40 million contribution to the Asset Retirement Trust. See Note 1 — *Investment Funds;*
- A damage award of $35 million that TVA received in 2006 in its breach of contract suit against the DOE not present in 2007; and
- An increase in expenditures for capital projects of $9 million.

Net cash used in financing activities increased from $289 million in 2006 to $473 million in 2007. This $184 million increase resulted primarily from:

- A decrease of $92 million in long-term debt issues; and
- An increase in net redemptions of short-term debt of $862 million.

These items were partially offset by a decrease in redemptions of long-term debt of $771 million in 2007 compared to 2006.

Cash Requirements and Contractual Obligations

Due to the nature of the power industry, which requires large multi-year capital investments, using trends and multi-year forecasts is important in assessing the effectiveness of management’s decisions related to capital expenditures, pricing, and accessing capital markets.

The future planned construction expenditures for property, plant, and equipment additions, including clean air projects and new generation, are estimated to be as follows:

Future Planned Construction Expenditures [1]
As of September 30

	Actual	Estimated Construction Expenditures				
	2008	2009	2010	2011	2012	2013
Watts Bar Unit 2	$ 245	$ 649	$ 681	$ 595	$ 314	$ –
Other Capacity Expansion Expenditures	827	665	773	957	1,507	1,954
Clean Air Expenditures	277	232	223	440	475	608
Transmission Expenditures [2]	98	32	45	34	40	41
Other Capital Expenditures [3]	547	510	489	557	566	557
Total Capital Projects Requirements	$ 1,994[4]	$ 2,088	$ 2,211	$ 2,583	$ 2,902	$ 3,160

Notes

(1) TVA plans to fund these expenditures with power revenues and proceeds from power program financings. This table shows only expenditures that are currently planned. Additional expenditures may be required for TVA to meet the anticipated growth in demand for power in its service area.

(2) Transmission Expenditures include reimbursable projects. Transmission expenditures for capacity expansion or load growth are included in Other Capacity Expansion Expenditures.

(3) Other Capital Expenditures are primarily associated with short lead time construction projects aimed at the continued safe and reliable operation of generating assets.

(4) The numbers above exclude allowance for funds used during construction of $4 million in 2008.

TVA conducts a continuing review of its construction expenditures and financing programs. The amounts shown in the table above are forward-looking amounts based on a number of assumptions and are subject to various uncertainties. Actual amounts may differ materially based upon a number of factors, including, but not limited to, changes in assumptions about system load growth, environmental regulation, rates of inflation, total cost of major projects, and availability and cost of external sources of capital, as well as the outcome of the ongoing restructuring of the electric industry. See *Forward-Looking Information.*

Management does not anticipate that TVA will substantially change its strategy for meeting long-term power supply needs due to recent conditions in the financial markets. TVA's primary sources of funding for new generation investments are expected to continue to be cash from operations and power program financings.

In the near term, TVA may be negatively impacted by investments in new generation (for example Watts Bar Unit 2) that are not expected to provide a cash return until put into service.

TVA also has certain obligations and commitments to make future payments under contracts. The following table sets forth TVA's estimates of future payments as of September 30, 2008. See Notes 9, 11, and 15 for a further description of these obligations and commitments.

Commitments and Contingencies
Payments due in the year ending September 30

	2009	2010	2011	2012	2013	Thereafter	Total
Debt	$ 2,215	$ –	$ 1,000	$ 1,514	$ 2,388	$ 15,563	$ 22,680[1]
Interest payments relating to debt	1,243	1,186	1,158	1,130	985	15,962	21,664
Lease obligations							
Capital	58	58	54	6	3	337	516
Non-cancelable operating	64	60	51	43	37	207	462
Purchase obligations							
Power	220	236	249	232	177	6,092	7,206
Fuel	1,184	787	603	398	327	863	4,162
Other	121	30	23	25	18	100	317
Payments on leasebacks	85	89	95	97	100	918	1,384
Payment to U.S. Treasury							
Return of Power Facilities Appropriation Investment	20	20	20	20	20	10	110
Return on Power Facilities Appropriation Investment	14	21	20	19	17	155	246
Retirement plans	–	–	–	–	–	–	–
Total	$ 5,224	$ 2,487	$ 3,273	$ 3,484	$ 4,072	$ 40,207	$ 58,747

Note

(1) Does not include noncash items of foreign currency valuation loss of $138 million and net discount on sale of Bonds of $199 million.

During 2008, TVA executed certain contracts related to the resumption of construction activities at Watts Bar Unit 2. As of September 30, 2008, expenditures against these contracts are forecasted to be approximately $1.3 billion through 2012.

In addition to the cash requirements above, TVA has contractual obligations in the form of revenue discounts related to energy prepayments. See Note 1 — *Energy Prepayment Obligations.*

Energy Prepayment Obligations
Payments due in the year ending September 30

	Total	2009	2010	2011	2012	2013	Thereafter
Energy Prepayment Obligations	$ 1,033	$ 105	$ 105	$ 105	$ 105	$ 102	$ 511

Results of Operations

Sales of Electricity

Sales of electricity accounted for substantially all of TVA's operating revenues in 2008, 2007, and 2006. TVA sells power at wholesale to distributor customers, consisting of municipalities and cooperatives that resell the power to their customers at retail rates. TVA also sells power to (1) directly served customers, consisting primarily of federal agencies and customers with large or unusual loads, and (2) exchange power customers (electric systems that border TVA's service area) with which TVA has entered into exchange power arrangements. The following table compares TVA's energy sales statistics for 2008, 2007, and 2006.

Sales of Electricity
For the years ended September 30
(millions of kWh)

	2008	Percent Change	2007	Percent Change	2006
Municipalities and cooperatives	139,596	(2.0%)	142,461	2.8%	138,624
Industries directly served	34,695	11.9%	30,993	0.0%	30,987
Federal agencies and other	2,013	(3.0%)	2,075	1.7%	2,040
Total sales of electricity	176,304	0.4%	175,529	2.3%	171,651
Heating degree days	3,109	(0.4%)	3,123	0.2%	3,118
Cooling degree days	1,990	(15.7%)	2,361	12.0%	2,108
Combined degree days	5,099	(7.0%)	5,484	4.9%	5,226

2008 Compared to 2007

Significant items contributing to the 775 million kilowatt-hour increase in electricity sales included:

- A 3,702 million kilowatt-hour increase in sales to industries directly served primarily due to increased sales to TVA's two largest industrial customers, and increased sales to one other large customer due to increased demand since becoming a directly served customer in October 2006. These three customers accounted for 86 percent of the increase in sales to industries directly served.

This increase in sales to industries directly served was partially offset by:

- A 2,865 million kilowatt-hour decrease in sales to municipalities and cooperatives primarily due to a decrease in combined degree days of 385 days, or 7.0 percent. The unfavorable weather effects were partially offset by the addition of a new municipal and cooperative customer (Bristol Virginia Utilities) beginning in January 2008 and an additional day of sales in 2008 due to leap year.

- A 62 million kilowatt-hour decrease in sales to F EDERAL AGENCIES AND OTHER.
  - This decrease was attributable to a 102 million kilowatt-hour decrease in off-system sales mainly reflecting decreased generation available for sale and market opportunities.
  - The decrease in off-system sales was partially offset by a 40 million kilowatt-hour increase in sales to federal agencies directly served due to increased demand load among federal agencies.

2007 Compared to 2006

Significant items contributing to the 3,878 million kilowatt-hour increase in electricity sales included:

- A 3,837 million kilowatt-hour increase in sales to municipalities and cooperatives primarily as a result of an increase in residential power demand (which is more weather sensitive) as a result of an increase in combined degree days of 258 days, or 4.9 percent, during 2007.
- A 35 million kilowatt-hour increase in sales to F EDERAL AGENCIES AND OTHER.
  - This increase was attributable to an 89 million kilowatt-hour increase in off-system sales mainly reflecting increased generation available for sale.
  - The increase in off-system sales was partially offset by a 54 million kilowatt-hour decrease in sales to federal agencies directly served primarily due to a decrease in demand by one of TVA's largest federal agencies directly served as a result of a change in the nature and scope of its load.
- A six million kilowatt-hour increase in sales to industries directly served largely attributable to customer growth.

As economic conditions have deteriorated, TVA has experienced roughly a two percent reduction from expected sales in early 2009, and TVA is not anticipating conditions to improve significantly in the near future. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Executive Summary —Future Challenges — Meeting the Power Needs in TVA's Service Area.*

Financial Results

The following table compares operating results and selected statistics for 2008, 2007, and 2006:

Summary Statements of Income
For the years ended September 30

	2008	2007	2006
Operating revenues	$ 10,382	$ 9,326	$ 8,983
Revenue capitalized during pre-commercial plant operations	–	(57)	–
Operating expenses	(8,198)	(7,726)	(7,560)
Operating income	2,184	1,543	1,423
Other income	15	73	80
Other expense	(6)	(2)	(2)
Unrealized gain (loss) on derivative contracts, net	–	41	(15)
Interest expense, net	(1,376)	(1,232)	(1,264)
Income before cumulative effects of accounting changes	817	423	222
Cumulative effect of change in accounting for conditional asset retirement obligations	–	–	(109)
Net income	$ 817	$ 423	$ 113

2008 Compared to 2007

Net income for 2008 was $817 million compared with net income of $423 million for 2007. The $394 million increase in net income was mainly attributable to:

- A $1,056 million increase in operating revenues; and
- A decrease of $57 million in revenue capitalized during pre-commercial plant operations.

These items were partially offset by:

- A $472 million increase in operating expenses;
- A $144 million increase in net interest expense;
- A $58 million decrease in other income;
- A $41 million decrease in net unrealized gain on derivative contracts resulting largely from the change in ratemaking methodology for gains and losses on swaps and swaptions used in call monetization transactions; and
- A $4 million increase in other expenses.

Operating Revenues. Operating revenues during 2008 and 2007 consisted of the following:

Operating Revenues
For the years ended September 30

	2008	2007	Percent Change
Operating revenues			
Municipalities and cooperatives	$ 8,659	$ 7,847	10.3%
Industries directly served	1,472	1,221	20.6%
Federal agencies and other	121	112	8.0%
Other revenue	130	146	(11.0%)
Total operating revenues	$ 10,382	$ 9,326	11.3%

Significant items contributing to the $1,056 million increase in operating revenues included:

- An $812 million increase in revenue from municipalities and cooperatives resulting from:
  - $605 million in additional FCA revenue;
  - $363 million in additional revenue from rate increases averaging 4.8 percent; and
  - $113 million in additional revenue due to sales growth of 1.2 percent.

These increases were partially offset by a $269 million decline in revenue due to decreased sales of 3.2 percent resulting from milder weather (7 percent fewer heating and cooling degree days) in 2008.

- A $251 million increase in revenue from industries directly served as a result of increased sales of 11.9 percent, the FCA, and fluctuations in rates. These items contributed to increased revenue of $145 million, $66 million, and $40 million respectively; and
- A $9 million increase in revenue from F EDERAL AGENCIES AND OTHER.
  - This increase was the result of a $14 million increase in revenues from federal agencies directly served due to the FCA, increased sales of 2.3 percent, and an increase in average rates of 4.1 percent.
  - The increase in revenues from federal agencies directly served was partially offset by a $5 million decrease in off-system sales reflecting decreased sales of 33.1 percent partially offset by an increase in average rates of 6.7 percent.

These items were partially offset by a $16 million decrease in other revenue primarily due to decreased revenues from wheeling activity and the inclusion in 2007 of sales of salvage inventory primarily related to Bellefonte Nuclear Plant that did not reoccur in 2008.

During 2007 there was also a $57 million revenue offset related to the Browns Ferry Unit 1 pre-commercial plant operations. See Note 1 — *Capitalized Revenue During Pre-Commercial Plant Operations* .

As economic conditions have deteriorated, TVA has experienced roughly a two percent reduction in expected sales in early 2009 and anticipates that the energy sales for the remainder of 2009 will be lower than expected in the 2009 budget.

Operating Expenses. A table of operating expenses for 2008 and 2007 follows:

TVA Operating Expenses
For the years ended September 30

	2008	2007	Percent Change
Operating expenses			
Fuel and purchased power	$ 4,176	$ 3,449	21.1%
Operating and maintenance	2,298	2,332	(1.5%)
Depreciation, amortization, and accretion	1,224	1,473	(16.9%)
Tax equivalents	491	451	8.9%
Loss on asset impairment	9	21	(57.1%)
Total operating expenses	$ 8,198	$ 7,726	6.1%

Significant drivers contributing to the $472 million increase in total operating expenses included:

- A $727 million increase in FUEL AND PURCHASED POWER expense.
  - o This increase was mainly due to a $507 million increase in fuel expense and a $221 million increase in purchased power expense.
    - – The increase in fuel expense resulted primarily from:
      - Higher aggregate fuel cost per kilowatt-hour net thermal generation of 11.0 percent, which resulted in $263 million in additional expense;
      - Increased net generation at coal-fired, combustion turbine, and nuclear plants of 2.9 percent, which resulted in $67 million in additional expense; and
      - A decrease in the FCA net deferral and amortization for fuel expense of $177 million.
    - – The increase in purchased power expense resulted primarily from:
      - An increase in the average price of purchased power of 16.8 percent, which resulted in $199 million in additional expense; and
      - A decrease in the FCA net deferral and amortization for purchased power expense of $93 million.
    - – These increases were partially offset by a decrease in volume of purchased power of 5.7 percent, which resulted in a decrease of $71 million in purchased power expense. Although purchased power volume decreased in 2008, TVA purchased significantly more power than planned due to decreased hydro generation of 26.1 percent as a result of ongoing drought conditions in 2008.
- A $40 million increase in TAX EQUIVALENT payments reflecting increased gross revenues from the sale of power (excluding sales or deliveries to other federal agencies and off-system sales with other utilities) during 2007 as compared to 2006.

The increases in FUEL AND PURCHASED POWER expense and TAX EQUIVALENT payments were partially offset by:

- A $249 million decrease in DEPRECIATION, AMORTIZATION, AND ACCRETION expense.
  - o The decrease was primarily attributable to a decrease in depreciation and accretion expense related to a change in regulatory accounting for non-nuclear asset retirement obligations. In August 2008, the TVA Board approved a potential funding source through rates for non-nuclear decommissioning costs through the accumulation of assets in an asset retirement trust. As a result, all cumulative costs that had been incurred previously were reclassified to a regulatory asset. This adjustment totaled $350 million and was a one-time decrease to depreciation, amortization, and accretion expense in 2008. See Note 6 .
  - o This decrease was partially offset by an increase in depreciation expense primarily due to increases in completed plant accounts as a result of net plant additions and an increase in depreciation rates at several of TVA's facilities.

- A $34 million decrease in OPERATING AND MAINTENANCE expense.
  - This decrease was mainly a result of:
    - A $61 million decrease in pension costs as a result of a 0.35 percent higher discount rate used during 2008;
    - A $21 million reduction in operating and maintenance costs related to power system operations and river operations due to a decrease in operating and maintenance projects and a reduction in headcount as part of TVA's efforts to reduce non-fuel operating and maintenance expense.
    - A $15 million decrease in operating and maintenance expense related to nuclear generation and development primarily due to the absence of Watts Bar Unit 2 studies during 2008; and
    - A $7 million decrease in operating and maintenance cost at coal-fired and combustion turbine plants largely due to:
      - A decrease in planned outages of 49 days in 2008; and
      - Significant operating and maintenance projects at Paradise and Cumberland Fossil Plants in 2007 that did not reoccur in 2008.
  - These items were partially offset by the following:
    - Increased operating and maintenance expense at nuclear plants of $62 million due to the following:
      - Increased cost of operating Browns Ferry Unit 1, which did not begin commercial operation until August 2007;
      - Increased contractor and labor cost;
      - Various forced maintenance outages; and
      - Increased costs at Browns Ferry related to maintenance projects undertaken in 2008 to improve plant performance and reliability in an effort to reduce future unplanned outages.
    - Increased workers' compensation expense of $14 million primarily due to a 0.74 percent lower discount rate utilized to estimate workers' compensation in 2008.
- A $12 million decrease in LOSS ON ASSET IMPAIRMENT .
  - The $9 million LOSS ON ASSET IMPAIRMENT in 2008 included $8 million from partial write-downs for scrubber projects at Bull Run and John Sevier related to CONSTRUCTION IN PROGRESS assets and approximately $1 million in write-offs of other CONSTRUCTION IN PROGRESS assets.
  - The $21 million LOSS ON ASSET IMPAIRMENT in 2007 resulted from:
    - A $17 million write-down of a scrubber project at Colbert during 2007; and
    - Write-downs of $4 million related to other CONSTRUCTION IN PROGRESS assets during 2007.

Other Income . The $58 million decrease in other income was largely attributable to decreased interest income from short-term investments, realized and unrealized losses on TVA's supplemental executive retirement plan funds and restricted investments related to the collateral held by TVA, and a decrease in external business revenues.

Other Expense . The $4 million increase in other expense was primarily due to the write off of two economic development investments in the fourth quarter of 2008.

Unrealized Gain on Derivative Contracts, Net. The decrease in UNREALIZED GAIN ON DERIVATIVE CONTRACTS, NET was attributable to a change in ratemaking methodology. Beginning in 2008, TVA began using regulatory accounting treatment for swaps and swaptions related to call monetization transactions to reflect that the gain or loss is included in the ratemaking formula when these transactions actually settle. This treatment removes the non-cash impacts to TVA's earnings that result from marking the value of these instruments to market each quarter. The values of the swaps and swaptions for 2008 were recorded on TVA's balance sheet and no income was recognized. However, TVA recognized $41 million as UNREALIZED GAIN ON DERIVATIVE CONTRACTS, NET during 2007. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Changes in Ratemaking Impacting Accounting.*

Interest Expense . Interest expense, outstanding debt, and interest rates during 2008 and 2007 were as follows:

Interest Expense
For the years ended September 30

	2008	2007	Percent Change
Interest expense			
Interest on debt and leaseback obligations	$ 1,373	$ 1,390	(1.2%)
Amortization of debt discount, issue, and reacquisition costs, net	20	19	5.3%
Allowance for funds used during construction and nuclear fuel expenditures	(17)	(177)	(90.4%)
Net interest expense	$ 1,376	$ 1,232	11.7%

	(percent)		
	2008	2007	Percent Change
Interest rates (average)			
Long-term	6.00	6.02	(0.3%)
Discount notes	3.71	5.21	(28.8%)
Blended	5.92	5.94	(0.3%)

Significant items contributing to the $144 million increase in net interest expense included:

- A $160 million decrease in capitalized interest on construction projects and nuclear fuel expenditures primarily due to the change in ratemaking methodology regarding AFUDC. TVA continues to capitalize a portion of current interest costs associated with funds invested in most nuclear fuel inventories, but since October 1, 2007, interest on funds invested in construction projects has been capitalized only if (1) the expected total cost of a project is $1 billion or more and (2) the estimated construction period is at least three years. AFUDC interest continues to be a component of asset cost for projects meeting this criteria and will be recovered in future periods through depreciation expense. In addition, AFUDC continues to be a reduction to interest expense as costs are incurred. The interest costs associated with funds invested in construction projects that do not satisfy the $1 billion and three-year criteria are no longer capitalized as AFUDC and are recovered in current year rates as a component of interest expense; and
- An increase of $1.5 billion in the average balance of long-term outstanding debt in 2008.

These items were partially offset by:

- A decrease in the average long-term interest rate from 6.02 percent in 2007 to 6.00 percent in 2008;
- A decrease in the average discount notes interest rate from 5.21 percent in 2007 to 3.71 percent in 2008; and
- A decrease of $1.5 billion in the average balance of discount notes outstanding in 2008.

2007 Compared to 2006

Net income for 2007 was $423 million compared with net income of $113 million for 2006. The $310 million increase in net income was mainly attributable to:

- A $109 million cumulative expense charge in 2006 for adoption of a new accounting standard related to conditional asset retirement obligations that did not occur in 2007;
- A $343 million increase in operating revenues;
- A change of $56 million in net unrealized gain/(loss) on derivative contracts; and
- A $32 million decrease in net interest expense.

These items were partially offset by:
- A $166 million increase in operating expenses;
- A $7 million decrease in other income; and
- Revenue of $57 million capitalized during pre-commercial plant operations during 2007.

Operating Revenues. Operating revenues during 2007 and 2006 consisted of the following:

Operating Revenues
For the years ended September 30

	2007	2006	Percent Change
Operating revenues			
Municipalities and cooperatives	$ 7,847	$ 7,659	2.5%
Industries directly served	1,221	1,065	14.6%
Federal agencies and other	112	116	(3.4%)
Other revenue	146	143	2.1%
Total operating revenues	$ 9,326	$ 8,983	3.8%

Significant items contributing to the $343 million increase in operating revenues included:

- A $188 million increase in revenue from MUNICIPALITIES AND COOPERATIVES primarily due to increased sales of 2.8 percent and increased FCA revenue of $76 million, partially offset by a decrease in average rates of 1.3 percent;
- A $156 million increase in revenue from INDUSTRIES DIRECTLY SERVED attributable to an increase in average rates of 15.1 percent and a slight increase in sales; and
- A $3 million increase in OTHER REVENUE primarily due to increased revenue from salvage sales partially offset by decreased transmission revenues from wheeling activity.

These items were partially offset by:

- A $4 million decrease in revenue from F EDERAL AGENCIES AND OTHER.
  - This decrease was the result of an $8 million decrease in revenues from federal agencies directly served due to decreased sales of 3.0 percent, and a decrease in average rates of 4.4 percent.
  - The decrease in revenues from federal agencies directly served was partially offset by a $4 million increase in off-system sales reflecting increased sales of 40.7 percent partially offset by a decrease in average rates of 6.5 percent.

During 2007 there was also a $57 million revenue offset related to the Browns Ferry Unit 1 pre-commercial plant operations. See Note 1 — *Capitalized Revenue During Pre-Commercial Plant Operations* .

Operating Expenses. A table of operating expenses for 2007 and 2006 follows:

TVA Operating Expenses
For the years ended September 30

	2007	2006	Percent Change
Operating expenses			
Fuel and purchased power	$ 3,449	$ 3,342	3.2%
Operating and maintenance	2,332	2,328	0.2%
Depreciation, amortization, and accretion	1,473	1,500	(1.8%)
Tax equivalents	451	376	19.9%
Loss on asset impairment	21	14	50.0%
Total operating expenses	$ 7,726	$ 7,560	2.2%

Significant drivers contributing to the $166 million increase in total operating expenses included:

- A $75 million increase in TAX EQUIVALENT payments reflecting increased gross revenues from the sale of power (excluding sales or deliveries to other federal agencies and off-system sales with other utilities) during 2006 as compared to 2005.

- A $107 million increase in FUEL AND PURCHASED POWER expense.

  - This increase was mainly due to a $114 million increase in purchased power expense.

    - The increase in purchased power expense was primarily a result of a 16.4 percent increase in the volume of purchased power to accommodate decreased hydroelectric generation of 9.2 percent and the extended outage of Unit 3 at TVA's Paradise Fossil Plant during the third quarter of 2007. The increase in volume resulted in $178 million in additional expense.

    - The increase in volume was partially offset by the following:

      - A decrease in the average price of purchased power of 0.8 percent, which decreased expense by $10 million; and

      - An FCA net deferral and amortization for purchased power expense of $54 million. In accordance with the FCA methodology, TVA has deferred the amount of purchased power costs that were higher than the amount included in power rates during 2007. This $54 million deferred amount will be charged to customers in future FCA adjustments.

  - The increase in purchased power expense was partially offset by a $7 million decrease in fuel expense.

    - The decrease in fuel expense resulted primarily from an FCA net deferral and amortization for fuel expense of $95 million. In accordance with the FCA methodology, TVA has deferred the amount of fuel costs that were higher than the amount included in power rates during 2007. This $95 million deferred amount will be charged to the customers in future FCA adjustments.

    - The decrease was partially offset by the following:

      - Higher aggregate fuel cost per kilowatt-hour net thermal generation of 2.7 percent; and

      - Increased generation of 0.6 percent, 14.9 percent, and 2.5 percent at the coal-fired, combustion turbine, and nuclear plants, respectively, in part because of the lower hydroelectric generation in 2007.

- A $7 million increase in LOSS ON ASSET IMPAIRMENT from $14 million in 2006 to $21 million in 2007.

  - The $21 million LOSS ON ASSET IMPAIRMENT in 2007 resulted from:

    - A $17 million write-down of a scrubber project at Colbert during 2007; and

    - Write-downs of $4 million related to other CONSTRUCTION IN PROGRESS assets during 2007.

  - The $14 million LOSS ON ASSET IMPAIRMENT in 2006 resulted from:

    - Write-downs of $12 million on certain CONSTRUCTION IN PROGRESS assets related to new pollution-control and other technologies that had not been proven effective and a re-evaluation of other projects due to funding limitations; and

    - A $2 million write-down on one of two buildings in TVA's Knoxville Office Complex based on TVA's plans to sell or lease the East Tower of the Knoxville Office Complex during 2006.

- A $4 million increase in OPERATING AND MAINTENANCE expense.

  - This increase was mainly a result of:

    - Increased outage and routine operating and maintenance costs at coal-fired plants of $55 million due to:

      - An increase in outage days of 78 days as a result of four more planned outages during 2007;

      - Significant repair work on Unit 3 at Paradise Fossil Plant; and

      - Acquisition of new combustion turbine units during 2007.

    - A $17 million increase in expense primarily related to Watts Bar Unit 2 studies during 2007;

– A $10 million increase in severance expense during 2007;

- A $5 million increase in workers' compensation expense primarily as a result of a 0.05 percent lower discount rate utilized during 2007 and increased costs to administer the program; and
- A $13 million increase in operating and maintenance expenses at nuclear plants primarily as a result of the restart of Browns Ferry Unit 1, which returned to commercial operation on August 1, 2007.

o These items were partially offset by decreased pension financing costs of $91 million as a result of a 0.52 percent higher discount rate and a 0.50 percent higher than expected long-term rate of return on pension plan assets.

The increases in TAX EQUIVALENT payments, FUEL AND PURCHASED POWER expense, LOSS ON ASSET IMPAIRMENT, and OPERATING AND MAINTENANCE expense were partially offset by:

- A $27 million decrease in DEPRECIATION, AMORTIZATION, AND ACCRETION expense.

o This decrease was mainly a result of a $41 million decrease in depreciation expense primarily attributable to the depreciation rate reduction for Browns Ferry Nuclear Plant reflecting the 20-year license extension approved by NRC on May 4, 2006.

o This item was partially offset by a $14 million increase in accretion expense reflecting the adoption of FIN No. 47, the updated incremental accretion for SFAS No. 143, and an increase in asset retirement obligation liability during 2007.

Other Income . The $7 million decrease in other income was largely attributable to decreased interest earnings on the collateral deposit funds held by TVA and decreased interest income from short-term investments due to a lower average outstanding balance on investments in 2007 partially offset by a higher average interest rate.

Unrealized Gain (Loss) on Derivative Contracts, Net. Significant items contributing to the $56 million change in net unrealized gain (loss) on derivative contracts included:

- A $58 million smaller loss related to the mark-to-market valuation adjustment of an embedded call option, from a $61 million loss during 2006 to a $3 million loss during 2007; and
- A $9 million larger gain related to the mark-to-market valuation of swaption contracts, from a $19 million gain during 2006 to a $28 million gain during 2007.

These items were partially offset by an $11 million smaller gain related to the mark-to-market valuation adjustment of an interest rate swap contract, from a $27 million gain during 2006 to a $16 million gain during 2007.

Interest Expense . Interest expense, outstanding debt, and interest rates during 2007 and 2006 were as follows:

Interest Expense
For the years ended September 30

	2007	2006	Percent Change
Interest expense			
Interest on debt and leaseback obligations	$ 1,390	$ 1,406	(1.1%)
Amortization of debt discount, issue, and reacquisition costs, net	19	21	(9.5%)
Allowance for funds used during construction and nuclear fuel expenditures	(177)	(163)	8.6%
Net interest expense	$ 1,232	$ 1,264	(2.5%)

	(percent)		
	2007	2006	Percent Change
Interest rates (average)			
Long-term	6.02	6.17	(2.4%)
Discount notes	5.21	4.47	16.6%
Blended	5.94	6.02	(1.3%)

Significant items contributing to the $32 million decrease in net interest expense included:

- A decrease in the average long-term interest rate from 6.17 percent in 2006 to 6.02 percent in 2007;
- A decrease of $283 million in the average balance of long-term outstanding debt in 2007; and
- A $14 million increase in AFUDC due to a 4.0 percent increase in the construction work in progress base in 2007.

These items were partially offset by:

- An increase in the average discount notes interest rate from 4.47 percent in 2006 to 5.21 percent in 2007; and
- An increase of $260 million in the average balance of discount notes outstanding in 2007.

Off -Balance Sheet Arrangements

In February 1997, TVA entered into a purchase power agreement with Choctaw Generation, Inc. (subsequently assigned to Choctaw Generation Limited Partnership) to purchase all the power generated from its facility located in Choctaw County, Mississippi. The facility had a committed capacity of 440 megawatts and the term of the agreement was 30 years. Under the accounting guidance provided by Financial Accounting Standards Board ("FASB") Interpretation No. 46, *"Consolidation of Variable Interest Entities,"* as amended by FASB Interpretation No. 46R (as amended, "FIN No. 46R"), TVA may be deemed to be the primary beneficiary under the contract; however, TVA does not have access to the financial records of Choctaw Generation Limited Partnership ("Choctaw"). As a result, TVA is unable to determine whether FIN No. 46R would require TVA to consolidate Choctaw Generation Limited Partnership's balance sheet, results of operations, and cash flows for the year ended September 30, 2008. Power purchases for 2008 under the agreement amounted to $118 million, and the remaining financial commitment under this agreement is $6.7 billion. TVA has no additional financial commitments beyond the purchase power agreement with respect to the facility.

Certain contracts with independent power producers qualify as operating leases in accordance with the requirements of EITF No. 01-08, " *Determining Whether an Arrangement Contains a Lease."* In accordance with SFAS No. 13, " *Accounting for Leases,"* variable costs associated with these contracts meet the definition of contingent rentals. Amounts under these contracts qualifying as contingent rentals through September 30, 2008, amounted to $96 million. In accordance with the requirements of EITF No. 98-09, " *Accounting for Contingent Rent,"* TVA accrues contingent rentals when the achievement of the event that triggers the contingent rental expense is probable. Because of the uncertainty associated with future power demand, TVA accrues contingent rentals under these arrangements as power is purchased.

Critical Accounting Policies and Estimates

The preparation of financial statements requires TVA to estimate the effects of various matters that are inherently uncertain as of the date of the financial statements. Although the financial statements are prepared in conformity with generally accepted accounting principles ("GAAP"), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the amounts of revenues and expenses reported during the reporting period. Each of these estimates varies in regard to the level of judgment involved and its potential impact on TVA's financial results. Estimates are deemed critical either when a different estimate could have reasonably been used, or where changes in the estimate are reasonably likely to occur from period to period, and such use or change would materially impact TVA's financial condition, changes in financial position, or results of operations. TVA's critical accounting policies are also discussed in Note 1 .

Regulatory Accounting

TVA power rates are not subject to regulation through a public service commission or other similar entity. TVA's Board is authorized by the TVA Act to set rates for power sold to its customers. This rate-setting authority meets the "self-regulated" provisions of SFAS No. 71, " *Accounting for the Effects of Certain Types of Regulation* ," and TVA meets the remaining criteria of SFAS No. 71 because (1) TVA's regulated rates are designed to recover its costs of providing electricity and (2) in view of demand for electricity and the level of competition, it is reasonable to assume that the rates, set at levels that will recover TVA's costs, can be charged and collected. Accordingly, TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred. Management assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, potential legislation, and

changes in technology. Based on these assessments, management believes the existing regulatory assets are probable of recovery. This determination reflects the current regulatory and political environment and is subject to change in the future. If future recovery of regulatory assets ceases to be probable, TVA would be required to write off these costs under the provisions of SFAS No. 101, " *Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No. 71* ." Any asset write-offs would be required to be recognized in earnings in the period in which future recoveries cease to be probable. See Note 6 .

Long-Lived Assets

TVA capitalizes long-lived assets such as property, plant, and equipment at historical cost, which includes direct and indirect costs and AFUDC. TVA recovers the costs of these long-lived assets through depreciation of the physical assets as they are consumed in the process of providing products or services. Depreciation is generally computed on a straight-line basis over the estimated productive lives of the various classes of assets. When TVA retires its regulated long-lived assets, it charges the original asset cost, less salvage value, to accumulated depreciation in accordance with utility industry practice.

Long-Lived Asset Impairments

TVA evaluates the carrying value of long-lived assets when circumstances indicate the carrying value of those assets may not be recoverable. Under the provisions of SFAS No. 144, " *Accounting for the Impairment or Disposal of Long-Lived Assets,* " an asset impairment exists for a long-lived asset to be held and used when the carrying value exceeds the sum of estimates of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, the asset's carrying value is adjusted downward to its estimated fair value with a corresponding impairment loss recognized in earnings. Additionally, TVA regularly evaluates construction in progress projects. If the project is cancelled or deemed to have no future economic benefit, the project costs are written off as an asset impairment.

Revenue Recognition

Revenues from power sales are recorded as power is delivered to customers. TVA is primarily a wholesale provider of power to distributor customers (distributors) that resell the power to end users at retail rates. Under TVA's end-use billing arrangements with distributors, TVA relies on the distributors to report their end-use sales. Because of the delay between the wholesale delivery of power to the customer and the report of end-use sales to TVA, TVA must estimate the unbilled revenue at the end of each financial reporting period. TVA accrues estimated unbilled revenues for power sales provided to customers for the period of time from the meter read date to the end of the month. The methodology for estimating unbilled revenue from electricity sales uses meter readings for each customer for the current billing period. See Note 1 — *Revenues.*

Asset Retirement Obligations

In accordance with the provisions of SFAS No. 143, *"Accounting for Asset Retirement Obligations,"* and FIN No. 47, *"Accounting for Conditional Asset Retirement Obligations — an Interpretation of FASB Statement No. 143,"* TVA recognizes legal obligations associated with the future retirement of certain tangible long-lived assets. These obligations relate to fossil-fired generating plants, nuclear generating plants, hydroelectric generating plants/dams, transmission structures, and other property-related assets. These other property-related assets include, but are not limited to, easements, leases, and coal rights. Activities involved with retiring these assets could include decontamination and demolition of structures, removal and disposal of wastes, and site reclamation. Revisions to the amount and timing of certain cash flow estimates of asset retirement obligations may be made based on engineering studies. For nuclear assets, the studies are performed annually in accordance with NRC requirements. For non-nuclear obligations, revisions are made as needed in accordance with guidance provided by SFAS No. 143 and FIN No. 47. Any accretion or depreciation expense related to these liabilities and assets are charged to a regulatory asset in accordance with SFAS No. 71. See Note 5.

Nuclear Decommissioning

Utilities that own and operate nuclear plants are required to use different procedures in estimating nuclear decommissioning costs under SFAS No. 143 than those that are used in estimating nuclear decommissioning costs that are reported to the NRC. The two sets of procedures produce different estimates for the costs of decommissioning primarily because of the difference in the discount rates used to calculate the present value of decommissioning costs. At September 30, 2008, the present value of the estimated future nuclear decommissioning cost under SFAS No. 143 was $1.7 billion and was included in ASSET RETIREMENT OBLIGATIONS , and the unamortized regulatory asset of $764 million was included in OTHER REGULATORY ASSETS . Under the NRC's regulations, the present value of the estimated future nuclear decommissioning cost was $862 million at September 30, 2008. This decommissioning cost estimate is based on NRC's

requirements for removing a plant from service, releasing the property for unrestricted use, and terminating the operating license. The actual decommissioning costs may vary from the derived estimates because of changes in current assumptions, such as the assumed dates of decommissioning, changes in regulatory requirements, changes in technology, and changes in the cost of labor, materials, and equipment.

TVA maintains a nuclear decommissioning trust to provide funding for the ultimate decommissioning of its nuclear power plants. The trust's funds are invested in securities generally designed to achieve a return in line with overall equity market performance. The assets of the fund are invested in debt and equity securities and certain derivative instruments. The derivative instruments are used across various asset classes to achieve a desired investment structure. The balance in the trust as of September 30, 2008, is less than the present value of the estimated future nuclear decommissioning costs under both the NRC methodology and under SFAS No. 143.

The following key assumptions can have a significant effect on estimates related to the nuclear decommissioning costs:

- Timing – In projecting decommissioning costs, two assumptions must be made to estimate the timing of plant decommissioning. First, the date of the plant's retirement must be estimated. At a multiple unit site, the expiration of the unit with the latest to expire operating license is typically used for this purpose, or an assumption could be made that the plant will be relicensed and operate for some time beyond the original license term. Second, an assumption must be made whether decommissioning will begin immediately upon plant retirement, or whether the plant will be held in SAFSTOR status — a status authorized by applicable regulations which allows for a nuclear facility to be maintained and monitored in a condition that allows the radioactivity to decay, after which the facility is decommissioned and dismantled. While the impact of these assumptions cannot be determined with precision, assuming either license extension or use of SAFSTOR status can significantly decrease the present value of these obligations.

- Technology and Regulation – There is limited experience with actual decommissioning of large nuclear facilities. Changes in technology and experience as well as changes in regulations regarding nuclear decommissioning could cause cost estimates to change significantly. The impact of these potential changes is not presently determinable. TVA's cost studies assume current technology and regulations.

- Discount Rate – TVA uses a blended rate of 5.32 percent to calculate the present value of the weighted estimated cash flows required to satisfy TVA's decommissioning obligation.

- Investment Rate of Return – TVA assumes that its decommissioning fund will achieve a rate of return that is five percent greater than the rate of inflation. This results in a 9.2 percent estimated investment rate of return for all periods presented.

- Cost Escalation Factors – TVA's decommissioning estimates include an assumption that decommissioning costs will escalate over present cost levels by four percent annually.

Pension and Other Postretirement Benefits

TVA sponsors a defined benefit pension plan that is qualified under IRS rules and covers substantially all of its full-time employees. The TVA Retirement System ("TVARS"), a separate legal entity governed by its own board of directors, administers TVA-sponsored retirement plans. TVA also provides a supplemental executive retirement plan to certain executives in critical positions that provides supplemental pension benefits in addition to those provided by the qualified defined benefit pension plan. Additionally, TVA provides postretirement health care benefits for most of its full-time employees who reach retirement age while still working for TVA. TVA's costs of providing these benefits are impacted by numerous factors including the provisions of the plans, changing employee demographics, and various actuarial calculations, assumptions, and accounting mechanisms. The most significant of these factors are discussed below.

Expected Return on Plan Assets. The qualified defined benefit pension plan is the only plan that is funded with qualified plan assets. The expected return on pension plan assets used to develop net pension cost was 8.75 percent, 8.75 percent, and 8.25 percent during 2008, 2007, and 2006, respectively, and is determined at the beginning of the period. Changes in the rates are generally based on studies performed by third party professional asset managers. A higher expected rate of return decreases net periodic pension cost, which in turn increases profitability. TVA plans to reduce the expected rate of return to 8.00 percent for 2009 based on a recent asset/liability study performed by third party professional asset managers. The 2009 expected rate of return also reflects a change in the allocation policy of TVARS assets. The change in the TVARS asset allocation policy was based on a recommendation by TVARS investment consultant. The changes in the expected return on plan assets discussed above do not affect TVA's postretirement benefits plan because TVA does not separately set aside assets to fund such benefits. TVA funds its postretirement plan

benefits on an as-paid basis. This change also does not impact the supplemental executive retirement plan as any assets set aside for that plan are not considered plan assets under SFAS No. 87, " *Employers' Accounting for Pensions,"* as amended by SFAS No. 158 " *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ." The actuarial loss related to the difference between expected and actual return on plan assets for the pension for 2008 was $2 billion. This amount has been recognized as a regulatory asset. Actual returns for the year ending September 30, 2008, decreased by 19 percent. Plan assets have further declined another $1,138 million, or 18 percent, through November 30, 2008.

Discount Rate. In the case of selecting an assumed discount rate, TVA reviews market yields on high-quality corporate debt and long-term obligations of the U.S. Treasury and endeavors to match, through the use of a proprietary bond portfolio, instrument maturities with the maturities of its pension obligations in accordance with the prevailing accounting standards. In addition, TVA looks at published pension spot yield curves and applies expected cash flows to the curve to approximate the rate expected to settle the projected benefit payments. The discount rates used to determine pension expense were 6.25 percent, 5.90 percent, and 5.38 percent during 2008, 2007, and 2006, respectively. The discount rate is determined at the beginning of the period. TVA plans to use a discount rate of 7.50 percent in the determination of 2009 net periodic pension cost and also used this rate to value plan obligations at the end of 2008. Changes in the discount rate were due to increased long-term interest rates. The discount rate is somewhat volatile because it is determined based upon the prevailing rate as of the measurement date. The discount rate used to determine the postretirement benefits costs is the same rate used to determine pension benefits costs due to a similar expected duration of the postretirement and pension benefit obligations. A higher discount rate decreases the plan obligations and correspondingly decreases the net periodic pension and postretirement benefits costs for those plans where actuarial losses are being amortized. On the other hand, a lower discount rate increases net periodic pension and postretirement benefits costs and thus reduces TVA's profitability.

The expected rate of return on pension plan assets and the discount rate, as well as the amortization of actuarial gains and losses, were determined in accordance with consistent methodologies, as described in Note 14.

Mortality . Mortality assumptions are based on the results obtained from an actual company experience study performed for the most recent six years for retirees as well as other plan participants. TVA obtained an updated study in 2008 and, accordingly, adjusted the mortality rates from the 1983 Group Annuity Mortality Tables to the RP-2000 Mortality Tables.

Health Care Cost Trends. TVA reviews actual recent cost trends and projected future trends in establishing health care cost trend rates. Based on this review process, TVA did not reset its health care cost trend rate assumption used in calculating the 2008 and 2007 accumulated postretirement benefit obligations. The assumed health care trend rate used for 2008 and 2007 was 8.0 percent. No change was made due to consistent actual performance in the plan. In addition, an 8.5 percent trend rate was used during 2006. The 2008 health care cost trend rate of 8.0 percent is assumed to gradually decrease each successive year until it reaches a five percent annual increase in health care costs in the year beginning October 1, 2014, and beyond.

Sensitivity of Costs to Changes in Assumptions. The following chart reflects the sensitivity of pension costs to changes in certain actuarial assumptions:

Sensitivity of Pension Costs to Changes in Assumptions

Actuarial Assumption	Change in Assumption	Impact on 2009 Pension Cost	Impact on 2008 Projected Benefit Obligation
		(Increase in millions)	
Discount rate	(0.25%)	$ 14	$ 195
Rate of return on plan assets	(0.25%)	$ 17	NA

Each fluctuation above assumes that the other components of the calculation are held constant and excludes any impact for unamortized actuarial gains or losses.

The following chart reflects the sensitivity of postretirement benefit costs to changes in the health care cost trend rate:

Sensitivity of Postretirement Benefit Costs to Changes in Assumptions

(Increase in millions)	1% Increase	1% Decrease
Effect on total of service and interest cost components	$ 4	$ (5)
Effect on end-of-year accumulated postretirement benefit obligation	$ 59	$ (60)

Each fluctuation above assumes that the other components of the calculation are held constant and excludes any impact for unamortized actuarial gains or losses.

Accounting Mechanisms . In accordance with current accounting methodologies, TVA utilizes a number of accounting mechanisms that reduce the volatility of reported pension costs. Differences between actuarial assumptions and actual plan results are deferred and are amortized into periodic cost only when the accumulated differences exceed 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets. If necessary, the excess is amortized over the average remaining service period of active employees.

Additionally, TVA recognizes the impact of asset performance on pension expense over a three-year phase-in period through a “market-related” value of assets calculation. Since the market-related value of assets recognizes investment gains and losses over a three year period, the future value of assets will be impacted as previously deferred gains or losses are recognized. As a result, the losses that the pension plan assets experienced in the current year may have an adverse impact on pension cost in future years depending on whether the actuarial losses at each measurement date exceed the 10 percent corridor in accordance with current accounting methodologies. See Note 14 for a discussion of obligations and funded status.

Medicare Provisions. There have been several recent developments related to retiree health care benefits, including cost sharing and legislation, such as Medicare Part D of the Medicare Prescription Drug, Improvement and Modernization Act of 2003. Under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, employers may receive retiree drug subsidies for Medicare-eligible retirees who enroll in the employer’s retiree prescription drug plan, provided that the plan is determined to be “actuarially equivalent” to standard coverage provided under Medicare Part D. TVA determined that its retiree prescription drug coverage did not qualify for retiree drug subsidies. As a result, through its prescription benefit manager, TVA maintained for 2008 an employer-sponsored prescription drug plan (“PDP”). By providing an employer-sponsored PDP, TVA’s prescription benefit manager receives subsidies from Medicare which are passed through to Medicare-eligible retirees in the form of lower premiums. See Note 14 for further description.

Expected Contributions. TVA expects to contribute $5 million to its supplemental executive retirement plan and $29 million to its postretirement health care benefit plans in 2009. TVA made a contribution to the qualified defined benefit pension plan on September 30, 2008, of $85 million that constitutes the amount that was expected to be contributed in 2009.

Changes in Ratemaking Impacting Accounting

At its September 27, 2007, meeting, the TVA Board approved the following changes in ratemaking, which resulted in changes in accounting for the types of transactions described below.

Allowance for Funds Used During Construction. C apitalization of interest and other financing costs has been a generally accepted practice in the utility industry. The concept of permitting the capitalization of interest on major plant construction projects results from a regulatory philosophy that today's customers should not pay for the costs of financing construction that will benefit only future customers. As a result, major plant construction costs are not included in rates until the plant is placed in service. To provide a return on investment during a period of construction, utilities typically recover the cost of construction funds from future users by capitalizing a portion of current interest costs associated with funds invested in the construction projects. This capitalized interest is referred to as AFUDC.

In accordance with the accounting policy that was in effect on September 30, 2007, TVA capitalized a portion of current interest costs associated with funds invested in most construction projects and most nuclear fuel inventories. TVA will continue to capitalize a portion of current interest costs associated with funds invested in most nuclear fuel inventories, but since October 1, 2007, interest on funds invested in construction projects has been capitalized only if (1) the expected total cost of a project is $1 billion or more and (2) the estimated construction period is at least three years. Capitalized interest continues to be a component of the asset cost and is recovered in future periods through depreciation expense. In addition, AFUDC continues to be a reduction to interest expense as costs are incurred. The interest costs associated with funds invested in construction projects that do not satisfy the $1 billion and three-year criteria are not capitalized as AFUDC, remain in the Statement of Income, and are recovered in current year rates as a component of interest expense. TVA recorded a total of $17 million in AFUDC in 2008 which reflects a decrease of $160 million from the $177 million in AFUDC that TVA recorded in 2007.

Call Monetizations. From time to time TVA has entered into swaption transactions to monetize the value of call provisions on certain of its Bond issues. A swaption essentially grants a third party an option to enter into a swap agreement with TVA under which TVA receives a floating rate of interest and pays the third party a fixed rate of interest equal to the interest rate on the Bond issue whose call provision TVA monetized. Selling such an option creates a liability for TVA until such time as TVA buys back the option or until the option matures.

These call monetization transactions result in long-term liabilities which are marked to market each quarter. In accordance with the accounting policy that was in effect on September 30, 2007, the changes in the value of these liabilities were reported as unrealized gains or losses through TVA's income statement in accordance with SFAS No. 133. The volatility of the valuations resulted in the recognition of sizable amounts of non-cash expense or income, which affects net income.

Beginning in 2008, the TVA Board approved the utilization of regulatory accounting treatment for swaps and swaptions related to call monetization transactions in order to better match the income statement recognition of gain and loss with the economic reality of when these transactions actually settle. This treatment removes the non-cash impacts to TVA's earnings that result from marking the value of these instruments to market each quarter. The value of the swaps and swaptions are still recorded on TVA's balance sheet, and any interest expense impacts continue to be reflected in TVA's income statement. If this new accounting treatment had been effective during 2007, TVA's net income for 2007 would have been reduced by less than $50 million.

Non-Nuclear Decommissioning Costs. In September 2007, the TVA Board approved the establishment of an asset retirement trust to more effectively segregate, manage, and invest funds to help meet future asset retirement obligations. TVA made a $40 million initial contribution to the asset retirement trust on September 28, 2007. TVA made an additional $40 million contribution to the asset retirement trust on September 26, 2008. As of September 30, 2008, the assets of the trust totaled $81 million. Although the TVA Board approved contributions to the asset retirement trust in 2007 and 2008, the TVA Board did not approve funding for the trust as part of its budget and ratemaking process in relation to providing a potential funding source through rates for non-nuclear decommissioning costs until August 2008, at which time the TVA Board approved making a contribution to the trust in 2009. The funds from the asset retirement trust may be used, among other things, to pay the cost of retiring non-nuclear long-lived assets from the accumulation of assets in the trust. The costs of retiring non-nuclear long-lived assets represent the net deferred costs related to the future closure and retirement of TVA's non-nuclear long-lived assets under various legal requirements as recognized by SFAS No. 143 and FIN No. 47. These costs had previously been included in rates as the asset retirement obligation ("ARO") was accreted and the ARO asset was depreciated. In accordance with EITF 93-4, these costs did not previously meet the asset recognition criteria in paragraph nine of SFAS No. 71 at the date the costs were incurred. Because of the establishment of the asset retirement trust and the approval of the funding in 2009 rates as part of the TVA Board's budget and ratemaking process, these costs currently meet asset recognition criteria. Therefore, all cumulative costs incurred since 2003, when SFAS No. 143 was adopted, were recaptured as a regulatory asset as of September 30, 2008. The regulatory asset initially created related to this adjustment totaled $350 million. The offset to this adjustment was a one-time decrease to depreciation, amortization, and accretion expense.

These future costs can be funded through a combination of investment funds already set aside in the asset retirement trust, future earnings on those investment funds, and future cash contributions to the investment funds. Through this rate action, the TVA Board has demonstrated the ability and intent to include non-nuclear retirement costs in allowable costs and in rates. Further, the TVA Board has included contributions for 2009 to the asset retirement trust fund in its 2009 budget and in the related rates. As a result, it is probable that future revenue will result from inclusion of the deferred non-nuclear asset retirement costs in allowable costs for ratemaking purposes.

New Accounting Standards and Interpretations

Accounting for Planned Major Maintenance Activities . On September 8, 2006, the Financial Accounting Standards Board ("FASB") released FASB Staff Position ("FSP") AUG AIR-1, *"Accounting for Planned Major Maintenance Activities."* The FSP addresses the accounting for planned major maintenance activities and amends certain provisions in the American Institute of Certified Public Accountants Industry Audit Guide, " *Audits of Airlines,"* and Accounting Principles Board Opinion No. 28, " *Interim Financial Reporting* ." The guidance in this FSP states that entities should adopt an accounting method that recognizes overhaul expenses in the appropriate period. The following accounting methods are most often employed/permitted: direct expensing method; built-in overhaul method; or deferral method. The guidance in this FSP is applicable to entities in all industries and must be applied to the first fiscal year beginning after December 15, 2006. TVA adopted this guidance for 2008. Except for the recording of certain regulatory assets, TVA's policy is to expense maintenance costs as incurred (direct expensing method). Therefore, the adoption of this FSP did not have a material impact on TVA's results of operations or financial position.

Fair Value Measurements . In September 2006, FASB issued SFAS No. 157, *"Fair Value Measurements."* ("SFAS No. 157"). SFAS No. 157 provides guidance for using fair value to measure assets and liabilities that currently require fair value measurement. SFAS No. 157 also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop measurement assumptions. Provisions of SFAS No. 157 were to be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, in February 2008, FASB issued FSP FAS 157-2, *"Effective Date of FASB Statement No. 157,"* ("SFAS No. 157-2"), which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. This FSP delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. TVA will implement SFAS No. 157 in the first quarter of 2009, and will utilize the deferral portion of FSP FAS 157-2 for all nonfinancial assets and liabilities within its scope. In October 2008, the FASB issued FSP No. FAS 157-3, *"Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active,"* ("FSP FAS 157-3"). FSP FAS 157-3 clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The guidance emphasizes that determining fair value in an inactive market depends on the facts and circumstances and may require the use of significant judgment. FSP FAS 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued, and will become effective for TVA at upon its implementation of SFAS No. 157 during the first quarter of 2009. TVA is evaluating the requirements of SFAS No. 157 and the related FSP's and has not yet determined the impact of their implementation, which may or may not be material to TVA's results of operations or financial position.

Fair Value Option . In February 2007, FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115,"* ("SFAS No. 159") . This statement permits an entity to choose to measure many financial instruments and certain other items at fair value. The fair value option established by SFAS No.159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Most of the provisions in SFAS No. 159 are elective. The provisions of SFAS No. 159 are effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. SFAS No. 159 will become effective for TVA during the first quarter of 2009. TVA is evaluating the requirements of this statement and has not yet determined the potential impact of its implementation, which may or may not be material to TVA's results of operations or financial position.

Offsetting Amounts . On April 30, 2007, FASB issued FSP FIN No. 39-1, *"Amendment of FASB Interpretation No. 39,"* which addresses certain modifications to FASB Interpretation No. 39, *"Offsetting of Amounts Related to Certain Contracts."* This FSP replaces the terms "conditional contracts" and "exchange contracts" with the term "derivative instruments" as defined in SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities."* The FSP also permits a reporting entity to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting arrangement. The guidance in the FSP is effective for fiscal years beginning after November 15, 2007, with early application permitted. At this time, TVA is evaluating the requirements of this guidance and has not yet determined the potential impact of its implementation, which may or may not be material to TVA's financial position.

Business Combinations . In December 2007, FASB issued SFAS No. 141R, *"Business Combinations,"* ("SFAS No. 141R"). This statement establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including non-controlling interests, contingent consideration, and certain acquired contingencies. SFAS No. 141R also requires acquisition-related transaction expenses and restructuring costs to be expensed as incurred rather than capitalized as a component of the business combination. The provisions of SFAS No. 141R are effective as of the beginning of an entity's first fiscal year that begins on or after December 15, 2008. Early adoption is prohibited. SFAS No. 141R will become effective for TVA as of October 1, 2009. TVA expects that SFAS No. 141R could have an impact on accounting for any businesses acquired after the effective date of this pronouncement.

Derivative Instruments and Hedging Activities . In March 2008, FASB issued SFAS No. 161, " *Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133," (*" SFAS No. 161") which establishes, among other things, the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 . *The effective date of adoption for TVA is the second quarter of 2009.*

Hierarchy of Generally Accepted Accounting Principles . In May 2008, FASB issued SFAS No. 162, *"The Hierarchy of Generally Accepted Accounting Principles," (*" SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *"The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles."* The implementation of SFAS No. 162 is not expected to have a material impact on TVA's consolidated financial position and results of operations.

Employers' Disclosures about Postretirement Benefit Plan Assets . On October 29, 2008, FASB issued FSP No.132 (R)-a, " *Employers' Disclosures about Pensions and Other Postretirement Benefits,"* to require that an employer disclose the following information about the fair value of plan assets: 1) the level within the fair value hierarchy in which fair value measurements of plan assets fall; 2) information about the inputs and valuation techniques used to measure the fair value of plan assets; and 3) a reconciliation of beginning and ending balances for fair value measurements of plan assets using significant unobservable inputs. The final FSP will be effective for fiscal years ending after December 15, 2009, with early application permitted. At initial adoption, application of the FSP would not be required for earlier periods that are presented for comparative purposes. TVA is currently evaluating the potential impact of adopting this FSP on its disclosures in the financial statements.

Legislative and Regulatory Matters

President's Budget

On February 4, 2008, the Office of Management and Budget ("OMB") transmitted the President's proposed 2009 federal budget to Congress. The proposed budget recommends allowing Congress to establish the amount of TVA's Office of Inspector General's budget and directing TVA to fund the amount with power revenues beginning in 2009. Funding for TVA's Office of the Inspector General is currently established by TVA. The U.S. Senate Appropriations Committee's ("Committee") report for the 2009 Energy and Water Development Appropriation Bill ("Bill") noted that the Committee did not recommend including this proposal of the President in the Bill because TVA has funded the requests of the TVA Inspector General from power revenues and receipts, and the Committee saw no compelling reason to change the funding mechanism for the TVA Inspector General.

In October 2008, Congress passed the Inspector General Reform Act of 2008 ("Reform Act"). Section 8 of the Reform Act addresses the budgets of Inspector Generals. It does not include the provision recommended in the President's proposed 2009 budget in connection with the funding of TVA's Office of the Inspector General. It provides an avenue for an Inspector General, including TVA's Inspector General, to inform Congress if he or she believes that the funding included in the President's budget for that Inspector General's office would substantially inhibit the office's performance.

Proposed Legislation

On March 13, 2007, Senators Jim Bunning and Mitch McConnell of Kentucky introduced the Access to Competitive Power Act of 2007 in the U.S. Senate. Under this bill, TVA and federal power marketing agencies would be subject to greater FERC jurisdiction with respect to transmission, including rates, terms, and conditions of service. No congressional action had taken place on this bill as of September 30, 2008, and none is expected prior to adjournment of the 110th Congress.

On October 18, 2007, Senators Joseph Lieberman and John Warner introduced America's Climate Security Act of 2007 in the U.S. Senate. This economy-wide bill would mandate the reduction of greenhouse gas emissions of covered facilities through a cap-and-trade structure. Covered facilities include those that use more than 5,000 tons of coal per year. Compliance may be met through trading, banking, borrowing, and offsets. In May 2008, Senators Lieberman and Warner reintroduced the bill as the Lieberman-Warner Climate Security Act of 2008, S. 3036. On June 6, 2008, the bill failed to obtain enough votes to overcome a filibuster and to move to final consideration in the U.S. Senate. No further congressional action is expected prior to adjournment of the 110th Congress.

For a discussion of environmental legislation and regulation, see Item 1, Business — *Environmental Matters* .

TVA can control neither what legislation becomes law nor what regulations are promulgated. Even legislation or regulations of which TVA has been made aware may be changed in ways which are difficult to predict or have unforeseen consequences. TVA cannot therefore predict with certainty or with any accuracy whether the initiatives discussed above will become law in the future and in what form, and what their impact would be on TVA. Moreover, given the nature of the legislative process, it is possible that new legislation or a change to existing legislation that has a significant impact on TVA's activities could become law with little or no advance notice. As a federal entity, the very nature of TVA can be changed by legislation. For a discussion of the potential impact of legislation and regulation on TVA, see Item 1A, Risk Factors.

Environmental Matters

TVA's power generation activities, like those across the utility industry and in other industrial sectors, are subject to federal, state, and local environmental laws and regulations. Major areas of regulation affecting TVA's activities include air quality control, water quality control, and management and disposal of solid and hazardous wastes. Looking to the future, regulations in all of these areas are expected to become more stringent along with increased emphasis on dealing with climate change, expanding renewable generation alternatives, and encouraging efficient use of electricity.

Due to the increasing level and complexity of environmental requirements and expectations, TVA completed a new high-level environmental policy to align with and execute the direction in the Strategic Plan. The Environmental Policy ("Environmental Policy") was approved by the TVA Board on May 19, 2008, and is intended to be an integrated framework which provides policy-level guidance to carry out TVA's mission of providing cleaner, affordable energy, sustainable economic development, and proactive environmental stewardship. The TVA Environmental Policy sets out environmental objectives and critical success factors in six environmental dimensions: climate change mitigation, air quality improvement, water resource protection and improvement, waste minimization, sustainable land use, and natural resource management.

TVA has incurred, and expects to continue to incur, substantial capital and operating and maintenance costs to comply with evolving environmental requirements primarily associated with, but not limited to, the operation of TVA's 59 coal-fired generating units. It is virtually certain that environmental requirements placed on the operation of TVA's coal-fired and other generating units will continue to become more restrictive. Litigation over emissions from coal-fired generating units is also occurring, including litigation against TVA. See Item 3, Legal Proceedings .

Air Quality Control Developments

Air quality in the United States and in the Tennessee Valley has significantly improved since the enactment of the Clean Air Act ("CAA") in 1970. These air quality improvements are expected to continue as the CAA continues to be implemented and evolve as a result of legislative and regulatory changes. Three substances emitted from coal-fired units — sulfur dioxide ("SO_2"), oxides of nitrogen ("NO_x"), and particulates — have historically been the focus of CAA emission reduction regulatory programs, and these are discussed in more detail below.

Expenditures related to clean air projects aimed at controlling emissions of these substances during 2008 and 2007 were approximately $274 million and $239 million, respectively. These figures include expenditures in 2008 of $9 million to continue to reduce NO_x emissions through the installation of selective non-catalytic reduction ("SNCR") systems, and $240 million for the installation of flue gas desulfurization systems ("scrubbers") to continue to reduce SO_2 emissions. TVA had previously estimated its total capital cost for reducing emissions from its power plants from 1977 through 2010 would reach $5.5 billion, $5.1 billion of which had already been spent as of September 30, 2008. TVA estimates that compliance with future CAA requirements and potential mercury regulations, but not including carbon dioxide ("CO_2"), as discussed below could lead to additional costs of $3.0 billion to $3.7 billion in the decade beginning in 2011. There could be additional material costs if reductions of greenhouse gases, including CO_2, are mandated under the CAA or via legislation, or if future legislative, regulatory, or judicial actions lead to more stringent emission reduction requirements for conventional pollutants. These costs cannot reasonably be predicted at this time.

On July 11, 2008, the U.S. Court of Appeals for the D.C. Circuit ("D.C. Circuit") issued a decision in *State of North Carolina vs. EPA* that vacated the Clean Air Interstate Rule ("CAIR") in its entirety and directed the EPA to promulgate a new rule that is consistent with the D.C. Circuit opinion. EPA promulgated CAIR in 2005 and the rule required significant additional utility SO_2 and NO_x emission reductions to address ozone and fine particulate matter attainment issues in 28 eastern states, including all of TVA's operating area, and the District of Columbia. The requirements of CAIR formed the basis for TVA's (and much of the utility industry's) planning with regard to air emission controls beginning in 2009 and continuing well into the next decade. In the absence of CAIR, the uncertainty regarding compliance requirements, methods, and timelines may result in increased capital expenditures and operating expenses. In addition, it is unclear whether the petitions for a re-hearing or review of this decision will be granted by the D.C. Circuit, which could prolong the uncertainty of the regulatory landscape.

In the absence of CAIR, other requirements of the CAA, such as achievement of ozone and fine particulate ambient air quality standards, requirements relating to regional haze, and control of interstate transport of air pollution (Section 126 petitions), will continue to drive installation of additional controls on electric generating units across the industry, including at TVA. As discussed in more detail below, TVA will continue its previously announced emissions reduction program, including completion of scrubber installations for SO_2 control at Bull Run, Kingston, and John Sevier Fossil Plants, and annual operation of the 21 selective catalytic reduction ("SCR") and other NO_x controls beginning in October 2008.

On February 8, 2008, the D.C. Circuit vacated the EPA's decision to remove coal and oil-fired Electric Generating Units from the list of stationary sources whose hazardous air pollutant ("HAP") emissions are subject to Maximum Achievable Control Technology ("MACT") standards under section 112 of the CAA. The D.C. Circuit also vacated and remanded the Clean Air Mercury Rule ("CAMR") which set mercury limits via a cap-and-trade program. Unless the D.C. Circuit's ruling is reversed, or EPA is able to determine that mercury emissions are adequately controlled in accordance with the D.C. Circuit's remand instructions, EPA will have to regulate mercury emissions from utilities under section 112(d) of the CAA, setting MACT standards for emissions based on command and control type requirements. The cost to comply with the MACT standards is not known, but is expected to be higher than the cost would have been to comply with CAMR. Regardless of the status of the EPA's regulatory program for mercury, TVA will continue to reduce mercury emissions from its coal-fired power plants. Over the next five years, mercury emissions from its coal-fired plants are expected to continue to decline, primarily as a result of the co-benefits received from the controls TVA is installing to reduce SO_2 and NO_x emissions.

The D.C. Circuit's recent decisions with regard to CAIR and CAMR may also have the effect of reviving interest in Congress in adopting multi-pollutant control legislation focused on the electric power sector. Among other things, such an approach could seek to establish coordinated caps for power plant emissions of mercury, SO_2, NO_x, and CO_2. The legislative and regulatory landscape is continuing to change for these and other issues and the outcome cannot be predicted accurately at this time.

Sulfur Dioxide. Utility SO_2 emissions are currently regulated under the Federal Acid Rain Program and state programs designed to meet the National Ambient Air Quality Standards ("NAAQS") for SO_2 and fine particulate matter. Looking forward, these programs, as well as implementation of the regional haze program, will result in additional regulation of SO_2 emissions.

Through calendar year 2007, TVA had reduced its SO_2 emissions by 84 percent from the peak 1977 level by switching to lower-sulfur coals, continuing to operate an Atmospheric Fluidized Bed Combustion ("AFBC") unit at its Shawnee Fossil Plant, operating existing scrubbers on six larger units, and installing and operating a scrubber on an additional large unit at Paradise Fossil Plant. TVA is constructing a scrubber at Bull Run Fossil Plant, which is scheduled to begin operation in 2009, and two scrubbers at its Kingston Fossil Plant, which are scheduled to begin operation in 2010. In April 2008, the TVA Board approved construction of additional flue gas desulfurization equipment at the four-unit John Sevier Fossil Plant in east Tennessee ("John Sevier"), which is expected to begin operation in 2012. Additionally, TVA has switched, or plans to switch, to lower-sulfur coal at several additional units in the next few years. It is likely that additional emission reduction measures will have to be undertaken in addition to these announced actions to achieve compliance with requirements yet to be adopted. Such measures will also help to meet the goal identified in TVA's Environmental Policy to reduce emissions by continuing to install emission reduction equipment and new technology with the aim of controlling over 80 percent of fossil generation in the next 10 years.

Nitrogen Oxides. Utility NO_x emissions continue to be regulated under state programs to achieve and maintain EPA's NAAQS for ozone and fine particles, the Federal Acid Rain Program, and the regional haze program. On March 12, 2008, EPA issued final rules adopting new, more stringent NAAQS for ozone. EPA lowered the primary standard, created to protect public health with an adequate margin of safety, from 0.084 parts per million ("ppm") to 0.075 ppm. EPA also promulgated a new secondary standard, mainly created to protect vegetation. The form and level of the secondary standard are the same as the primary standard.

In 2009, states will have to recommend to EPA those counties proposed to be designated as "non-attainment" counties under the new standards, and in 2010, EPA is expected to finalize attainment designations using 2006 to 2008 monitoring data. States must submit plans to EPA no later than 2013 that demonstrate attainment with the standard. Areas must reach attainment by deadlines that vary (2013 to 2030) depending on the severity of the ozone problem.

Based on 2005-2007 monitoring data, virtually all of the larger cities in the Tennessee Valley area and their associated Metropolitan Statistical Areas, as well as those rural counties where ozone monitors are present, will likely be designated as non-attainment areas under the new standard.

Non-attainment designation can impact industrial development and expansion since new businesses tend to avoid non-attainment areas, and expansion of existing businesses becomes more difficult. Non-attainment can have serious repercussions for counties by increasing costs to industry, delaying the air permitting process, and restricting expansion of existing sources. Consumers are also likely to be affected as a result of the institution of vehicle inspection and fuel restriction programs. Non-attainment can also impact transportation planning since loss of federal highway funds can occur unless projects demonstrate "conformity" with the new standards.

TVA contributes to ambient ozone levels primarily as a result of NO_x emissions from fossil-fired power plants. As a result of its emission reduction program, TVA's summertime NO_x emissions have declined substantially. Since 1995, TVA has reduced its NO_x emissions during the summer (when ozone levels increase) by 82 percent by installing various controls, including low-NO_x burners and/or combustion controls, on 58 of its 59 coal-fired units and installing SCRs on 21 of the largest units. (The AFBC unit at Shawnee Fossil Plant is inherently low NO_x emitting.)

In 2005, TVA installed SNCR systems, which generally have lower NO_x removal capabilities than SCRs, on two units, Johnsonville Unit 1 and Shawnee Unit 1, to demonstrate long-term technology capability, and continues to operate the SNCR at Johnsonville Unit 1 in West Tennessee. In 2007, TVA began operating the High Energy Reagent Technology ("HERT") system on Unit 1 at John Sevier, and on Unit 4 at Johnsonville Fossil Plant ("Johnsonville"). HERT is similar to SNCR technology but has higher removal capabilities. Similar HERT equipment is planned for installation on the other three John Sevier units and Johnsonville Units 2 and 3 by May 2009, and TVA has announced plans to install SCRs at John Sevier by 2015.

TVA's NO_x emission reduction program is expected to continue to depend primarily on SCRs, but will also incorporate some mix of SNCRs and/or HERTs as TVA gains more experience with these technologies. These plans may change depending on the timing and severity of future regulatory developments affecting power plant emissions. In October 2008, TVA began operating this NO_x control equipment year round (except for maintenance outages).

An increase in the number of counties in the Tennessee Valley designated as non-attainment areas is likely to focus additional regulatory attention on all NO_x emission sources, including TVA sources.

Particulates/Opacity. Coarse particulates (defined as particles of 10 micrometers or larger), which include fly ash, have long been regulated by states to meet EPA's NAAQS for particulate matter. All of TVA's coal-fired units have been equipped with mechanical collectors, electrostatic precipitators, scrubbers, or baghouses, which have reduced particulate emissions from the TVA system by more than 99 percent compared to uncontrolled units. In 1997, EPA issued separate NAAQS for even smaller particles with a size of up to 2.5 micrometers ("fine particles" or "$PM_{2.5}$"). Counties and parts of counties in the Knoxville and Chattanooga, Tennessee, metropolitan areas have been designated as non-attainment areas under the 1997 standard.

In September 2006, EPA revised the 1997 standards. The 2006 revisions tighten the 24-hour fine particle standard and retain the 1997 annual fine particle standard. EPA also decided to retain the existing 24-hour standard for coarse particles, but revoked the related annual standard. On August 19, 2008, EPA sent letters to state and tribal representatives responding to their initial recommendations for areas meeting and not meeting the 24-hour national ambient air quality standards for $PM_{2.5}$. States and tribes now have the opportunity to comment on EPA's modifications to their recommendations and to provide new information and analyses to EPA if appropriate. Several counties and parts of counties in the Tennessee Valley that include or are close to TVA coal-fired generating plants are included in this preliminary designation. Particular areas of concern to TVA are the Kentucky counties of Muhlenberg and McCracken, the Tennessee counties of Humphreys, Montgomery, and Stewart, and the counties in the Knoxville area. EPA has announced plans to make final designations in December 2008 using air quality monitoring data from 2005, 2006, and 2007. TVA will continue efforts to reduce emissions and engage regional and national stakeholders to further understand and improve regional air quality. TVA's continued installations of scrubbers for SO_2 control and SCRs and other technologies for NO_x control as described above are expected to continue to reduce fine particle levels.

Issues regarding utility compliance with state opacity requirements are also increasing. Opacity measures the denseness (or color) of power plant plumes and has traditionally been used by states as a means of monitoring good maintenance and operation of particulate control equipment. Under some conditions, retrofitting a unit with additional equipment to better control SO_2 and NO_x emissions can adversely affect opacity performance, and TVA and other utilities are addressing this issue. There are also disputes and lawsuits over the role of continuous opacity monitors in determining compliance with opacity limitations, and TVA has received an adverse decision in one such lawsuit. See Item 3, Legal Proceedings.

Climate Change. In 1995, TVA was the first utility in the nation to participate in "Climate Challenge," a DOE-sponsored voluntary greenhouse gas reduction program. Over the past decade, TVA has reduced, avoided, or sequestered over 305 million tons of CO_2 under this program. TVA also participates in the President's Climate VISION program which calls on the electric utility sector, along with other industry sectors, to help meet a national goal of reducing the greenhouse intensity of the U.S. economy by 18 percent from 2002 to 2012.

TVA has taken and is continuing to take significant voluntary steps that will reduce the carbon intensity of its electric generation, including the recovery of Browns Ferry Unit 1, planned power up-rates of Browns Ferry Units 1, 2 and 3 (which will increase the generating capability of the units resulting in additional avoided emissions of CO_2), the completion of Watts Bar Unit 2, and the completion of the hydroelectric modernization program. TVA has also filed with the NRC a combined operating license application for two advanced nuclear reactors at the Bellefonte Nuclear Plant near Hollywood, Alabama, and requested that the NRC reinstate the construction permit for Bellefonte Nuclear Units 1 and 2, although no decision has been made to complete those units or to build the new reactors. TVA is also committed to increasing its renewable energy by adding regional renewable energy sources to its generation portfolio.

In addition, TVA is a member of the Southeast Regional Carbon Sequestration Partnership and is working with the Electric Power Research Institute and other electric utilities on projects investigating technologies for CO_2 capture and geologic storage, as well as carbon sequestration via reforestation. Legislation was introduced in the last Congress to require reductions of CO_2 that, if enacted, could have resulted in significant additional costs for TVA and other utilities with coal-fired generation. In general, any carbon legislation will result in some level of increase in the price of electricity to consumers, regardless of form, severity, and timing of the legislation, and TVA's analyses of previous versions of several proposed climate bills indicate that the price increases could be substantial. These analyses also show that TVA's existing coal-fired generating assets will continue to play an important role in meeting the energy needs of the Tennessee Valley. TVA expects that the next Congress and Administration will again take up the issue of climate change and is incorporating the possibility of mandatory carbon reductions and a renewable portfolio standard into its long range planning. TVA will continue to monitor legislative and regulatory developments related to CO_2 and a renewable portfolio standard to assess any potential financial and operational impacts as information becomes available. Looking ahead, TVA's Environmental Policy contains a Climate Change Mitigation objective to stop the growth in volume of emissions and reduce the rate of carbon emissions by 2020.

In addition to legislative activity, climate change issues are the subject of a number of lawsuits, including lawsuits against TVA. See Item 3, Legal Proceedings. On November 29, 2006, the U.S. Supreme Court heard the case of *Massachusetts v. EPA* , concerning whether EPA has the authority and duty to regulate CO_2 emissions under the CAA. On April 2, 2007, the Supreme Court found that greenhouse gases, including CO_2, are pollutants under the CAA, and that EPA thus does have the authority to regulate these gases. The Supreme Court also concluded that EPA's refusal to regulate these pollutants was based on impermissible reasons, and remanded the case to EPA to make a judgment regarding endangerment (either that greenhouse gases do, or do not, pose a threat to health and welfare) with respect to certain mobile sources. While this case focused on CO_2 emissions from motor vehicles, it sets a precedent for regulation in other industrial sectors, such as the electric utility industry.

In July 2008, EPA issued an Advance Notice of Proposed Rulemaking ("ANPR") that addressed essentially all regulatory proceedings before EPA in which greenhouse gas emissions and climate change are issues, including consideration of greenhouse gas emissions in establishing new source performance standards and resolving pending appeals of new source review permit applications. The ANPR sought comments on the framework and direction of EPA's actions to regulate greenhouse gas emissions from a wide range of facilities, including electric generating facilities. The ANPR outlines issues to be addressed in new legislation that may be required in order to regulate greenhouse gas emissions. Regulatory options that may be considered in such legislation include, but are not limited to, the enactment of a cap-and-trade policy and development and deployment of alternative fuels, renewable energy resources, and energy conservation. Whether climate change legislation will be enacted during the 2009 to 2010 legislative session, and if so its potential impacts, cannot be assessed at this time. Any such legislation, or similar regulatory action by EPA under the CAA or otherwise, would probably have a significant impact on fossil-fueled generation facilities.

States are also becoming more active in the regulation of emissions that are believed to be contributing to global climate change. Several northeastern states have formed the Regional Greenhouse Gas Initiative, which is in the process of being implemented, and California passed a bill capping greenhouse gas emissions in the state. Other states are considering a variety of actions. North Carolina is studying initiatives aimed at climate change under the provisions of the state's Clean Smokestacks Act of 2002. This act required the State Division of Air Quality to study potential control of CO_2 emissions from coal-fired utility plants and other stationary sources. This has also prompted efforts to develop a climate action plan for North Carolina.

Renewables and Clean Energy

In light of increasing national focus on renewable and clean energy and TVA's desire to reduce its environmental footprint, on May 19, 2008, the TVA Board approved guiding principals for an Energy Efficiency and Demand Response Plan and a Renewable and Clean Energy Assessment.

The Energy Efficiency and Demand Response Plan seeks to slow the current rate of growth in the region's power demand by providing opportunities for residential, business, and industrial consumer groups to use energy more efficiently. In the short term, the plan proposes reducing the growth in peak demand by up to 1,400 megawatts by the end of the 2012 fiscal year.

The Renewable and Clean Energy Assessment strives to add clean energy resources to TVA's generating mix to help reduce carbon emissions while minimizing costs and maintaining a reliable power supply. The assessment proposes to review TVA's generation mix and identify a road map for pursuing additional renewable and clean energy supply in the region, and recommends consideration of different sources of renewable energy and a reduction in carbon intensity in TVA's generation mix, along with additional energy conservation by everyone who uses electricity.

Water Quality Control Developments

In the second phase of a three-part rulemaking to minimize the adverse impacts from cooling water intake structures on fish and shellfish, as required under Section 316(b) of the Clean Water Act ("CWA"), EPA promulgated a final rule for existing power producing facilities ("Phase II Rule") that became effective on September 7, 2004. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit (the "Second Circuit") remanded the Phase II Rule, holding, among other things, that costs cannot be compared to benefits in picking the best technology available ("BTA") to minimize the adverse environmental impacts of intake structures. The Utility Water Act Group, Entergy Corporation, and PSEG Fossil LLC filed a petition seeking review of the decision by the U.S. Supreme Court. TVA and the attorneys general of several states, including Alabama, Kentucky, and Tennessee, supported this petition. On April 14, 2008, the U.S. Supreme Court granted the petition, limiting its review to one issue: "Whether Section 316(b) of the CWA authorizes EPA to compare costs with benefits in determining the 'best technology available for minimizing adverse environmental impact' at cooling water intake structures." The Department of Justice and industry petitioners will defend the EPA rule supporting the concept that costs under the rule should be limited to those that are "not significantly greater than" the benefits to be derived. The case has been argued before the U.S. Supreme Court. TVA is unable to predict the outcome.

On July 9, 2007, EPA suspended all but one provision of the Phase II Rule until the agency resolves the issues raised by the Second Circuit's remand. The provision that was retained requires permitting authorities to apply, in the interim, Best Professional Judgment ("BPJ") controls for existing facilities. BPJ controls are those that reflect the best technology available for minimizing the adverse environmental impacts of intake structures. The use of BPJ controls reflects a return to the regulatory process that was used by permitting authorities to regulate the impact of intake structures prior to the promulgation of the Phase II Rule.

All of the intakes at TVA's existing coal and nuclear generating facilities were subject to the Phase II Rule. Given the uncertainty over the ultimate outcome of the appellate process and what the changes in the final rule as ultimately issued by EPA will be, the impacts of the eventual rulemaking are uncertain at this time.

Section 303d of the CWA requires states to develop and report to EPA on a two-year cycle a list of waters that are “impaired” or are expected to not meet water quality standards in the next two years and need additional pollution controls. The Tennessee Department of Environment and Conservation (“TDEC”) placed a portion of Barkley Reservoir downstream of TVA's Cumberland Fossil Plant on its 2008 list of impaired streams (the “303d List”). This section of Barkley Reservoir had not been listed previously. The reservoir conditions in 2007, especially for temperature and dissolved oxygen, changed significantly due primarily to reduced flows in the Cumberland River resulting from emergency dam repairs on the Wolf Creek and Center Hill Dams coupled with the most severe drought on record in the region. The lower flows made less water available to dissipate the heated discharge from Cumberland Fossil Plant and resulted in increased river temperatures. The prospect of continued reduced flows through the Cumberland River system during the period required to complete the necessary repairs to Wolf Creek and Center Hill Dams may impact the generation of electricity from TVA's Cumberland and Gallatin Fossil Plants. Placing this section of Barkley reservoir on the 303d List could also impact the thermal limits imposed by the State of Tennessee when the discharge permit for Cumberland Fossil Plant is renewed in 2010, or earlier if the state or EPA determines that additional actions are required to protect the aquatic environment below the plant. TVA is working with the U.S. Army Corps of Engineers and TDEC to minimize the impacts to TVA's generating plants and improve the conditions observed in the river in 2007. TVA began operating temporary cooling towers at Cumberland Fossil Plant to reduce the temperature of the water discharged to the river.

EPA, and many states, are taking increased interest in evaluating the potential effects of thermal discharges from steam-electric generating facilities. TVA is working with states and EPA Region IV to demonstrate that the data collected by TVA in the vicinity of its facilities is sufficient to meet the requirements for assessing the impacts of thermal discharges on the aquatic environment.

In March 2007, TDEC adopted a lower, more conservative threshold (0.3 ppm) for issuing precautionary advisories for fish consumption due to mercury. Adoption of the lower threshold resulted in the issuance of several new precautionary fish consumption advisories in April 2007 for all or parts of five TVA reservoirs (Norris, Cherokee, South Holston, Watauga, and Tellico) and parts of four rivers in the Tennessee Valley (Buffalo, Emory, Hiwassee, and Holston) as well as the Loosahatchie, Wolf, and Mississippi Rivers in Tennessee that are not in the Tennessee River watershed.

As part of the 2007 advisory determinations, TDEC also identified several water bodies where more data were needed to determine if advisories were necessary. State agencies have since collected fish from those water bodies and decided several of them needed advisories to protect public health. The new Precautionary Advisory list for 2008 includes one additional TVA reservoir (Beech) and three additional river segments in the Tennessee River watershed (French Broad, Sequatchie, and Duck). Also, existing advisories for several reservoirs and rivers were expanded to include mercury as a chemical of concern and/or to include more kinds of fish.

TDEC’s announcement of additional Precautionary Advisories for several Tennessee water bodies does not mean that mercury levels in fish are increasing, but is more reflective of the effect of the lowered threshold values for issuing a precautionary consumption advisory. TVA has been monitoring mercury levels in fish and sediments in TVA reservoirs for the last 35 years, and TVA’s data were provided to TDEC as a part of its review process. TVA’s data show significant reductions in mercury concentrations in fish from the reservoirs with known industrial discharges that have now ceased. Other than those areas historically impacted by industrial discharges, mercury concentrations in fish have tended to fluctuate through time with no discernible trend in fish from most reservoirs. Despite increased burning of coal for electricity generation, current and historic data records indicate that mercury concentrations in reservoir sediments have remained stable or declined.

One of the results of the major reductions in atmospheric emissions resulting from the clean air expenditures discussed above is that wastewaters at TVA coal-fired facilities and across the utility industry may be changing because of waste streams from air quality control technologies. Varying amounts of ammonia or similar compounds used as a necessary component of SCR and SNCR operations may end up in facility wastewater ponds that may discharge through outfalls regulated under the CWA. Operation of scrubbers for SO_2 control also results in additional amounts of pollutants being introduced into facility wastewater treatment ponds. EPA is currently collecting information to determine if the national Steam Electric Point Source Effluent Guidelines (“Effluent Guidelines”) under the CWA need to be revised. If the Effluent Guidelines are revised, potentially more restrictive discharge limitations for existing parameters or the addition of new parameters could result in additional wastewater treatment expenses to meet requirements of the CWA. These costs cannot be accurately predicted at this time, but TVA is involved in and closely monitoring EPA’s data collection activities and the progress of the Effluent Guidelines review process. On the state level, new numeric nutrient criteria development and implementation (an EPA requirement) may require additional treatment costs to reduce nitrogen concentrations being added to the waste treatment ponds as a result of the operation of air pollution control equipment. TVA is closely monitoring the development and implementation of numeric nutrient criteria, particularly by the states in TVA’s service area and is encouraging regulatory agencies in the Valley states to incorporate water quality trading regulations into their water quality standards.

As is the case across the utility industry and in other industrial sectors, TVA is also facing more stringent requirements related to protection of wetlands, reductions in storm water impacts from construction activities, water quality degradation, new water quality criteria, and laboratory analytical methods. TVA is also following litigation related to the use of herbicides, water transfers, and releases from dams. TVA is not facing any substantive requirements related to non-compliance with existing CWA regulations.

Hazardous Substance Response, Oil Cleanup, and Similar Environmental Work

Liability for releases and cleanup of hazardous substances is primarily regulated under the federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), and other federal and parallel state statutes. In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances over the years. TVA is aware of alleged hazardous-substance releases at 10 non-TVA areas for which it may have some liability. TVA has reached agreements with EPA to settle its liability at two of the non-TVA areas for a total of less than $23,000. There have been no recent assertions of TVA liability for five of the non-TVA areas, and there is little or no known evidence that TVA contributed any significant quantity of hazardous substances to these five sites. There is evidence that TVA sent some materials to the remaining three non-TVA areas: the David Witherspoon site in Knoxville, Tennessee, the Ward Transformer site in Raleigh, North Carolina, and the General Waste Products site in Evansville, Indiana. As discussed below, TVA is not able to estimate its liability related to these sites at this time.

The Witherspoon site is contaminated with radionuclides, polychlorinated biphenyls ("PCBs"), and metals. DOE has admitted to being the main contributor of materials to the Witherspoon site and is currently performing clean up activities. DOE claims that TVA sent equipment to be recycled at this facility, and there is some supporting evidence for the claim. However, TVA believes it sent only a relatively small amount of equipment and that none of it was radioactive. DOE has asked TVA to "cooperate" in completing the cleanup, but it has not provided to TVA any evidence of TVA's percentage share of the contamination.

The Ward Transformer site is contaminated by PCBs from electrical equipment. EPA and a working group of potentially responsible parties (the "PRP Work Group") have provided documentation showing that TVA sent a limited amount of equipment containing PCBs to the site in 1974. The PRP Work Group is cleaning up on-site contamination in accordance with an agreement with EPA. The cleanup effort has been divided into four areas: two phases of soil cleanup; cleanup of off-site contamination in the downstream drainage basin; and supplemental groundwater remediation. The first phase of soil cleanup is underway, and the high-end cost estimate for this work is about $66 million. There are no reliable estimates for the second phase of soil cleanup or the supplemental groundwater remediation. EPA has selected a cleanup plan for the down stream drainage basin with a present-worth cost estimate of $6.1 million. TVA understands that EPA has incurred approximately $3 million in past response costs, and the PRP Work Group has reimbursed EPA approximately $725,000 of those costs. The PRP Work Group plans to propose a cost allocation schedule which it will use as the basis for offering settlements to PRPs for the first phase of soil cleanup. It plans to sue PRPs who do not settle. There also may be natural resource damages liability at this site, but TVA is not aware of any estimated amount for any such damages. TVA has a potential defense that it only sent useful equipment to Ward and thus is not liable for arranging for disposal of a hazardous substance at the site.

General Waste Products was a scrap metal salvage yard that operated from the 1930s until 1998. The original defendants in a CERCLA action have filed a third party complaint against TVA and others seeking cost contribution for cleanup of contamination from lead batteries and PCB transformers at the facility. There is evidence that TVA sent scrap metal to the facility, but TVA has not found any records indicating that it sent batteries or PCB equipment. There are two cleanup sites at the facility. TVA has been informed that the first site has been cleaned up at a cost of $3.2 million, and cleanup estimates for the second site range from $2 million to $7 million. TVA's allocated share of the cleanup costs, if any, is expected to be relatively small.

TVA operations at some TVA facilities have resulted in oil spills and other contamination TVA plans to address, and TVA expects to incur costs of about $15 million for environmental work related to decommissioning of the Watts Bar Fossil Plant.

As of September 30, 2008, TVA's estimated liability for cleanup and similar environmental work for those sites for which sufficient information is available to develop a cost estimate (primarily the TVA sites) is approximately $18 million on a non-discounted basis, including the Watts Bar Fossil Plant work, and is included in OTHER LIABILITIES on the Balance Sheet.

Coal-Combustion Wastes

In accordance with a regulatory determination by EPA in May 2000, coal-combustion and certain related wastes disposed of in landfills and surface impoundments are not regulated as hazardous waste. In conjunction with this determination, EPA committed to developing non-hazardous management standards for these wastes. These standards are likely to include increased groundwater monitoring, more stringent siting requirements, and closure of existing waste-management facilities not meeting minimum standards. On August 29, 2007, EPA issued a Notice of Data Availability ("NODA") in which it requested public comment on whether the additional information mentioned in the notice should affect EPA's decisions as it continues to follow up on its commitment to develop management standards for coal-combustion wastes. Although TVA did not comment on the NODA, the Utility Solid Waste Activity Group, of which TVA is a member, did file extensive comments with EPA regarding the risk assessment method that EPA chose to support the NODA.

Legal Proceedings

TVA is subject to various legal proceedings and claims that have arisen in the ordinary course of business. These proceedings and claims include the matters discussed in Item 3, Legal Proceedings. In accordance with SFAS No. 5, *"Accounting for Contingencies,"* TVA had accrued approximately $46 million and $3 million with respect to the proceedings described in Item 3, Legal Proceedings, as of September 30, 2008, and 2007, respectively, as well as approximately $5 million and $4 million as of September 30, 2008, and 2007, respectively, with respect to other proceedings that have arisen in the normal course of TVA's business. No assurance can be given that TVA will not be subject to significant additional claims and liabilities. If actual liabilities significantly exceed the estimates made, TVA's results of operations, liquidity, and financial condition could be materially adversely affected.

For a discussion of TVA's current legal proceedings and anticipated outcomes, see Item 3, Legal Proceedings.

Risk Management Activities

Risk Governance

The Enterprise Risk Council ("ERC") was created in August 2005 to strengthen and formalize TVA's enterprise-wide risk management efforts. The ERC is responsible for the highest level of risk oversight at TVA and is also responsible for communicating enterprise-wide risks with policy implications to the TVA Board or a designated TVA Board committee. The ERC's current members are the president and chief executive officer (chair), the chief financial officer, the chief operating officer, the general counsel, and a designated representative from the Office of the Inspector General ("OIG") (advisory).

In addition to the ERC, TVA has established three subordinate risk committees, Financial, Operational, and Strategic, to manage risks based on natural groupings. Each of the subordinate committees reports directly to the ERC. Membership in the subordinate committees includes senior management from organizations that manage the applicable risks and advisory representatives from the OIG and from the Office of the General Counsel. The ERC and the risk committees meet regularly.

The ERC and risk committees have cataloged major enterprise level risks for TVA into three main categories: strategic risks, operational risks, and financial risks. A discussion of significant risk factors under each of these categories, as well as risk factors related to TVA securities, is presented in Item 1A, Risk Factors. Enterprise risk management is an on-going effort at TVA. As such, it will continue to evolve in a manner that will best support TVA's mission.

Commodity Price Risk

TVA measures price risk associated with the commodities that are critical to its operations using either a Value at Risk ("VaR") methodology or sensitivity analysis. Following is an explanation of these methods along with their calculated measures of TVA's commodity price risk.

Value at Risk

TVA uses a VaR methodology, which is also used by other energy companies, to measure the amount of price risk that exists within certain of its commodity portfolios. Price risk is quantified using what is referred to as the variance-covariance technique of measuring VaR, which provides a consistent measure of risk across diverse energy markets and products. This technique requires the use of a number of assumptions including a confidence level for losses, market liquidity, and a specified holding period. This methodology uses standard statistical techniques to predict market movements in light of current prices, historical volatilities, and current specific commodity correlations.

The VaR calculation gives TVA a dollar amount which reflects the maximum potential loss in the fair value of its portfolios due to adverse market movements over a 10-day period within a specified confidence level. TVA's VaR calculations are based on a 95 percent confidence level, which means that there is a 2.5 percent probability that TVA's portfolios will incur a loss in value in 10 days at least as large as the reported VaR. For example, if the VaR is calculated at $5 million, there is a 97.5 percent probability that if prices move against current positions, the reduction in the value of the portfolio resulting from such 10-day price movements would be less than $5 million.

The following table illustrates the potential unfavorable price impact on TVA's electricity, natural gas, SO_2 emission allowance, and NO_x emission allowance portfolios as measured by the VaR model based on a 10-day holding period and a 95 percent confidence level. The high and low valuations represent the highest and lowest VaR values during 2008, and the average calculation represents the average of the VaR values during 2008.

Value at Risk

	September 30, 2008	Average	High	Low	September 30, 2007
Electricity [1]	$ 23	$ 30	$ 64	$ 18	$ 69
Natural Gas [2]	18	15	26	3	5
SO_2 Emission Allowances [3]	24	63	64	15	20
NO_x Emission Allowances [4]	2	2	3	2	1

Notes

(1) TVA's VaR calculations for electricity are based on its on-peak electricity portfolio, which includes electricity forwards and option contracts.

(2) TVA's VaR calculations for natural gas are based on TVA's natural gas portfolio, which includes natural gas forwards, futures, options on futures, and swap futures contracts.

(3) TVA's VaR calculations for SO_2 emission allowances are based on TVA's portfolio of SO_2 emission allowances.

(4) TVA's VaR calculations for NO_x emission allowances are based on TVA's portfolio of NO_x emission allowances.

VaR has several limitations as a measure of portfolio risk, including, but not limited to, its inability to adequately reflect (1) the risk of a portfolio with significant option exposure, (2) the risk of extreme price movements, and (3) the significant regulatory and legislative risks facing TVA.

Electricity . TVA enters into electricity forward contracts in order to hedge its economic risks directly associated with meeting its power supply obligations. During 2008, TVA supplied approximately 9.7 percent of system energy requirements with power purchased under electricity forward contracts.

TVA's average electricity market risk exposure has increased annually since 2003. The increases have resulted primarily from TVA's purchases of power to meet growing demand and, to a lesser extent, from increased volatility in the electricity markets.

As shown in the Value at Risk table above, at a 95 percent confidence level, the average VaR for TVA's electricity portfolio for 2008 for a 10-day holding period was $30 million.

Natural Gas. TVA uses natural gas to operate combustion turbine peaking units and to supply fuel under power purchase agreements in which TVA is the fuel supplier. TVA hedges a portion of its natural gas needs by entering into futures contracts, options on futures contracts, swaps, and options on swaps under a financial hedging program. At September 30, 2008, TVA had derivative positions outstanding under the program equivalent to about 3,154 contracts, made up of 2,090 futures contracts, 160 options contracts, and 904 swap futures contracts, with an approximate net market value of $715 million.

As shown on the Value at Risk table above, at a 95 percent confidence level, the average VaR for TVA's natural gas portfolio for 2008 for a 10-day holding period was $15 million.

Emission Allowances. TVA acquires both SO_2 emission allowances and NO_x emission allowances to help TVA comply with the emission requirements of the CAA and its implementing regulations. In addition to meeting TVA's emissions requirements, TVA also manages the emission positions utilizing the market to optimize the value of its emission allowance portfolio. As shown in the VaR table above, at a 95 percent confidence level, the average VaR for 2008 for a 10-day holding period for TVA's SO_2 emission allowance portfolio and NO_x emission allowance portfolio was $63 million and $2 million, respectively.

Fuel Oil . TVA purchases fuel oil as a substitute fuel source for TVA's combustion turbines and for start up purposes at many of TVA's fossil plants. In addition, many of TVA's rail transport contracts for movement of certain commodities such as coal are indexed to fuel oil. TVA is currently in the process of developing an additional portion of the financial hedging program to purchase fuel oil derivative contracts to hedge TVA's exposure to price movements.

Sensitivity Analysis

TVA uses sensitivity analysis to measure the potential impact that selected hypothetical changes in certain commodity prices would have on TVA over a selected period of time. The selected hypothetical changes in commodity prices are intended to reflect reasonably possible near-term changes.

Coal . During 2008, TVA purchased 93 percent of its coal requirements under long-term coal contracts and 7 percent of its coal requirements under short-term contracts. If the rates that TVA paid for coal under short-term contracts during 2008 were 10 percent higher than the rates TVA actually paid, TVA's coal expense would have increased by $15 million in 2008.

Uranium . During 2008, TVA did not have to purchase any uranium on the spot market, and as of September 30, 2008, TVA had all of its uranium requirements through 2011 either in inventory or under contract. Accordingly, a hypothetical 10 percent change in uranium prices during 2009 would have no material effect on TVA's financial position, results of operations, or cash flows. See Item 1, Business — *Fuel Supply — Nuclear Fuel.*

Cash Flow at Risk

Cash Flow at Risk ("CFaR") is a risk metric that reflects how energy commodity volatility and price changes translate into fluctuations in TVA's financial health captured by cash flow. Although TVA currently has a FCA that mitigates much of its fuel-cost risk and also conducts an extensive financial trading program to hedge some of its portfolio risks, TVA still faces volumetric risk and other uncertainties that affect cash flow. TVA continues to manage CFaR for the mutual benefit of TVA and its customers.

TVA forecasts CFaR using a computer model. The rolling 12 month forecast is used to pinpoint months with greater amounts of CFaR that need to be hedged to limit price exposure. At September 30, 2008, TVA estimated its 2009 CFaR at $228 million based on a 90 percent confidence level.

Investment Price Risk

TVA's investment price risk relates primarily to investments in TVA's nuclear decommissioning trust, asset retirement trust, and pension plan.

Nuclear Decommissioning Trust

The nuclear decommissioning trust is generally designed to achieve a return in line with overall equity market performance. The assets of the trust are invested in debt and equity securities and certain derivative instruments including forwards, futures, options, and swaps, and through these investments the trust has exposure to U.S. equities, international equities, real estate investment trusts, high-yield debt, U.S. Treasury inflation-protected securities, commodities, and currencies. As of September 30, 2008, the value of the investments in the trust was $845 million, and an immediate 10 percent decrease in the price of the investments in the trust would have reduced the value of the trust by $85 million. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Critical Accounting Policies and Estimates — Nuclear Decommissioning* for more information regarding TVA's nuclear decommissioning trust.

Asset Retirement Trust

The asset retirement trust is presently invested to achieve a return in line with fixed income market performance. The assets of the trust are invested in fixed income commingled funds. As of September 30, 2008, the value of the investments in the trust was $81 million, and an immediate 10 percent decrease in the price of the investments in the trust would have reduced the value of the trust by $8 million.

Pension Fund

The assets in TVA's pension plan are primarily stocks and bonds. The Tennessee Valley Authority Retirement System ("TVARS") targets an asset allocation policy for its pension plan assets which, in prior years, approximated 60 percent equity securities and 40 percent fixed income securities. TVARS is transitioning to a new asset allocation policy adopted March 1, 2007, which targets an asset allocation policy of 65 percent equity securities and 35 percent fixed income securities. The pension fund is invested in equity securities, debt securities, and derivative instruments such as futures, options, and swaps, and through these investments the fund has exposure to U.S. equities, international equities, real estate investment trusts, investment-grade debt, high-yield debt, U.S. Treasury inflation-protected securities, commodities, and currencies. As of September 30, 2008, the value of the investments in the pension fund was $6.2 billion, and an immediate 10 percent decrease in the value of the investments in the fund would have reduced the value of the fund by approximately $622 million. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Critical Accounting Policies and Estimates — Pension and Other Postretirement Benefits* and Note 14 for additional information regarding TVA's pension fund.

Interest Rate Risk

TVA's interest rate risk is related primarily to its short-term investments, Bonds, swaption transaction, and interest rate swaps related to three of TVA's swaption transactions.

Short-Term Investments

At September 30, 2008, TVA had $213 million of cash and cash equivalents, and the average balance of cash and cash equivalents for 2008 was $357 million. If the rates of interest that TVA received on its short-term investments during 2008 had been one percentage point lower than the rates of interest that TVA actually received on these investments, TVA would have received approximately $4 million less in interest from its short-term investments during 2008. In addition, changes in interest rates could affect the value of TVA's investments in its pension fund, asset retirement trust, and nuclear decommissioning trust. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities — Investment Price Risk* .

Debt Portfolio

Short-Term Debt . At September 30, 2008, TVA's short-term borrowings were $185 million, and the current maturities of long-term debt were $2 billion. Based on TVA's interest rate exposure at September 30, 2008, an immediate one percentage point increase in interest rates would have resulted in an increase of $22 million in TVA's short-term interest expense during 2009. This calculation assumes that the balance of short-term debt during 2009 equals the short-term debt balance at September 30, 2008, plus an amount representing the refinancing of current maturities of long-term debt.

Long-Term Debt. At September 30, 2008, the interest rates on all of TVA's outstanding long-term debt were fixed. Accordingly, an immediate one percentage point increase in interest rates would not have affected TVA's interest expense associated with its long-term debt. When TVA's long-term debt matures or is redeemed, however, TVA typically refinances this debt by issuing additional long-term debt. Accordingly, if interest rates are high when TVA issues this additional long-term debt, TVA's cash flows, results of operations, and financial condition may be adversely affected. This risk is somewhat mitigated by the fact that TVA's debt portfolio is diversified in terms of maturities and has a long average life. As of September 30, 2008, the average life of TVA's debt portfolio was 15.8 years. A schedule of TVA's debt maturities is contained in Note 11.

Swaption and Related Interest Rate Swap Agreements

Changes in interest rates also affect the mark-to-market valuation of TVA's swaption agreement and related interest rate swaps. Unrealized gains and losses on these transactions are reflected on TVA's balance sheets in a regulatory asset account, and realized gains and losses are reflected in earnings. Based on TVA's interest rate exposure at September 30, 2008, an immediate one percentage point decrease in interest rates would have decreased the mark-to-market valuation of TVA's swaption agreement and related interest rate swaps by $353 million.

Currency Exchange Rate Risk

As of September 30, 2008, TVA had three issues of Bonds outstanding whose principal and interest payments are denominated in British pounds sterling. TVA issued these Bonds in amounts of £200 million, £250 million, and £150 million in 1999, 2001, and 2003, respectively. When TVA issued these Bonds, it hedged its currency exchange rate risk by entering into currency swap agreements. Accordingly, as of September 30, 2008, a 10 percent change in the British pound sterling-U.S. dollar exchange rate would not have had a material impact on TVA's cash flows, results of operations, or financial position.

Credit Risk

Credit risk is the exposure to economic loss that would occur as a result of a counterparty's nonperformance of its contractual obligations. Where exposed to credit risk, TVA analyzes the counterparty's financial condition prior to entering into an agreement, establishes credit limits, monitors the appropriateness of those limits, as well as any changes in the creditworthiness of the counterparty on an ongoing basis, and employs credit mitigation measures, such as collateral or prepayment arrangements and master purchase and sale agreements, to mitigate credit risk.

Credit of Customers

The majority of TVA's credit risk is limited to trade accounts receivable from delivered power sales to municipal and cooperative distributor customers, all located in the Tennessee Valley region. To a lesser extent, TVA is exposed to credit risk from industries and federal agencies directly served and from exchange power arrangements with a small number of investor-owned regional utilities related to either delivered power or the replacement of open positions of longer-term purchased power or fuel agreements. As previously mentioned in Item 1, Business — *Customers — Other Customers* , power sales to the United States Enrichment Corporation ("USEC") represented 5.3 percent of TVA's total operating revenues in 2008. USEC's senior unsecured credit ratings are currently 'CCC' by Standard & Poor's and 'Caa2' by Moody's Investors Service. As a result of USEC's credit ratings, the company has provided credit assurance to TVA, under the terms of its power contract.

TVA had concentrations of accounts receivable from seven customers that represented 40 percent of total accounts receivable as of September 30, 2008.

The table below summarizes TVA's customer credit risk from trade accounts receivable as of September 30, 2008:

Customer Credit Risk
As of September 30

Trade Accounts Receivable [1]		
Municipalities and Cooperative Distributor Customers		
Investment Grade	$	868
Internally Rated — Investment Grade		430
Industries and Federal Agencies Directly Served		
Investment Grade		46
Non-investment Grade		20
Internally Rated — Investment Grade		3
Internally Rated — Non-investment Grade		9
Exchange Power Arrangements		
Investment Grade		4
Non-investment Grade		–
Internally Rated — Investment Grade		–
Internally Rated — Non-investment Grade		1
Subtotal		1,381
Other Accounts Receivable		
Miscellaneous Accounts		26
Provision for Uncollectible Accounts		(2)
Subtotal		24
Total	$	1,405

Note___
(1) Includes unbilled power receivables of $1,000 million.

Credit of Other Counterparties

In addition to being exposed to economic loss due to the nonperformance of TVA's customers, TVA is exposed to economic loss because of the nonperformance of its other counterparties, including suppliers and counterparties to its derivative contracts. Where exposed to performance risk, TVA analyzes the counterparty's financial condition prior to entering into an agreement and employs performance assurance measures, such as parent guarantees, letters of credit, cash deposits, or performance bonds, to mitigate the risk.

TVA has various agreements under which it has exposure to various institutions with which it does business. Most of these are not material on a net exposure basis. Policies and procedures for counterparty credit review have generally protected TVA against significant exposure to institutions in poor financial condition due to current market and economic conditions.

Credit of Suppliers. If one of TVA's fuel or purchased power suppliers fails to perform under the terms of its contract with TVA, TVA might lose the money that it paid to the supplier under the contract and have to purchase replacement fuel or power on the spot market, perhaps at a significantly higher price than TVA was entitled to pay under the contract. In addition, TVA might not be able to acquire replacement fuel or power in a timely manner and thus might be unable to satisfy its own obligations to deliver power. As mentioned in Item 1, Business — *Power Supply — Purchased Power and Other Agreements* , TVA has a power purchase agreement with Choctaw that expires on March 31, 2032. Choctaw's senior secured credit ratings are currently 'BB' by Standard & Poor's and 'Ba1' with Moody's Investors Service. As a result of Choctaw's credit ratings, the company has provided credit assurance to TVA, per the terms of its agreement.

In September 2008, Lehman Brothers Holdings Inc. ("Lehman"), an investment bank, filed for protection under Chapter 11 of the Federal Bankruptcy Code. Lehman's relationship with TVA had primarily been as an underwriter and market maker for TVA debt securities. TVA had no net exposure to Lehman or its subsidiaries as of the date of its bankruptcy filing. TVA's pension and NDT funds held minimal amounts of Lehman securities.

Credit of Derivative Counterparties. TVA has entered into derivative contracts for hedging purposes, and TVA's nuclear decommissioning trust and pension fund have entered into derivative contracts for investment purposes. If a counterparty to one of TVA's hedging transactions defaults, TVA might incur substantial costs in connection with entering into a replacement hedging transaction. If a counterparty to the derivative contracts into which the nuclear decommissioning trust and the pension fund have entered for investment purposes defaults, the value of the investment could decline significantly, or perhaps become worthless.

Credit of TVA

A downgrade in TVA's credit rating could have material adverse effects on TVA's cash flows, results of operations, and financial condition and would harm investors in TVA securities. Among other things, a downgrade could have the following effects:

- A downgrade would increase TVA's interest expense by increasing the interest rates that TVA pays on debt securities that it issues. An increase in TVA's interest expense would reduce the amount of cash available for other purposes, which could result in the need to increase borrowings, to reduce other expenses or capital investments, or to increase electricity rates.

- A significant downgrade could result in TVA having to post additional collateral under certain physical and financial contracts that contain rating triggers.

- A downgrade below a contractual threshold could prevent TVA from borrowing under two credit facilities totaling $2.25 billion.

- A downgrade could lower the price of TVA securities in the secondary market, thereby hurting investors who sell TVA securities after the downgrade and diminishing the attractiveness and marketability of TVA Bonds.

For a discussion of factors that could lead to a downgrade in TVA's credit rating, see Item 1A, Risk Factors.

Subsequent Events

See Note 18 .

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and qualitative disclosures about market risk are reported in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — *Risk Management Activities* .

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF INCOME
For the years ended September 30
(in millions)

	2008	2007	2006
Operating revenues			
Sales of electricity			
Municipalities and cooperatives	$ 8,659	$ 7,847	$ 7,659
Industries directly served	1,472	1,221	1,065
Federal agencies and other	121	112	116
Other revenue	130	146	143
Operating revenues	10,382	9,326	8,983
Revenue capitalized during pre-commercial plant operations	–	(57)	–
Net operating revenues	10,382	9,269	8,983
Operating expenses			
Fuel and purchased power	4,176	3,449	3,342
Operating and maintenance	2,298	2,332	2,328
Depreciation, amortization, and accretion	1,224	1,473	1,500
Tax equivalents	491	451	376
Loss on asset impairment	9	21	14
Total operating expenses	8,198	7,726	7,560
Operating income	2,184	1,543	1,423
Other income	15	73	80
Other expense	(6)	(2)	(2)
Unrealized gain (loss) on derivative contracts, net	–	41	(15)
Interest expense			
Interest on debt and leaseback obligations	1,373	1,390	1,406
Amortization of debt discount, issue, and reacquisition costs, net	20	19	21
Allowance for funds used during construction and nuclear fuel expenditures	(17)	(177)	(163)
Net interest expense	1,376	1,232	1,264
Income before cumulative effects of accounting changes	817	423	222
Cumulative effect of change in accounting for conditional asset retirement obligations	–	–	(109)
Net income	$ 817	$ 423	$ 113

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

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TENNESSEE VALLEY AUTHORITY
BALANCE SHEETS
At September 30
(in millions)

ASSETS

	2008	2007
Current assets		
Cash and cash equivalents	$ 213	$ 165
Restricted cash and investments	106	150
Accounts receivable, net	1,405	1,458
Inventories and other, net	779	663
Total current assets	2,503	2,436
Property, plant, and equipment (Note 3)		
Completed plant	40,079	38,811
Less accumulated depreciation	(16,983)	(15,937)
Net completed plant	23,096	22,874
Construction in progress	1,892	1,286
Nuclear fuel and capital leases	791	672
Total property, plant, and equipment, net	25,779	24,832
Investment funds	956	1,169
Regulatory and other long-term assets		
Deferred nuclear generating units	2,738	3,130
Other regulatory assets (Note 6)	4,166	1,790
Subtotal	6,904	4,920
Other long-term assets	995	375
Total regulatory and other long-term assets	7,899	5,295
Total assets	$ 37,137	$ 33,732
LIABILITIES AND PROPRIETARY CAPITAL		
Current liabilities		
Accounts payable and accrued liabilities	$ 1,333	$ 1,205
Collateral funds held	103	157
Accrued interest	441	406
Current portion of leaseback obligations	54	43
Current portion of energy prepayment obligations	106	106
Short-term debt, net	185	1,422
Current maturities of long-term debt (Note 11)	2,030	90
Total current liabilities	4,252	3,429
Other liabilities		
Other liabilities	3,514	2,067
Regulatory liabilities (Note 6)	860	83
Asset retirement obligations	2,318	2,189
Leaseback obligations	1,299	1,029
Energy prepayment obligations	927	1,032
Total other liabilities	8,918	6,400
Long-term debt, net (Note 11)	20,404	21,099
Total liabilities	33,574	30,928
Commitments and contingencies (Note 15)		
Proprietary capital		
Appropriation investment	4,723	4,743
Retained earnings	2,571	1,763
Accumulated other comprehensive loss	(37)	(19)
Accumulated net expense of stewardship programs	(3,694)	(3,683)
Total proprietary capital	3,563	2,804

Total liabilities and proprietary capital	$ 37,137	$ 33,732

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CASH FLOWS
For the years ended September 30
(in millions)

	2008	2007	2006
Cash flows from operating activities			
Net income	$ 817	$ 423	$ 113
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation, amortization, and accretion	1,244	1,492	1,521
Nuclear refueling outage amortization	107	86	89
Loss on asset impairment	9	21	14
Cumulative effect of change in accounting principle	–	–	109
Amortization of nuclear fuel	189	137	128
Non-cash retirement benefit expense	141	201	302
Net unrealized (loss) gain on derivative contracts	–	(41)	15
Prepayment credits applied to revenue	(105)	(105)	(105)
Fuel cost adjustment deferral	123	(150)	–
Other, net	(13)	(31)	(3)
Changes in current assets and liabilities			
Accounts receivable, net	(59)	(144)	(15)
Inventories and other, net	(138)	(98)	(120)
Accounts payable and accrued liabilities	(88)	103	96
Accrued interest	35	4	23
Pension contributions	(160)	(75)	(75)
Refueling outage costs	(150)	(96)	(72)
Other, net	5	61	(35)
Net cash provided by operating activities	1,957	1,788	1,985
Cash flows from investing activities			
Construction expenditures	(1,508)	(1,379)	(1,370)
Combustion turbine asset acquisitions	(466)	(111)	–
Nuclear fuel expenditures	(322)	(203)	(277)
Change in restricted cash and investments	25	48	(91)
Purchases of investments	(39)	(44)	–
Loans and other receivables			
Advances	(6)	(16)	(17)
Repayments	13	16	13
Proceeds from sale of receivables/loans (Note 1)	–	2	11
Proceeds from settlement of litigation	–	–	35
Other, net	4	1	(2)
Net cash used in investing activities	(2,299)	(1,686)	(1,698)
Cash flows from financing activities			
Long-term debt			
Issues	2,105	1,040	1,132
Redemptions and repurchases (Note 11)	(689)	(470)	(1,241)
Short-term (redemptions)/borrowings, net	(1,237)	(955)	(93)
Proceeds from sale/leaseback	325	–	–
Payments on leaseback financing	(36)	(30)	(28)
Payments on equipment financing	(7)	(7)	(6)
Financing costs, net	(32)	(11)	(14)
Payments to U.S. Treasury	(40)	(40)	(38)
Other	1	–	(1)
Net cash provided by (used in) financing activities	390	(473)	(289)
Net change in cash and cash equivalents	48	(371)	(2)
Cash and cash equivalents at beginning of year	165	536	538
Cash and cash equivalents at end of year	$ 213	$ 165	$ 536

See Note 12 for supplemental cash flow information.

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL
For the years ended September 30
(in millions)

	Appropriation Investment	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Accumulated Net Expense of Stewardship Programs	Total	Comprehensive Income
Balance at September 30, 2005	$ 4,783	$ 1,244	$ 27	$ (3,662)	$ 2,392	
Net income (loss)	–	123	–	(10)	113	$ 113
Return on Power Facility Appropriation Investment	–	(18)	–	–	(18)	–
Accumulated other comprehensive income (Note 9)	–	–	16	–	16	16
Return of Power Facility Appropriation Investment	(20)	–	–	–	(20)	–
Balance at September 30, 2006	$ 4,763	$ 1,349	$ 43	$ (3,672)	$ 2,483	$ 129
Net income (loss)	–	434	–	(11)	423	$ 423
Return on Power Facility Appropriation Investment	–	(20)	–	–	(20)	–
Accumulated other comprehensive loss (Note 9)	–	–	(62)	–	(62)	(62)
Return of Power Facility Appropriation Investment	(20)	–	–	–	(20)	–
Balance at September 30, 2007	$ 4,743	$ 1,763	$ (19)	$ (3,683)	$ 2,804	$ 361
Net income (loss)	–	828	–	(11)	817	$ 817
Return on Power Facility Appropriation Investment	–	(20)	–	–	(20)	–
Accumulated other comprehensive loss (Note 9)	–	–	(18)	–	(18)	(18)
Return of Power Facility Appropriation Investment	(20)	–	–	–	(20)	–
Balance at September 30, 2008	$ 4,723	$ 2,571	$ (37)	$ (3,694)	$ 3,563	$ 799

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

NOTES TO FINANCIAL STATEMENTS
(Dollars in millions except where noted)

1. Summary of Significant Accounting Policies

General

The Tennessee Valley Authority ("TVA") is a wholly-owned corporate agency and instrumentality of the United States. TVA was created by the U.S. Congress in 1933 by virtue of the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (as amended, the "TVA Act"). TVA was created to improve navigation on the Tennessee River, reduce flood damage, provide agricultural and industrial development, and provide electric power to the Tennessee Valley region. TVA manages the Tennessee River and its tributaries for multiple river-system purposes, such as navigation; flood damage reduction; power generation; environmental stewardship; shoreline use; and water supply for power plant operations, consumer use, recreation, and industry.

Substantially all of TVA's revenues and assets are attributable to the power program. TVA provides power in most of Tennessee, northern Alabama, northeastern Mississippi, and southwestern Kentucky, and in portions of northern Georgia, western North Carolina, and southwestern Virginia to a population of nearly nine million people. The power program has historically been separate and distinct from the stewardship programs. It is required to be self-supporting from power revenues and proceeds from power financings, such as proceeds from the issuance of bonds, notes, and other evidences of indebtedness ("Bonds"). Although TVA does not currently receive congressional appropriations, it is required to make annual payments to the U.S. Treasury in repayment of, and as a return on, the government's appropriation investment in TVA power facilities (the "Power Facility Appropriation Investment"). In the 1998 Energy and Water Development Appropriations Act, Congress directed TVA to fund essential stewardship activities related to its management of the Tennessee River system and TVA properties with power funds in the event that there were insufficient appropriations or other available funds to pay for such activities in any fiscal year. Congress has not provided any appropriations to TVA to fund such activities since 1999. Consequently, during 2000, TVA began paying for essential stewardship activities primarily with power revenues, with the remainder funded with user fees and other forms of revenues derived in connection with those activities. These activities related to stewardship properties do not meet the criteria of an operating segment pursuant to Statement of Financial Accounting Standard ("SFAS") No. 131, *"Disclosures About Segments of an Enterprise and Related Information."* Accordingly, these assets and properties are included as part of the power program, TVA's only operating segment.

Power rates are established by the TVA board of directors ("TVA Board") as authorized by the TVA Act. The TVA Act requires TVA to charge rates for power that will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes; debt service on outstanding indebtedness; payments to the U.S. Treasury in repayment of and as a return on the Power Facility Appropriation Investment; and such additional margin as the TVA Board may consider desirable for investment in power system assets, retirement of outstanding Bonds in advance of maturity, additional reduction of the Power Facility Appropriation Investment, and other purposes connected with TVA's power business. In setting TVA's rates, the TVA Board is charged by the TVA Act to have due regard for the primary objectives of the TVA Act, including the objective that power shall be sold at rates as low as are feasible. Rates set by the TVA Board are not subject to review or approval by any state or federal regulatory body.

Fiscal Year

Unless otherwise indicated, years (2008, 2007, etc.) refer to TVA's fiscal years ended September 30.

Cost-Based Regulation

The rate-setting authority vested in the TVA Board by the TVA Act meets the "self-regulated" provisions of SFAS No. 71, *"Accounting for the Effects of Certain Types of Regulation."* In addition, TVA meets the remaining criteria for the application of SFAS No. 71 because (1) TVA's regulated rates are designed to recover its costs of providing electricity and (2) in view of the demand for electricity and the level of competition it is reasonable to assume that the rates, set at levels that will recover TVA's costs, can be charged and collected. Accordingly, TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under generally accepted accounting principles ("GAAP") for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred or deferral of gains that will be credited to customers in future periods. Management assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, potential legislation, and changes in technology. Based on these assessments, management believes the existing regulatory assets are probable of recovery. This determination reflects the current regulatory and political environment and is subject to change in the future. If future recovery of regulatory assets ceases to be probable, TVA would be required to write off these costs. Any asset write-offs would be required to be recognized in earnings in the period in which future recovery ceases to be probable.

Management Estimates

TVA prepares its financial statements in conformity with GAAP in the United States applied on a consistent basis. In some cases, management may make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the related amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents

CASH AND CASH EQUIVALENTS include the cash available in TVA's commercial bank accounts and U.S. Treasury accounts, as well as short-term securities held for the primary purpose of general liquidity. Such securities mature within three months from the original date of issuance.

Restricted Cash and Investments

As of September 30, 2008 and 2007, TVA had $106 million and $150 million, respectively, in RESTRICTED CASH AND INVESTMENTS on its Balance Sheets primarily related to collateral posted with TVA by a swap counterparty in accordance with certain credit terms included in the swap agreement, which resulted in the funds being reported in RESTRICTED CASH AND INVESTMENT S.

Accounts Receivable

Accounts Receivable . Accounts receivable primarily consist of amounts due from customers for power sales. The table below summarizes the types and amounts of receivables:

Accounts Receivable
As of September 30

	2008	2007
Power receivables billed	$ 357	$ 316
Power receivables unbilled	1,000	986
Fuel cost adjustment – current	24	132
Total power receivables	1,381	1,434
Other receivables	26	26
Allowance for uncollectible accounts	$ (2)	$ (2)
Net accounts receivable	$ 1,405	$ 1,458

Allowance for Uncollectible Accounts

The allowance for uncollectible accounts reflects TVA's estimate of probable losses inherent in the accounts receivable, unbilled revenue, and loans receivable balances. TVA determines the allowance based on known accounts, historical experience, and other currently available information including events such as customer bankruptcy and/or a customer failing to fulfill payment arrangements after 90 days. TVA's corporate credit department is consulted to assess the financial condition of customers and the credit quality of the accounts. The allowance for uncollectible accounts was $2 million at both September 30, 2008, and 2007, for accounts receivable. Additionally, loans receivable of $75 million and $79 million as of September 30, 2008, and 2007, respectively, are included in OTHER LONG-TERM ASSETS, and reported net of allowances for uncollectible accounts of $13 million and $15 million as of September 30, 2008, and 2007, respectively.

Revenues

Revenues from power sales are recorded as power is delivered to customers. In addition to power sales invoiced and recorded during the month, TVA accrues estimated unbilled revenues for power sales provided to customers for the period of time from the end of the customer's billing cycle to the end of TVA's accounting period. Components of the unbilled revenue include estimated wholesale meter readings at the applicable rates and sales of excess generation at market rates. These components can fluctuate as a result of a number of factors including weather, generation patterns, and other operational constraints. These factors can be unpredictable and can vary from historical trends. Exchange power sales are presented in the accompanying Statements of Income as a component of SALES OF ELECTRICITY-FEDERAL AGENCIES AND OTHER . Exchange power sales are sales of excess power after meeting TVA native load and direct served requirements. (Native load refers to the customers on whose behalf a company, by statute, franchise, regulatory requirement, or contract, has undertaken an obligation to serve.)

Reserve for Future Generation

During the first quarter of 2007, TVA began collecting in rates amounts intended to fund future generation based on the need for additional generating capacity that would be required to meet future power demand in its service area. Because these amounts were intended to fund future costs, they were originally deferred as a regulatory liability. The funds were based on a predetermined rate applied to electricity sales approved as part of TVA's 2007 budget. Collections for 2007 amounted to $76 million. Following the purchase of two combustion turbine facilities, these funds were applied as credits to COMPLETED PLANT and are reflected on the September 30, 2008, and September 30, 2007, Balance Sheets. These funds collected for future generation were amortized to revenue in order to match revenue with the corresponding depreciation expense of the purchased assets on the Statement of Income. This revenue recognition process began when the assets were placed into service. The reserve for future generation was not extended beyond 2007.

Inventories

Certain Fuel, Materials, and Supplies . Coal, oil, limestone, tire-based fuel inventories, and materials and supplies inventories are valued using an average unit cost method. A new average cost is computed after each transaction and inventory issuances are priced at the latest moving weighted average unit cost. At September 30, 2008 and 2007, TVA had $381 million and $316 million, respectively, in fuel inventories and $347 million and $317 million, respectively, in materials and supplies inventory.

Allowance for Inventory Obsolescence . TVA reviews supply and material inventories by category and usage on a periodic basis. Each category is assigned a probability of becoming obsolete based on the type of material and historical usage data. Based on the estimated value of the inventory, TVA adjusts its allowance for inventory obsolescence. The allowance for surplus and obsolete inventory was $47 million and $43 million at September 30, 2008, and 2007, respectively.

Emission Allowances . TVA has emission allowances for sulfur dioxide ("SO_2") and nitrogen oxides ("NO_x") which are accounted for as inventory. The average cost of allowances used each month is charged to operating expense based on tons of SO_2 and NO_x emitted. NO_x emission allowances are used only during the ozone season, which occurs from May through September. Allowances granted to TVA by the Environmental Protection Agency ("EPA") are recorded at zero cost.

Property, Plant, and Equipment, and Depreciation

Additions to plant are recorded at cost, which includes direct and indirect costs and an allowance for funds used during construction ("AFUDC"). Beginning in 2008, TVA continues to capitalize a portion of current interest costs associated with funds invested in most nuclear fuel inventories, but interest on funds invested in construction projects will be capitalized only if (1) the expected total cost of a project is $1 billion or more, and (2) the estimated construction period is at least three years. The cost of current repairs and minor replacements is charged to operating expense. Nuclear fuel inventories, which are included in PROPERTY, PLANT, AND EQUIPMENT , are valued using the average cost method for raw materials and the specific identification method for nuclear fuel in a reactor. Amortization of nuclear fuel is calculated on a units-of-production basis and is included in fuel expense.

TVA accounts for its properties using the composite depreciation convention of accounting. Accordingly, the original cost of property retired, less salvage value, is charged to accumulated depreciation. Depreciation is generally computed on a straight-line basis over the estimated service lives of the various classes of assets. Depreciation expense expressed as a percentage of the average annual depreciable completed plant was 2.97 percent for 2008, 2.90 percent for 2007, and 3.17 percent for 2006. Depreciation rates by asset class are as follows:

TVA Property, Plant, and Equipment Depreciation Rates
As of September 30

	2008	2007	2006
Asset Class:		*(percent)*	
Nuclear	2.57	2.29	3.00
Coal-Fired	3.44	3.59	3.53
Hydroelectric	1.72	1.82	1.79
Combustion turbine/diesel generators	4.39	4.70	4.54
Transmission	2.74	2.53	2.57
Other	6.38	7.05	6.26

Depreciation rates are determined based on an external cost study. TVA obtained and implemented a new study during the fourth quarter of 2008. Rates were changed prospectively as a change in estimate. The effect of the change in rates related to this study was a $3.3 million decrease in depreciation expense for the year ended September 30, 2008. The monthly decrease is $1.7 million, resulting in an annualized impact to depreciation expense of approximately $20 million. Depreciation expense for the years ended September 30, 2008, 2007, and 2006, was $1,129 million, $1,048 million, and $1,090 million, respectively. The single major reason for the reduction in depreciation expense for 2007 and 2006 was the change in the depreciation rate for Browns Ferry Nuclear Plant. The depreciation rate change was the result of NRC granting TVA a 20-year operating license extension. The change in the depreciation rate for the OTHER ASSET class category was due to the addition of communication-type equipment in 2007 having a depreciable life of five years.

Property, plant, and equipment also includes assets recorded under capital lease agreements which primarily consist of office facilities of $34 million and $30 million as of September 30, 2008, and 2007, respectively, and fuel fabrication and blending facilities of $34 million and $39 million as of September 30, 2008, and 2007, respectively.

Blended Low Enriched Uranium Program

Under the blended low enriched uranium ("BLEU") program, TVA, the Department of Energy ("DOE"), and nuclear fuel contractors have entered into agreements providing for surplus highly enriched uranium to be blended with other uranium down to a level that allows the blended uranium to be fabricated into fuel that can be used in nuclear power plants. This blended nuclear fuel was first loaded in a Browns Ferry reactor in 2005, which initiated the amortization of the costs of the BLEU fuel assemblies to nuclear fuel expense.

Under the terms of an interagency agreement between TVA and DOE, DOE supplies off-specification, highly enriched uranium materials to the appropriate third party fuel processors for processing into usable fuel for TVA. In exchange, DOE will participate to a degree in the savings generated by TVA's use of this blended nuclear fuel. Over the life of the program, TVA projects that DOE's share of savings generated by TVA's use of this blended nuclear fuel could result in future payments to DOE of as much as $251 million. TVA anticipates these future payments could begin in 2009 and last until 2013. TVA accrued an obligation related to the portion of the ultimate future payments estimated to be attributable to the BLEU fuel currently in use. As of September 30, 2008 this obligation was $22 million.

The third party fuel processors own the conversion and processing facilities and will retain title to all land, property, plant, and equipment used in the BLEU fuel program. In accordance with the requirements of EITF No. 01-08, *"Determining Whether an Arrangement Contains a Lease,"* and SFAS No. 13, *"Accounting for Leases,"* however, TVA recognized a capital lease asset and corresponding lease obligation related to amounts paid or payable to a third party fuel processor. Accounting recognition of the capital lease asset and obligation recharacterization resulted from contract modifications to the preexisting fuel fabrication contract.

Investment Funds

INVESTMENT FUNDS consist primarily of trust funds designated to fund nuclear decommissioning requirements (see Note 15 — *Contingencies — Decommissioning Costs*), asset retirement obligations (see Note 5 — *Asset Retirement Trust*), and the supplemental executive retirement plan ("SERP") (see Note 14 — Overview of Plans and Benefits — *Supplemental Executive Retirement Plan)* . Decommissioning funds and SERP funds, which are classified as trading, are invested in portfolios of securities generally designed to earn returns in line with overall equity market performance. Asset retirement funds, which are classified as trading, are invested in commingled funds designed to earn returns in line with fixed income market performance.

Other Long-Term Assets

The year-end balances of TVA's OTHER LONG-TERM ASSETS are as follows:

Other Long-Term Assets
As of September 30

	2008	2007
Loans and long-term receivables, net	$ 81	$ 79
Valuation of currency swaps	101	280
Valuation of commodity contracts	813	16
Total other long-term assets	$ 995	$ 375

TVA enters into coal contracts with volume options to protect against market prices. The $797 million increase in VALUATION OF COMMODITY CONTRACTS is related to increases in the price of this commodity.

For additional information on the components of OTHER LONG-TERM ASSETS , see Note 1 — *Allowance for Uncollectible Accounts* , Note 10 — *Overview of Accounting Treatment, Commodity Contracts,* and *Swaps* , and Note 13 — *Loans and Other Long-term Receivables.*

Energy Prepayment Obligations

During 2002, TVA introduced an energy prepayment program, the discounted energy units ("DEU") program. Under this program, TVA customers could purchase DEUs generally in $1 million increments, and each DEU entitles the purchaser to a $0.025/kilowatt-hour discount on a specified quantity of firm power over a period of years (five, 10, 15, or 20) for each kilowatt-hour in the prepaid block. The remainder of the price of the kilowatt-hours delivered to the customer is due upon billing.

TVA did not offer the DEU program after 2005. Total sales for the program since inception have been approximately $55 million. TVA is accounting for the prepayment proceeds as unearned revenue and is reporting the obligations to deliver power as ENERGY PREPAYMENT OBLIGATIONS and CURRENT PORTION OF ENERGY PREPAYMENT OBLIGATIONS on the September 30, 2008, and 2007, Balance Sheets.

TVA recognizes revenue as electricity is delivered to customers, based on the ratio of units of kilowatt-hours delivered to total units of kilowatt-hours under contract. As of September 30, 2008, approximately $32 million has been applied against power billings on a cumulative basis during the life of the program, of which over approximately $6 million was recognized as noncash revenue during each of 2008, 2007, and 2006.

In 2004, TVA and its largest customer, Memphis Light, Gas and Water Division ("MLGW"), entered into an energy prepayment agreement under which MLGW prepaid TVA $1.5 billion for the future costs of electricity to be delivered by TVA to MLGW over a period of 180 months. TVA accounted for the prepayment as unearned revenue and is reporting the obligation to deliver power under this arrangement as ENERGY PREPAYMENT OBLIGATIONS and CURRENT PORTION OF ENERGY PREPAYMENT OBLIGATIONS on the September 30, 2008, and 2007, Balance Sheets. TVA expects to recognize approximately $100 million of noncash revenue in each year of the arrangement as electricity is delivered to MLGW based on the ratio of units of kilowatt-hours delivered to total units of kilowatt-hours under contract. As of September 30, 2008, $490 million had been recognized as noncash revenue on a cumulative basis during the life of the agreement, $100 million of which was recognized as noncash revenue during each of 2008, 2007, and 2006.

Insurance

Although TVA uses private companies to administer its health-care plans for eligible active and retired employees not covered by Medicare, TVA does not purchase health insurance. Consulting actuaries assist TVA in determining certain liabilities for self-assumed claims. TVA recovers the costs of losses through power rates and through adjustments to the participants' contributions to their benefit plans. These liabilities are included in OTHER LIABILITIES on the Balance Sheets.

TVA purchases nuclear liability insurance, nuclear property, decommissioning, and decontamination insurance, and nuclear accidental outage insurance. See Note 15 — *Contingencies — Nuclear Insurance* .

TVA purchases excess liability and excess workers' compensation liability insurance above a self-insured retention. TVA recovers the costs of losses through power rates. The Federal Employees' Compensation Act governs liability to employees for service-connected injuries.

TVA purchases property insurance for certain conventional (non-nuclear) assets as well as outage insurance (business interruption) for selected conventional generating assets. TVA also purchases liability insurance which provides coverage for its directors and officers subject to the terms and conditions of the policy.

Sale of Receivables/Loans

During 2008, TVA sold $2 million of receivables at par such that TVA did not recognize a gain or loss on the sale. These receivables were from a power customer and were related to energy conservation projects. The proceeds from the sale of these receivables are included in the Cash Flow Statement under the caption CASH FLOWS FROM INVESTING ACTIVITIES .

During 2007, TVA sold $2 million of receivables at par such that TVA did not recognize a gain or loss on the sale. These receivables were from a power customer and were related to the construction of a substation. The proceeds from the sale of these receivables are included in the Cash Flow Statement under the caption CASH FLOWS FROM INVESTING ACTIVITIES .

TVA did not retain any claim on these receivables sold, and they are no longer reported on TVA's Balance Sheets.

Asset Retirement Obligations

In accordance with the provisions of SFAS No. 143, " *Accounting for Asset Retirement Obligations,"* TVA recognizes legal obligations associated with the future retirement of certain tangible long-lived assets. TVA records estimates of such disposal costs only at the time the legal obligation arises. See Note 5.

Based on updating assumptions in the engineering studies annually in accordance with NRC requirements, revisions to the amount and timing of certain cash flow estimates of nuclear asset retirement obligations may be made. TVA recognizes as incurred all obligations related to closure and removal of its nuclear units. TVA measures the liability for closure at the present value of the weighted estimated cash flows required to satisfy the related obligation, discounted at the credit adjusted rate of interest in effect at the time the liability was actually incurred or originally accrued. Earnings from decommissioning fund investments, amortization of the decommissioning regulatory asset, and interest expense on the decommissioning liability are deferred as a regulatory asset. See Note 15 — *Contingencies — Decommissioning Costs* . Beginning in 2003, TVA evaluated the nature and scope of its decommissioning policy as it relates to all electric plants. The evaluation was used to determine the need for recognition of additional asset retirement obligations as described in SFAS No. 143, *"Accounting for Asset Retirement Obligations."* SFAS No. 143 became effective for TVA at the beginning of 2003. See Note 5. On September 30, 2006, TVA began applying the guidance of FIN No. 47, *"Accounting for Conditional Asset Retirement Obligations—an Interpretation of FASB Statement No. 143."* See Note 5 for the effects of applying this interpretation.

Non-Nuclear Decommissioning Costs

In September 2007, the TVA Board approved the establishment of an asset retirement trust to more effectively segregate, manage, and invest funds to help meet future asset retirement obligations. TVA made a $40 million initial contribution to the asset retirement trust on September 28, 2007. TVA made an additional $40 million contribution to the asset retirement trust on September 26, 2008. As of September 30, 2008, the assets of the trust totaled $81 million. Although the TVA Board approved contributions to the asset retirement trust in 2007 and 2008, the TVA Board did not approve funding for the trust as part of its budget and ratemaking process in relation to providing a potential funding source through rates for non-nuclear decommissioning costs until August 2008, at which time the TVA Board approved making

a contribution to the trust in 2009. The funds from the asset retirement trust may be used, among other things, to pay the cost of retiring non-nuclear long-lived assets from the accumulation of assets in the trust. The costs of retiring non-nuclear long-lived assets represent the net deferred costs related to the future closure and retirement of TVA's non-nuclear long-lived assets under various legal requirements as recognized by SFAS No. 143 and FIN No. 47. These costs had previously been included in rates as the asset retirement obligation (“ARO”) was accreted and the asset was depreciated. In accordance with EITF 93-4, these costs did not previously meet the asset recognition criteria in paragraph nine of SFAS No. 71 at the date the costs were incurred. Because of the establishment of the asset retirement trust and the approval of the funding in 2009 rates as part of the TVA Board’s budget and ratemaking process, these costs currently meet asset recognition criteria. Therefore, all cumulative costs incurred since 2003, when SFAS No. 143 was adopted, were recaptured as a regulatory asset as of September 30, 2008. The regulatory asset initially created related to this adjustment totaled $350 million. The offset to this adjustment was a one-time decrease to depreciation, amortization, and accretion expense.

These future costs can be funded through a combination of investment funds already set aside in the asset retirement trust, future earnings on those investment funds, and future cash contributions to the investment funds. Through this rate action, the TVA Board has demonstrated the ability and intent to include non-nuclear retirement costs in allowable costs and in rates. Further, the TVA Board has included contributions for 2009 to the asset retirement trust fund in its 2009 budget and in the related rates. As a result, it is probable that future revenue will result from inclusion of the deferred non-nuclear asset retirement costs in allowable costs for ratemaking purposes.

Capitalized Revenue During Pre-Commercial Plant Operations

As part of the process of restarting Browns Ferry Unit 1, TVA commenced pre-commercial plant operations on June 2, 2007. The pre-commercial plant operations period ended July 31, 2007, and commercial operations began on August 1, 2007. The electricity produced during the pre-commercial plant operations period was used to serve the demands of the system; therefore, TVA calculated estimates of revenue realized from such pre-commercial generation based on the guidance provided by FERC regulations. The calculated revenue of $57 million was capitalized to offset project costs and is reported as a contra-revenue account on the income statement. During this same period, TVA capitalized operating costs, including fuel, of over $9 million.

Discounts on Sales

TVA’s DEU program (see Note 1 — *Energy Prepayment Obligations*) allowed customers to use cash on hand to prepay TVA for some of their power needs, providing funding to TVA and a savings to customers in the form of a discount on future purchases. The distributor customer receives a discount on a specified volume of firm energy purchased. The supplement to the power contract specifies the discount rate (2.5 cents per kilowatt-hour), the monthly block of kilowatt-hours to which the discount applies, the number of years (term), and contingencies upon contract termination.

TVA’s largest customer, MLGW, also has a power prepayment agreement (see Note 1 — *Energy Prepayment Obligations*) under which it has prepaid $1.5 billion for a fixed amount of power. TVA repays MLGW in the form of a monthly credit sufficient for MLGW to pay debt service on its prepayment bonds and receive a return on its investment.

Discounts for these programs amounted to $47 million for each of the years ended September 30, 2008, 2007, and 2006.

Allowance for Funds Used During Construction

AFUDC capitalized during the year ended September 30, 2008, was $17 million as compared with $177 million capitalized during the year ended September 30, 2007. TVA capitalizes interest as an allowance for funds used during construction ("AFUDC"), based on the average interest rate of TVA’s outstanding debt. The allowance is applicable to construction in progress related to certain projects and certain nuclear fuel inventories. TVA will continue to capitalize a portion of current interest costs associated with funds invested in most nuclear fuel inventories, but since October 1, 2007, interest on funds invested in capital projects has been capitalized only for projects with (1) an expected total project cost of $1 billion or more, and (2) an estimated construction period of at least three years in duration. The adoption of this new criteria has greatly reduced the number of qualifying projects, which was approximately 800 at September 30, 2007. Only one project — Watts Bar Nuclear Plant Unit 2 — met the new AFUDC criteria during the year ended September 30, 2008. The accumulated balance of costs for qualifying projects, which is used to calculate AFUDC, averaged approximately $3 billion for the year ended September 30, 2007. By contrast, the accumulated balance of costs for qualifying construction projects averaged approximately $81 million for the year ended September 30, 2008.

Software Costs

TVA capitalizes certain costs incurred in connection with developing or obtaining internal-use software. Capitalized software costs are included in PROPERTY, PLANT, AND EQUIPMENT on the Balance Sheet and are primarily amortized over five years. TVA capitalized costs of $31 million in 2008 and $22 million in 2007 related to an enterprise management project. Software costs that do not meet capitalization criteria are expensed as incurred.

Research and Development Costs

Research and development costs are expensed when incurred. TVA's research programs include those related to transmission technologies, emerging technologies (clean energy, renewables, distributed resources, and energy efficiency), technologies related to generation (fossil, nuclear, and hydro), and environmental technologies. Annual research and development costs of $21 million in 2008, and $20 million in 2007 and 2006 were expensed and included in the Statements of Income caption OPERATING AND MAINTENANCE.

Payments In Lieu of Taxes

The TVA Act requires TVA to make payments to states and counties in which TVA conducts its power operations and in which TVA has acquired power properties previously subject to state and local taxation. The amount of these payments is five percent of gross revenues from sales of power during the preceding year, excluding sales or deliveries to other federal agencies and off-system sales with other utilities, with a provision for minimum payments under certain circumstances.

Impairment of Assets

TVA evaluates long-lived assets for impairment in accordance with the provisions of SFAS No. 144, *"Accounting for the Impairment or Disposal of Long-Lived Assets,"* when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. For long-lived assets, TVA bases its evaluation on impairment indicators such as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, and other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of an asset may not be recoverable, TVA determines whether an impairment has occurred based on an estimate of undiscounted cash flows attributable to the asset as compared with the carrying value of the asset. If an impairment has occurred, the amount of the impairment recognized is measured as the excess of the asset's carrying value over its fair value. Additionally, TVA regularly evaluates construction projects. If the project is cancelled or deemed to have no future economic benefit, the project is written off as an asset impairment. See Note 7.

Maintenance Costs

TVA records maintenance costs and repairs related to its property, plants, and equipment on TVA's Statements of Income as they are incurred except for the recording of certain regulatory assets. See Note 6.

Impact of New Accounting Standards and Interpretations

Accounting for Planned Major Maintenance Activities . On September 8, 2006, the Financial Accounting Standards Board ("FASB") released FASB Staff Position ("FSP") AUG AIR-1, *"Accounting for Planned Major Maintenance Activities."* The FSP addresses the accounting for planned major maintenance activities and amends certain provisions in the American Institute of Certified Public Accountants Industry Audit Guide, " *Audits of Airlines,"* and Accounting Principles Board Opinion No. 28, " *Interim Financial Reporting* ." The guidance in this FSP states that entities should adopt an accounting method that recognizes overhaul expenses in the appropriate period. The following accounting methods are most often employed/permitted: direct expensing method; built-in overhaul method; or deferral method. The guidance in this FSP is applicable to entities in all industries and must be applied to the first fiscal year beginning after December 15, 2006. TVA adopted this guidance for 2008. Except for the recording of certain regulatory assets, TVA's policy is to expense maintenance costs as incurred (direct expensing method). Therefore, the adoption of this FSP did not have a material impact on TVA's results of operations or financial position.

Fair Value Measurements . In September 2006, FASB issued SFAS No. 157, *"Fair Value Measurements."* ("SFAS No. 157"). SFAS No. 157 provides guidance for using fair value to measure assets and liabilities that currently require fair value measurement. SFAS No. 157 also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop measurement assumptions. Provisions of SFAS No. 157 were to be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, in February 2008, FASB issued FSP FAS 157-2, *"Effective Date of FASB Statement No. 157,"* ("SFAS No. 157-2"), which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. This FSP delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. TVA will implement SFAS No. 157 in the first quarter of 2009, and will utilize the deferral portion of FSP FAS 157-2 for all nonfinancial assets and liabilities within its scope. In October 2008, the FASB issued FSP No. FAS 157-3, *"Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active,"* ("FSP FAS 157-3"). FSP FAS 157-3 clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The guidance emphasizes that determining fair value in an inactive market depends on the facts and circumstances and may require the use of significant judgment. FSP FAS 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued,

and will become effective for TVA at upon its implementation of SFAS No. 157 during the first quarter of 2009. TVA is evaluating the requirements of SFAS No. 157 and the related FSP's and has not yet determined the impact of their implementation, which may or may not be material to TVA's results of operations or financial position.

Fair Value Option . In February 2007, FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115,"* ("SFAS No. 159") . This statement permits an entity to choose to measure many financial instruments and certain other items at fair value. The fair value option established by SFAS No.159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Most of the provisions in SFAS No. 159 are elective. The provisions of SFAS No. 159 are effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. SFAS No. 159 will become effective for TVA during the first quarter of 2009. TVA is evaluating the requirements of this statement and has not yet determined the potential impact of its implementation, which may or may not be material to TVA's results of operations or financial position.

Offsetting Amounts . On April 30, 2007, FASB issued FSP FIN No. 39-1, *"Amendment of FASB Interpretation No. 39,"* which addresses certain modifications to FASB Interpretation No. 39, *"Offsetting of Amounts Related to Certain Contracts."* This FSP replaces the terms "conditional contracts" and "exchange contracts" with the term "derivative instruments" as defined in SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities."* The FSP also permits a reporting entity to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting arrangement. The guidance in the FSP is effective for fiscal years beginning after November 15, 2007, with early application permitted. At this time, TVA is evaluating the requirements of this guidance and has not yet determined the potential impact of its implementation, which may or may not be material to TVA's financial position.

Business Combinations . In December 2007, FASB issued SFAS No. 141R, *"Business Combinations,"* ("SFAS No. 141R"). This statement establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including non-controlling interests, contingent consideration, and certain acquired contingencies. SFAS No. 141R also requires acquisition-related transaction expenses and restructuring costs to be expensed as incurred rather than capitalized as a component of the business combination. The provisions of SFAS No. 141R are effective as of the beginning of an entity's first fiscal year that begins on or after December 15, 2008. Early adoption is prohibited. SFAS No. 141R will become effective for TVA as of October 1, 2009. TVA expects that SFAS No. 141R could have an impact on accounting for any businesses acquired after the effective date of this pronouncement.

Derivative Instruments and Hedging Activities . In March 2008, FASB issued SFAS No. 161, " *Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133," (*" SFAS No. 161") which establishes, among other things, the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 . *The effective date of adoption for TVA is the second quarter of 2009.*

Hierarchy of Generally Accepted Accounting Principles . In May 2008, FASB issued SFAS No. 162, *"The Hierarchy of Generally Accepted Accounting Principles," (*" SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *"The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles."* The implementation of SFAS No. 162 is not expected to have a material impact on TVA's consolidated financial position and results of operations.

Employers' Disclosures about Postretirement Benefit Plan Assets . On October 29, 2008, FASB issued FSP No.132 (R)-a, " *Employers' Disclosures about Pensions and Other Postretirement Benefits,"* to require that an employer disclose the following information about the fair value of plan assets: 1) the level within the fair value hierarchy in which fair value measurements of plan assets fall; 2) information about the inputs and valuation techniques used to measure the fair value of plan assets; and 3) a reconciliation of beginning and ending balances for fair value measurements of plan assets using significant unobservable inputs. The final FSP will be effective for fiscal years ending after December 15, 2009, with early application permitted. At initial adoption, application of the FSP would not be required for earlier periods that are presented for comparative purposes. TVA is currently evaluating the potential impact of adopting this FSP on its disclosures in the financial statements.

2. Nuclear Power Program

At September 30, 2008, TVA's nuclear power program consisted of seven units — six operating (commercially generating electricity) and one in the planning stages on which construction resumed in 2008. The units are in three locations with investments in property, plant, and equipment as follows and in the status indicated:

Nuclear Production Plants
As of September 30, 2008

	Completed Plant, Net	Construction in Progress	Fuel Investment
Browns Ferry	$ 3,927	$ 150	$ 306
Sequoyah	1,461	94	118
Watts Bar*	5,228	250	84
Raw materials	–	–	214
Total Nuclear Production	$ 10,616	$ 494	$ 722

Note

* Watts Bar Unit 2 is in planning stages, and construction on it resumed in 2008.

On August 1, 2007, the TVA Board approved the completion of Watts Bar Nuclear Plant Unit 2 ("Watts Bar Unit 2"), construction of which was halted in 1985. Preliminary project activities began at Watts Bar Unit 2 in October 2007. TVA began to engage in unrestricted construction activities at the end of December 2007. The project is scheduled to be completed by 2013.

The TVA Board determined as of the end of 2001 that the values of some of its existing assets were impaired and should be reduced. Certain nuclear assets — portions of Bellefonte Unit 1 and Unit 2 and Watts Bar Unit 2 in its entirety — were identified as assets for which the estimated cash flows expected to be provided through future rates were less than recorded book values. Accordingly, TVA revalued certain nuclear assets — Watts Bar Unit 2 in its entirety and portions of Bellefonte Unit 1 and Unit 2 — downward by $2.2 billion and recognized an impairment loss. During 2004, the TVA Board approved the reclassification of approximately $203 million of Bellefonte assets from DEFERRED NUCLEAR GENERATING UNITS to COMPLETED PLANT . In July 2005, the TVA Board approved the amortization of TVA's remaining investment in the deferred generating units at Bellefonte over a 10-year period beginning in 2006. See Note 1 — *Cost-Based Regulation* . TVA began amortizing and recovering in rates the investment of the $3.9 billion in deferred nuclear generating units at Bellefonte Nuclear Plant ("Bellefonte") on October 1, 2005. TVA's Board approved canceling the unfinished Bellefonte construction project in November 2005 and the NRC approved TVA's request to terminate the construction permits in September 2006. See Note 6 — *Deferred Nuclear Generating Units* . None of these actions interfere in any way with TVA's ability to use the site for future projects.

In September 2005, NuStart Development LLC ("NuStart") selected Bellefonte as one of the two sites in the country for a new advanced design nuclear plant. NuStart is an industry consortium comprised of 10 utilities and two reactor vendors whose purpose is to satisfactorily demonstrate the new NRC licensing process for new nuclear plants. NuStart intends to seek a combined construction and operating license for the site for the new Advanced Passive 1000 reactor design by Westinghouse Electric Co. As the license applicant, TVA submitted its combined license application to NRC for Bellefonte Units 3 and 4 in October 2007, and it was accepted for detailed review by the NRC on January 18, 2008. If approved, the license to build and operate the plant would be issued to TVA. The NRC will complete an evaluation of its combined construction and operating license application review schedule in December 2008 prior to making a decision as to the new schedule. Costs related to preparation of the construction and operating license are being paid by NuStart. The TVA Board has not made a decision to construct a new plant at the Bellefonte site, and TVA continues to evaluate all nuclear generation options at the site. As part of this evaluation, TVA asked the NRC in August 2008 to reinstate the construction permits for its two unfinished nuclear units also at the Bellefonte site. Reinstating the construction permits would allow TVA to place the units in a deferred status again with the NRC and would help TVA clarify the regulatory requirements and continue to evaluate the feasibility of using Bellefonte Units 1 and 2 to meet future base-load power demand.

3. Completed Plant

Completed plant consisted of the following at September 30:

TVA Completed Plant
As of September 30

	2008			2007		
	Cost	Accumulated Depreciation	Net	Cost	Accumulated Depreciation	Net
Coal-Fired	$ 11,371	$ 5,950	$ 5,421	$ 11,093	$ 5,606	$ 5,487
Combustion turbine	1,608	614	994	1,212	555	657
Nuclear	17,598	6,982	10,616	17,514	6,551	10,963
Transmission	5,074	1,745	3,329	4,680	1,682	2,998
Hydroelectric	2,098	762	1,336	1,991	718	1,273
Other electrical plant	1,358	604	754	1,315	471	844
Subtotal	39,107	16,657	22,450	37,805	15,583	22,222
Multipurpose dams	928	316	612	962	345	617
Other stewardship	44	10	34	44	9	35
Subtotal	972	326	646	1,006	354	652
Total	$ 40,079	$ 16,983	$ 23,096	$ 38,811	$ 15,937	$ 22,874

4. Asset Acquisitions and Dispositions

New Generation

On May 9, 2008, TVA completed the purchase, as part of a bankruptcy auction process, of a three-unit, 792-megawatt summer net capability combined cycle combustion turbine facility located in Southaven, Mississippi, owned by Southaven Power, LLC ("Southaven Power"). The purchase of the facility fits with the goals of TVA's Strategic Plan adopted by the TVA Board on May 31, 2007, to diversify its generation facilities by acquiring natural gas plants.

The purchase price of the facility included a base purchase price of $461 million and a $5 million payment to Southaven Power in connection with a termination of an operation-and-maintenance agreement held by a Southaven Power affiliate. The aggregated purchase price of $466 million was allocated to the cost of the facility which is included in COMPLETED PLANT on the Balance Sheet.

On September 30, 2008, Seven States Power Corporation ("SSPC") exercised an option to buy a portion of the Southaven facility. SSPC bought this portion through its wholly-owned subsidiary, Seven States Southaven, LLC ("SSSL"). SSSL paid TVA approximately $325 million and purchased an undivided 69.69 percent interest in the facility. SSPC has the ability to acquire up to a 90 percent undivided interest in the facility and may increase its ownership in the facility up to this amount on or after January 2, 2009, and not later than May 9, 2009. SSSL and TVA have entered into a lease under which TVA leases SSSL's undivided interest in the facility and operates the entire facility through April 30, 2010. Revenues resulting from the sale of electricity generated by Southaven Power and resulting expenses related to generation are included on the income statement for the year ended September 30, 2008.

As part of the transaction, SSSL has the right at any time and for any reason to require TVA to buy back SSSL's interest in the facility at SSSL's original purchase price (plus the cost of SSSL's share of any capital improvements) minus amortization costs that TVA pays under the lease. As part of any such buy-back, TVA would pay off the remaining balance on SSSL's loan, with that amount being credited against the buy-back price that TVA would pay to SSSL. A buy-back may also be triggered under certain circumstances including, among other things, a default by SSSL. Finally, TVA will buy back SSSL's interest in the facility if long-term operational and power sales arrangements for the facility among TVA, SSSL, and SSPC are not in place by April 30, 2010. TVA's buy-back obligation will terminate if such long-term arrangements are in place by that date. In the event of a buy-back, TVA would re-acquire SSSL's interest in the facility and the related assets. While TVA does not plan to liquidate the assets to cover the payments in the event of a buy-back, TVA believes its recourse in obtaining full interest in the assets is sufficient to cover its obligation. Because of TVA's continued ownership interest in the facility as well as the buy-back provisions, the transaction did not qualify as a sale and, accordingly, has been recorded as a leaseback obligation. As of September 30, 2008, the carrying amount of the obligation was approximately $325 million. TVA recognized the buy-back obligation as a CURRENT PORTION OF LEASEBACK OBLIGATIONS of $13 million and a long-term LEASEBACK OBLIGATION of $312 million on its September 30, 2008 Balance Sheet.

Buildings

On February 8, 2008, TVA finalized an agreement to purchase the portion of TVA's Chattanooga Office Complex in Chattanooga, Tennessee, leased from Chattanooga Valley Associates (with the exception of Monteagle Place, which includes approximately 131,979 square feet) upon the expiration of the existing lease term on January 1, 2011. The purchase price is $22 million, payable on January 3, 2011. Accordingly, the regulatory liability for capital lease liabilities and the property, plant, and equipment account for capital leases were adjusted in accordance with FASB Interpretation No. 26, " *Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease — an interpretation of FASB Statement No. 13."*

5. Asset Retirement Obligations

During 2008, TVA's total asset retirement obligations ("ARO") liability increased $129 million. The increase was comprised of $1.5 million in new AROs, $121 million in ARO accretion, and $6.5 million in non-nuclear AROs as a result of changes in estimated annual cash outflows related to certain obligations and revisions in the estimated lives of certain plants. The nuclear accretion expense of $92 million and the non-nuclear accretion expense of $29 million were deferred and charged to a regulatory asset in accordance with SFAS No. 71. The amount of the write-offs equaled TVA's actual accumulated costs incurred on the projects.

Reconciliation of Asset Retirement Obligation Liability
As of September 30

	2008	2007
Balance at beginning of period	$ 2,189	$ 1,985
Changes in nuclear estimates to future cash flows	–	90
Non-nuclear additional obligations	8	1
	8	91
Add: ARO (accretion) expense		
Nuclear accretion (recorded as a regulatory asset)	92	85
Non-nuclear accretion (recorded as a regulatory asset)	29	28
	121	113
Balance at end of period	$ 2,318	$ 2,189

Asset Retirement Trust. In September 2007, the TVA Board approved the establishment of the asset retirement trust ("ART") to more effectively segregate, manage, and invest funds to help, among other things, meet future asset retirement obligations. The purpose of the trust is to hold funds for the contemplated future retirement of TVA's long-lived assets and to comply with any order relating to the retirement of long-lived assets. While the asset retirement trust is broad enough to assist in funding the costs of decommissioning nuclear assets, TVA's nuclear decommissioning trust is the established means to fund the cost of decommissioning nuclear plants. TVA made a $40 million initial contribution to the ART on September 28, 2007. TVA made an additional $40 million contribution to the ART on September 26, 2008. As of September 30, 2008, the assets of the trust totaled $81 million. While similar in concept, the ART is separate from TVA's nuclear decommissioning trust fund. TVA is not legally obligated to establish or maintain a trust for funding non-nuclear related asset retirement obligations, nor is it obligated to make any future contributions, regardless of funded status, to the ART. Future contributions may be made at the discretion of the TVA Board.

6. Regulatory Assets and Liabilities

Regulatory assets capitalized under the provisions of SFAS No. 71 are included in DEFERRED NUCLEAR GENERATING UNITS and OTHER REGULATORY ASSETS on the September 30, 2008 and 2007, Balance Sheets. Components of OTHER REGULATORY ASSETS include certain charges related to the closure and removal from service of nuclear generating units, debt reacquisition costs, non-nuclear decommissioning costs, deferred outage costs, deferred losses relating to TVA's financial trading program, unrealized losses on certain swap and swaption contracts, deferred capital lease asset costs, deferred pension costs, deferred other postretirement benefit costs, and fuel cost adjustments. All regulatory assets are probable of recovery in future revenues. Components of REGULATORY LIABILITIES include unrealized gains on coal purchase contracts, a reserve for future generation, capital lease liabilities, and accrued in lieu of tax payments. See Note 1 — *Cost-Based Regulation* and Note 2.

The year-end balances of TVA's regulatory assets and liabilities are as follows:

TVA Regulatory Assets and Liabilities
As of September 30

	2008	2007
Regulatory Assets:		
Deferred other postretirement benefit costs	$ 157	$ 142
Deferred pension costs	2,120	831
Nuclear decommissioning costs	764	419
Non-nuclear decommissioning costs	349	–
Debt reacquisition costs	209	210
Deferred losses relating to TVA's financial trading program	146	8
Unrealized loss on certain swap and swaption contracts	226	–
Deferred outage costs	139	96
Deferred capital lease asset costs	52	66
Fuel cost adjustment: long-term	4	18
Subtotal	4,166	1,790
Deferred nuclear generating units	2,738	3,130
Subtotal	6,904	4,920
Fuel cost adjustment receivable: short-term	24	132
Total	$ 6,928	$ 5,052
Regulatory Liabilities:		
Unrealized gain on coal purchase contracts	$ 813	$ 16
Capital lease liability	47	67
Subtotal	860	83
Reserve for future generation	70	74
Accrued tax equivalents	40	4
Total	$ 970	$ 161

Deferred Other Postretirement Benefit Costs . With the adoption of SFAS No. 158 " *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R),"* (" SFAS No. 158") in 2007, TVA was required to measure its benefit obligations related to other postretirement benefit costs as of the year end balance sheet date. TVA was required to recognize the funded status of the plan on the balance sheet with a corresponding offset to Accumulated Other Comprehensive Income ("AOCI"). SFAS No. 71 defines "incurred cost" as a cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for. In this case, the unfunded obligation represents a projected liability to the employee for services rendered, and thus it meets the definition of an incurred cost. Therefore, amounts otherwise charged to AOCI for these costs will be recorded as a regulatory asset since TVA has historically recovered other postretirement benefit expense in rates. Through historical and current year expense included in ratemaking, the TVA Board has demonstrated the ability and intent to include other postemployment benefit ("OPEB") costs in allowable costs and in rates for ratemaking purposes. As a result, it is probable that future revenue, if necessary, will result from inclusion of the OPEB regulatory asset in allowable costs for ratemaking purposes.

Deferred Pension Costs . With the adoption of SFAS No. 158 in 2007, TVA was required to measure its benefit obligations related to pension benefit costs as of the year end balance sheet date. TVA was required to recognize the funded status of the qualified pension plan on the balance sheet with a corresponding offset to AOCI. Note 5 of SFAS No. 71 defines "incurred cost" as a cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for. In this case, the unfunded obligation represents a projected liability to the employee for services rendered, and thus it meets the definition of an incurred cost. Therefore, amounts otherwise charged to AOCI for these costs will be recorded as a regulatory asset since TVA has historically recovered pension benefit expense in rates. Through historical and current year expense and/or contributions included in ratemaking, the TVA Board has demonstrated the ability and intent to include pension costs in allowable costs and in rates for ratemaking purposes. As a result, it is probable that future revenue, if necessary, will result from inclusion of the pension regulatory asset in allowable costs for ratemaking purposes.

Nuclear Decommissioning Costs. Nuclear decommissioning costs include: (1) certain deferred charges related to the future closure and decommissioning of TVA's nuclear generating units under NRC requirements and (2) recognition of changes in the liability, investment funds, and certain other deferred charges under the accounting rules for asset retirement obligations. These future costs will be funded through a combination of investment funds already set aside by TVA, future earnings on those investment funds, and if necessary, additional TVA cash contributions to the investment funds. See Note 1 — *Investment Funds* and Note 5.

Non-Nuclear Decommissioning Costs. In September 2007, the TVA Board approved the establishment of an asset retirement trust to more effectively segregate, manage, and invest funds to help meet future asset retirement obligations. TVA made a $40 million initial contribution to the asset retirement trust on September 28, 2007. TVA made an additional $40 million contribution to the asset retirement trust on September 26, 2008. As of September 30, 2008, the assets of the trust totaled $81 million. Although the TVA Board approved contributions to the asset retirement trust in 2007 and 2008, the TVA Board did not approve funding for the trust as part of its budget and ratemaking process in relation to providing a potential funding source through rates for non-nuclear decommissioning costs until August 2008, at which time the TVA Board approved making a contribution to the trust in 2009. The funds from the asset retirement trust may be used, among other things, to pay the cost of retiring non-nuclear long-lived assets from the accumulation of assets in the trust. The costs of retiring non-nuclear long-lived assets represent the net deferred costs related to the future closure and retirement of TVA's non-nuclear long-lived assets under various legal requirements as recognized by SFAS No. 143 and FIN No. 47. These costs had previously been included in rates as the ARO was accreted and the asset was depreciated. In accordance with EITF 93-4, these costs did not previously meet the asset recognition criteria in paragraph nine of SFAS No. 71 at the date the costs were incurred. Because of the establishment of the asset retirement trust and the approval of the funding in 2009 rates as part of the TVA Board's budget and ratemaking process, these costs currently meet asset recognition criteria. Therefore, all cumulative costs incurred since 2003, when SFAS No. 143 was adopted, were recaptured as a regulatory asset as of September 30, 2008. The regulatory asset initially created related to this adjustment totaled $350 million. The offset to this adjustment was a one-time decrease to depreciation, amortization, and accretion expense.

Debt Reacquisition Costs . Reacquisition expenses, call premiums, and other related costs, such as unamortized debt issue costs associated with redeemed Bond issues, are deferred under provisions of the FERC's Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act ("Uniform System of Accounts"). These costs are deferred and amortized (accreted) on a straight-line basis over the weighted average life of TVA's debt portfolio. (Even though TVA is not a public utility subject generally to FERC jurisdiction, the TVA Act requires TVA to keep accounts in accordance with the requirements established by FERC.)

Deferred Losses Relating to TVA's Financial Trading Program. Deferred losses relating to TVA's financial trading program represent unrealized gains and losses on futures and options. The program is used to reduce TVA's economic risk exposure associated with electricity generation, purchases, and sales. Unrealized losses as of September 30, 2008, were approximately $146 million and as of September 30, 2007, were $8 million. This accounting treatment reflects TVA's ability and intent to recover the cost of these commodity contracts in future periods through the FCA.

Swap and Swaption Transactions . On October 1, 2007, TVA began using regulatory accounting treatment to defer the mark-to-market unrealized gains and losses on certain swap and swaption contracts to reflect that the gain or loss is included in the ratemaking formula when these transactions actually settle. The value of the swap and swaptions is recorded on TVA's Balance Sheet with realized gains or losses, if any, recorded in TVA's Income Statement. The deferred unrealized loss on the value of swaps and swaptions was $226 million at September 30, 2008, and is included as a REGULATORY ASSET on the September 30, 2008, Balance Sheet.

Deferred Outage Costs . TVA's investment in the fuel used in its nuclear units is being amortized and accounted for as a component of fuel expense. See Note 2. Nuclear refueling outage and maintenance costs already incurred are deferred and amortized on a straight-line basis over the estimated period until the next refueling outage. The balance of deferred outage costs at September 30, 2008, and 2007, were $139 million and $96 million, respectively.

Deferred Capital Lease Asset Costs . Deferred capital lease asset costs represent the difference between FERC's Uniform System of Accounts model balances recovered in rates and the SFAS No. 13, *"Accounting for Leases,"* model balances. Under the Uniform System of Accounts, TVA recognizes the initial capital lease asset and liability at inception of the lease in accordance with SFAS No. 13; however, the annual expense under the Uniform System of Accounts is equal to the annual lease payments, which differs from SFAS No. 13 accounting treatment. This practice results in TVA's capital lease asset balances being higher than they otherwise would have been under the SFAS No. 13 model, with the difference representing a regulatory asset related to each capital lease. These costs are being amortized over the respective lease terms as lease payments are made.

Fuel Cost Adjustment. On July 28, 2006, the TVA Board approved the FCA to be applied quarterly as a mechanism to adjust TVA's rates to reflect changing fuel and purchased power costs beginning in 2007. As of September 30, 2008, TVA had recognized a regulatory asset of $28 million, including $24 million classified as a receivable representing deferred power costs to be recovered through the FCA adjustments in future periods. To more closely reflect the cash flows related to the collection of the FCA, TVA recorded $24 million in accounts receivable and the remaining balance of $4 million in regulatory assets.

Deferred Nuclear Generating Units . In July 2005, the TVA Board approved the amortization, and inclusion into rates, of TVA's $3.9 billion investment in the deferred nuclear generating units at Bellefonte Nuclear Plant over a 10-year period beginning in 2006. The TVA Board determined that a 10-year recovery period would not place an undue burden on ratepayers while still ensuring the probability of cost recovery during that 10-year period. See Note 2.

Regulatory liabilities accounted for under the provisions of SFAS No. 71 consist of mark-to-market valuation gains on coal purchase contracts, capital leases, accrued tax equivalents, and reserve for future generation.

Unrealized Gains on Coal Purchase Contracts. Unrealized gains on coal purchase contracts represent the estimated unrealized gains related to the mark-to-market valuation of coal purchase contracts. Under the accounting rules contained in SFAS No. 133, as amended, these contracts qualify as derivative contracts but do not qualify for cash flow hedge accounting treatment. As a result, TVA recognizes the changes in the market value of these derivative contracts as a regulatory liability. This treatment reflects TVA's ability and intent to recover the cost of these commodity contracts on a settlement basis for ratemaking purposes through the FCA. TVA has historically recognized the actual cost of fuel received under these contracts in fuel expense at the time the fuel is used to generate electricity. These contracts expire at various times through 2017. See Note 10.

Capital Lease Liability . As a result of a capital lease payment stream requiring larger cash payments during the latter years of the lease term than during the early years of the lease term, TVA levelized the annual lease expense recognition related to this lease in order to promote the fair and equitable cost recovery from ratepayers. These levelized costs are being amortized over the lease term.

Reserve for Future Generation. During 2007, TVA collected $76 million in rates intended to fund future generation based on the need for additional generating capacity that would be required to meet future power demand in its service area. Because these amounts were intended to fund future costs, they were originally deferred as a regulatory liability. Once generating capacity is acquired, funds in the reserve account are to be reclassified from a regulatory liability to completed plant. In December 2006, TVA purchased two combustion turbine facilities for a combined purchase price of $98 million. One facility is a 659-megawatt summer net capability, dual-fuel combustion turbine facility and includes certain related transmission facilities. The second facility is a 519-megawatt summer capability, natural gas-fired combustion turbine facility. The 519-megawatt summer net capability facility was available for commercial operation in January 2007, and the 659-megawatt summer net capability facility was available for commercial operation in May 2007. During 2008, depreciation related to the 519-megawatt summer capability facility was $0.9 million and depreciation related to the 659-megawatt summer net capability facility was $3 million. TVA also recognized revenue of nearly $4 million during 2008 consistent with the manner in which the related assets are being depreciated. The balance of the reserve for future generation was $70 million at September 30, 2008. See Note 1 — *Reserve for Future Generation.*

Accrued Tax Equivalents. The FCA structure approved by the TVA Board in 2007 included a provision related to the current funding of the future expense TVA will incur for tax equivalent payments. As TVA records the fuel cost adjustment, the percent of the calculation that relates to a future liability for tax equivalent payments is recorded as a regulatory liability. The resulting liability of $40 million at September 30, 2008, and $4 million at September 30, 2007, is included in ACCOUNTS PAYABLE on the respective Balance Sheets.

7. Asset Impairment

During 2008 and 2007, TVA recognized a total of $9 million and $21 million, respectively, in impairment losses related to its PROPERTY, PLANT, AND EQUIPMENT. The $9 million LOSS ON ASSET IMPAIRMENT in 2008 included a $4 million write-off due to project and technology changes from a wet scrubber to a dry scrubber at John Sevier Fossil Plant. The LOSS ON ASSET IMPAIRMENT also included a $4 million write-off of limestone grinding equipment purchased for the Bull Run Fossil Plant when the decision was made to purchase limestone in the pre-ground state, as well as approximately $1 million in write-offs of other C ONSTRUCTION WORK IN PROGRESS assets. The $21 million LOSS ON ASSET IMPAIRMENT in 2007 included a $17 million write-off of a scrubber project at TVA's Colbert Fossil Plant ("Colbert") and write-downs of $4 million related to other CONSTRUCTION IN PROGRESS assets.

8. Variable Interest Entities

In February 1997, TVA entered into a purchase power agreement with Choctaw Generation, Inc. (subsequently assigned to Choctaw Generation Limited Partnership) to purchase all the power generated from its facility located in Choctaw County, Mississippi. The facility had a committed capacity of 440 megawatts and the term of the agreement was 30 years. Under the accounting guidance provided by FASB Interpretation No. 46, *"Consolidation of Variable Interest Entities,"* as amended by FASB Interpretation No. 46R (as amended, "FIN No. 46R"), TVA may be deemed to be the primary beneficiary under the contract; however, TVA does not have access to the financial records of Choctaw Generation Limited Partnership. As a result, TVA was unable to determine whether FIN No. 46R would require TVA to consolidate Choctaw Generation Limited Partnership's balance sheet, results of operations, and cash flows for the year ended September 30, 2008. Power purchases for 2008 under the agreement amounted to $118 million, and the remaining financial commitment under this agreement is $6.7 billion. TVA has no additional financial commitments beyond the purchase power agreement with respect to the facility.

9. Proprietary Capital

Appropriation Investment

TVA's power program and stewardship program were originally funded primarily by appropriations from Congress. In 1959, however, Congress passed legislation that required TVA's power program to be self-financing from power revenues and proceeds from power program financings. While TVA's power program did not directly receive appropriated funds after it became self-financing, TVA continued to receive appropriations for certain multipurpose and other mission-related activities as well as for its stewardship activities. TVA has not received any appropriations from Congress for any activities since 1999, and since that time, TVA has funded stewardship program activities primarily with power revenues in accordance with a statutory directive from Congress.

In 1959, Congress also passed legislation that required TVA, beginning in 1961, to make annual payments to the U.S. Treasury from net power proceeds as a repayment of and as a return on the Power Facility Appropriation Investment until an additional $1 billion of the Power Facility Appropriation Investment has been repaid. Of this $1 billion amount, $110 million remained unpaid at September 30, 2008. Once the additional $1 billion of the Power Facility Appropriation Investment has been repaid, the TVA Act requires TVA to continue making payments to the U.S. Treasury as a return on the remaining Power Facility Appropriation Investment. The remaining Power Facility Appropriation Investment will be $258 million if TVA receives no additional appropriations from Congress for its power program.

The table below summarizes TVA's activities related to appropriated funds.

Appropriations Activity
As of September 30

	Power Facility Appropriation Investment	Stewardship Program Appropriations	Total Appropriation Investment
Appropriation Investment at September 30, 2006	$ 408	$ 4,355	$ 4,763
Less repayments to the U.S. Treasury	(20)	–	(20)
Appropriation Investment at September 30, 2007	388	4,355	4,743
Less repayments to the U.S. Treasury	(20)	–	(20)
Appropriation Investment at September 30, 2008	$ 368	$ 4,355	$ 4,723

Payments to the U.S. Treasury

TVA paid $20 million each year for 2008, 2007, and 2006 as a repayment of the Power Facility Appropriation Investment. In addition, TVA paid the U.S. Treasury $20 million in 2008, $20 million in 2007, and $18 million in 2006 as a return on the Power Facility Appropriation Investment. The amount of the return on the Power Facility Appropriation Investment is based on the Power Facility Appropriation Investment balance as of the beginning of that year and the computed average interest rate payable by the U.S. Treasury on its total marketable public obligations as of the same date. The interest rates payable by TVA on the Power Facility Appropriation Investment were 4.90 percent, 4.87 percent, and 4.24 percent for 2008, 2007, and 2006, respectively.

Accumulated Other Comprehensive Income

SFAS No. 130, *"Reporting Comprehensive Income,"* requires the disclosure of comprehensive income or loss to reflect changes in capital that result from transactions and economic events from nonowner sources. The items included in ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) consist of market valuation adjustments for certain derivative instruments (see Note 10). The ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) as of September 30, 2008, 2007, and 2006, was $(37) million, $(19) million, and $43 million, respectively.

Total Other Comprehensive Income (Loss) Activity
As of September 30

Accumulated other comprehensive income, September 30, 2005	$ 27
Changes in fair value:	
Inflation swap	(11)
Foreign currency swaps [1]	27
Accumulated other comprehensive income, September 30, 2006	43
Changes in fair value:	
Inflation swap	9
Foreign currency swaps [1]	(71)
Accumulated other comprehensive loss, September 30, 2007	(19)
Changes in fair value:	
Foreign currency swaps [1]	(18)
Accumulated other comprehensive loss, September 30, 2008	$ (37)

Notes
(1) Foreign currency swap changes are shown net of reclassifications from OTHER COMPREHENSIVE INCOME to earnings.

TVA records exchange rate gains and losses on debt in earnings and marks its currency swap assets to market through other comprehensive income. TVA then reclassifies an amount out of other comprehensive income into earnings, offsetting the earnings gain/loss from recording the exchange gain/loss on the debt. The amounts reclassified from other comprehensive income resulted in a charge to earnings of $161 million in 2008, an increase to earnings of $104 million in 2007, and an increase to earnings of $143 million in 2006. These reclassifications, coupled with the recording of the exchange gain/loss on the debt, resulted in a net effect on earnings of zero for 2008, 2007, and 2006. Due to the number of variables affecting the future gains/losses on these instruments, TVA is unable to reasonably estimate the amount to be reclassified from other comprehensive income to earnings in future years.

Unrealized Losses on Swap/Swaption Contracts

In the first quarter of 2008, TVA began using regulatory accounting treatment to defer the unrealized mark-to-market gains and losses on certain swap and swaption contracts to reflect that the gain or loss is included in the ratemaking formula when these transactions actually settle. The value of the swap and swaptions is still recorded on TVA's balance sheet with realized gains or losses on these contracts recorded in TVA's income statement. The deferred unrealized loss on the value of the swaps and swaption was $226 million for 2008 and is included as a REGULATORY ASSET on the September 30, 2008, Balance Sheet. See *Swap and Swaption Transactions* in Note 6.

10. Risk Management Activities and Derivative Transactions

TVA is exposed to various market risks. These market risks include risks related to commodity prices, investment prices, interest rates, currency exchange rates, inflation, and counterparty credit risk. To help manage certain of these risks, TVA has entered into various derivative transactions, principally commodity option contracts, forward contracts, swaps, swaptions, futures, and options on futures. It is TVA's policy to enter into derivative transactions solely for hedging purposes and not for speculative purposes.

Overview of Accounting Treatment

The following tables summarize the accounting treatment that certain of TVA's financial derivative transactions receive.

Summary of Derivative Instruments That Receive Hedge Accounting Treatment
At September 30, 2008

Derivative Hedging Instrument	Hedged Item	Purpose of Hedge Transaction	Type of Hedge	Accounting for Derivative Hedging Instrument	Accounting for the Hedged Item
Currency Swaps	Anticipated payment denominated in a foreign currency	To protect against changes in cash flows caused by changes in foreign-currency exchange rates	Cash Flow	Cumulative unrealized gains and losses are recorded in Other comprehensive income and reclassified to earnings to the extent they are offset by cumulative gains and losses on the hedged transaction.	No adjustment is made to the basis of the hedged item.

Summary of Derivative Instruments That Do Not Receive Hedge Accounting Treatment
At September 30, 2008

Derivative Type	Purpose of Derivative	Accounting for Derivative Instrument
Swaption	To protect against decreases in value of the embedded call	Gains and losses are recorded as regulatory assets or liabilities until settlement, at which time the gains/losses (if any) are recognized in gain/loss on derivative contracts.
Interest Rate Swaps	To fix short-term debt variable rate to a fixed rate	Gains and losses are recorded as regulatory assets or liabilities until settlement, at which time the gains/losses (if any) are recognized in gain/loss on derivative contracts.
Coal Contracts with Volume Options	To protect against fluctuations in market prices of the item to be purchased	Gains and losses are recorded as regulatory assets or liabilities until settlement at which time they are recognized in fuel and purchased power expense.
Futures and Options on Futures	To protect against fluctuations in the price of the item to be purchased	Realized gains and losses are recorded in earnings as purchased power expense; unrealized gains and losses are recorded as a regulatory asset/liability.

TVA has recorded the following amounts for its derivative financial instruments described in the tables above:

Mark-to-Market Values of TVA Derivatives
At September 30

	2008 Balance	2008 Balance Sheet Presentation	2007 Balance	2007 Balance Sheet Presentation	2008 Notional Amount	Year of Expiration
Currency swaps:						
Sterling	$ 2	Other long-term assets	$ 63	Other long-term assets	£200 million	2021
Sterling	72	Other long-term assets	148	Other long-term assets	£250 million	2032
Sterling	27	Other long-term assets	69	Other long-term assets	£150 million	2043
Swaption						
$1 billion notional	(416)	Other liabilities	(269)	Other liabilities	$1 billion	2042
Interest rate swaps:						
$476 million notional	(188)	Other liabilities	(115)	Other liabilities	$476 million	2044
$28 million notional	(5)	Other liabilities	(3)	Other liabilities	$28 million	2022
$14 million notional	(2)	Other liabilities	(1)	Other liabilities	$14 million	2022
Coal contracts with volume options	813	Other long-term assets	16	Other long-term assets	37 million tons	2011
Futures and options on futures:						
Margin cash account*	25	Inventories and other, net	18	Inventories and other, net	89,810,000 mmBtu	2009
Unrealized losses	(146)	Other regulatory assets	(8)	Other regulatory assets	–	–

Note

* In accordance with certain credit terms, TVA used leveraging to trade financial instruments under the financial trading program. Therefore, the margin cash account balance does not represent 100 percent of the net market value of the derivative positions outstanding as shown in the

Financial Trading Program Activity table.

Swaps

To hedge certain market risks to which TVA is subject, TVA has entered into three currency swaps which were still outstanding at September 30, 2008. Additionally, TVA was a party to an inflation swap which expired during 2007. Following is a discussion of these swaps as well as a discussion of the hedge accounting treatment that these swaps receive.

Currency Swaps. TVA entered into currency swap contracts during 2003, 2001, and 1999 as hedges for sterling-denominated Bond transactions in which TVA issued £150 million, £250 million, and £200 million of Bonds, respectively. The overall effective cost to TVA of these Bonds and the associated swaps was 4.96 percent, 6.59 percent, and 5.81 percent, respectively. Any gains or losses on the Bonds due to the foreign currency transactions are offset by losses or gains on the swap contracts. At September 30, 2008 and 2007, the currency transactions had resulted in net exchange losses of $138 million and of $299 million, respectively, which are included in LONG-TERM DEBT, NET . However, the net exchange losses were offset by corresponding gains on the swap contracts, which are reported as a deferred asset.

In accordance with SFAS No. 133, as amended, the foreign currency swap contracts represent cash flow hedges of certain Bond transactions and any mark-to-market gains or losses have been recognized in ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) . If any loss (gain) were to be incurred as a result of the early termination of the foreign currency swap contract, any resulting charge (income) would be amortized over the remaining life of the associated Bond as a component of interest expense.

Inflation Swap. In 1997, TVA issued $300 million of inflation-indexed accreting principal Bonds. The 10-year Bonds had a fixed coupon rate that was paid on the inflation-adjusted principal amount. TVA hedged its inflation exposure under the securities through a receive-floating, pay-fixed inflation swap agreement. The overall effective cost to TVA of these Bonds and the associated swap was 6.64 percent. At the termination of the swap in 2007, TVA received the additional $23 million in accretion from the swap counterparty.

In accordance with SFAS No. 133, as amended, the inflation swap contract represented a cash flow hedge of a Bond transaction, with mark-to-market gains or losses recognized in ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS). The inflation swap contract expired during 2007.

Swaptions and Related Interest Rate Swaps

TVA has entered into four swaption transactions to monetize the value of call provisions on certain of its Bond issues. A swaption essentially grants a third party the right to enter into a swap agreement with TVA under which TVA receives a floating rate of interest and pays the third party a fixed rate of interest equal to the interest rate on the bond issue whose call provision TVA monetized.

- In 2003, TVA monetized the call provisions on a $1 billion Bond issue by entering into a swaption agreement with a third party in exchange for $175 million (the “2003A Swaption”).
- In 2003, TVA also monetized the call provisions on a Bond issue of $476 million by entering into a swaption agreement with a third party in exchange for $81 million (the “2003B Swaption”).
- In 2005, TVA monetized the call provisions on two electronotes ® issues ($42 million total par value) by entering into swaption agreements with a third party in exchange for $5 million (the “2005 Swaptions”).

In February 2004, the counterparty to the 2003B Swaption transaction exercised its option to enter into a swap with TVA, effective April 10, 2004, requiring TVA to make fixed rate payments to the counterparty of 6.875 percent and the counterparty to make floating payments to TVA based on London Interbank Offered Rate (“LIBOR”). These payments are based on a notional principal amount of $476 million, and the parties began making these payments on June 15, 2004.

In February 2008, the counterparty to the 2005 Swaption transactions exercised its options to enter into swaps with TVA, effective March 11, 2008. Under the swaps, TVA is required to make fixed rate payments to the counterparty at 6.125 percent and the counterparty is required to make floating payments to TVA based on LIBOR. These payments are based on a combined notional amount of $41.7 million and began on April 15, 2008.

The 2003A Swaption was recorded in OTHER LIABILITIES on the September 30, 2008, and 2007, Balance Sheets and was designated as a hedge of future changes in the fair value of the original call provision. Under SFAS No. 133, as amended, TVA records the changes in market value of both the swaption and the embedded call. These values historically have been highly correlated; however, to the extent that the values do not perfectly offset, any differences will be recognized currently through earnings. In the third quarter of 2006, the hedge related to the 2003A Swaption ceased to be effective and continued to be ineffective during the fourth quarter of 2007 from an accounting perspective.

On October 1, 2007, TVA began using regulatory accounting treatment to defer the mark-to-market gains and losses on these swap and swaption contracts to reflect that the gain or loss is included in the ratemaking formula when these transactions settle. The value of the swap and swaption contracts is recorded on TVA's balance sheet with realized gains or losses, if any, recorded in TVA's income statement.

For the year-ended September 30, 2008, the changes in market value resulted in a deferred unrealized loss on the value of swaps and swaptions of $226 million and is included as a regulatory asset on the September 30, 2008, balance sheet. For the year ended September 30, 2007, the changes in market value resulted in an unrealized gain of $41 million, which was recognized in earnings.

Commodity Contracts

TVA enters into forward contracts that hedge cash flow exposures to market fluctuations in the price and delivery of certain commodities including coal, natural gas, and electricity. TVA expects to take or make delivery, as appropriate, under these forward contracts. Accordingly, these contracts qualify for normal purchases and normal sales accounting under SFAS No. 133, as amended. As of September 30, 2008, TVA did not have derivative contracts related to the purchase of electricity.

Coal Contracts with Volume Options

TVA enters into certain coal supply contracts that require delivery of a contractual quantity of coal (base tons) at contract prices. Certain coal contracts also contain options that permit TVA to either increase or reduce the amounts of coal delivered within contract guidelines. Essentially, the option to take more or less coal represents a purchased option that is combined with the forward coal contract in a single supply contract. TVA marks to market the value of these contracts on a quarterly basis in accordance with SFAS No. 133.

At September 30, 2008, TVA had 10 coal contracts containing volume optionality and had an approximate net market value of $813 million, which TVA deferred as a regulatory asset/liability. TVA will continue to defer all unrealized gains or losses related to the exercise of these options and record only realized gains or losses as fossil fuel expense at the time the commodity is consumed.

At September 30, 2007, TVA had 15 coal contracts containing volume optionality and had an approximate net market value of $16 million, which TVA deferred as a regulatory asset/liability. TVA will continue to defer all unrealized gains or losses related to the exercise of these options and record only realized gains or losses as fossil fuel expense at the time the commodity is consumed.

Coal Contracts with Volume Options
At September 30

	2008			2007		
	Number of Contracts	Notional Amount (in Tons)	Total Contract Value (in millions)	Number of Contracts	Notional Amount (in Tons)	Total Contract Value (in millions)
Coal Contracts with Volume Options	10	37 million	$ 813	15	103 million	$ 16

Futures and Options on Futures

In 2005, the TVA Board approved a financial trading program under which TVA can purchase swaps, options on swaps, futures, and options on futures to hedge TVA's exposure to natural gas and fuel oil prices. In August 2007, the TVA Board expanded the financial trading program, among other things, (1) to permit financial trading for the purpose of hedging or otherwise limiting the economic risks associated with the price of electricity, coal, emission allowances, nuclear fuel, and other commodities such as ammonia and limestone, as well as the price of natural gas and fuel oil, (2) to authorize the use of futures, swaps, options, and combinations of these instruments as long as these instruments are standard in the industry, (3) to authorize the use of the Intercontinental Exchange as well as the New York Mercantile Exchange to trade financial instruments, and (4) to increase the aggregate transaction limit to $130 million (based on one-day Value at Risk). Under the expanded program, TVA is still prohibited from trading financial instruments for speculative purposes.

Futures and Options Activity
At September 30

	2008		2007	
	Notional Amount (in mmBtu)	**Contract Value** (in millions)	**Notional Amount** (in mmBtu)	**Contract Value** (in millions)
Futures contracts				
Financial positions, beginning of period, net	16,230,000	$ 131	4,290,000	$ 35
Purchased	46,540,000	419	52,780,000	403
Settled	(41,870,000)	(390)	(40,840,000)	(273)
Realized gains (losses)	–	22	–	(34)
Net positions-long	20,900,000	182	16,230,000	131
Swap futures				
Financial positions, beginning of period, net	1,970,000	12	1,822,500	11
Fixed portion	92,090,200	900	17,007,500	120
Floating portion - realized	(23,550,200)	(222)	(16,860,000)	(108)
Realized (losses)	–	(3)	–	(11)
Net positions-long	70,510,000	687	1,970,000	12
Option contracts				
Financial positions, beginning of period, net	5,600,000	1	–	–
Calls purchased	3,550,000	1	2,900,000	2
Puts sold	(5,150,000)	(2)	2,900,000	(1)
Positions closed or expired	(5,600,000)	(8)	(200,000)	–
Net positions-long	(1,600,000)	(8)	5,600,000	1
Holding (losses)/gains				
Unrealized (losses) at beginning of period, net	–	(8)	–	(6)
Unrealized (losses) for the period	–	(138)	–	(2)
Unrealized (losses) at end of period, net	–	(146)	–	(8)
Financial positions at end of period, net	89,810,000	$ 715	23,800,000	$ 136

At September 30, 2008, TVA had derivative positions outstanding under the program equivalent to about 3,154 natural gas contracts, made up of 2,090 futures contracts, 904 swap futures contracts, and 160 options contracts with an approximate net market value of $715 million. For the year ended September 30, 2008, TVA recognized realized gains of $11 million, which were recorded as a decrease to purchased power expense. Unrealized losses at the end of the year were $146 million, which TVA deferred as a regulatory asset in accordance with the FCA rate mechanism. TVA will continue to defer all financial trading program unrealized gains or losses and record only realized gains or losses as purchased power costs at the time the derivative instruments are settled.

At September 30, 2007, TVA had derivative positions outstanding under the program equivalent to about 2,971 natural gas contracts, made up of 1,623 futures contracts, 788 swap futures contracts, and 560 options contracts with an approximate net market value of $136 million. For the year ended September 30, 2007, TVA recognized realized losses of $45 million, which were recorded as an increase to purchased power expense. Unrealized losses at the end of the year were $8 million, which TVA deferred as a regulatory asset in accordance with the FCA rate mechanism. TVA will continue to defer all financial trading program unrealized gains or losses and record only realized gains or losses as purchased power costs at the time the derivative instruments are settled.

Natural Gas Positions Outstanding
At September 30

	2008			2007		
	Number of Contracts	Notional Amount per Contract (in mmBtu)	Total Notional Amount (in mmBtu)	Number of Contracts	Notional Amount per Contract (in mmBtu)	Total Notional Amount (in mmBtu)
Natural gas futures	2,090	10,000	20,900,000	1,623	10,000	16,230,000
Natural gas swaps						
Bilateral swaps (daily)	551	9,274	5,110,000	–	–	–
Bilateral swaps (monthly)	353	185,269	65,400,000	788	2,500	1,970,000
Subtotal	904		70,510,000	788		1,970,000
Natural gas options						
Bilateral options	–	10,000	–	–	–	–
Exchange traded options	160	–	(1,600,000)	560	10,000	5,600,000
Subtotal	160	10,000	(1,600,000	560		5,600,000
Total	3,154		89,810,000	2,971		23,800,000

Concentration of Credit Risk

Credit risk is the exposure to economic loss that would occur as a result of a counterparty's nonperformance of its contractual obligations. Where exposed to credit risk, TVA analyzes the counterparty's financial condition prior to entering into an agreement, establishes credit limits, monitors the appropriateness of those limits, as well as any changes in the creditworthiness of the counterparty on an ongoing basis, and employs credit mitigation measures, such as collateral or prepayment arrangements and master purchase and sale agreements, to mitigate credit risk. The majority of TVA's credit risk is limited to trade accounts receivable from delivered power sales to municipal and cooperative distributor customers, all located in the Tennessee Valley region. To a lesser extent, TVA is exposed to credit risk from industries and federal agencies directly served and from exchange power arrangements with a small number of investor-owned regional utilities related to either delivered power or the replacement of open positions of longer-term purchased power or fuel agreements.

Seven customers, which represented approximately 36 percent and 37 percent of TVA's total power sales in 2008 and 2007, respectively, purchased power from TVA under contracts that require either five or 10 years' notice to terminate. Six of these are municipal and cooperative distributor customers, who were assigned investment grade (public or internally rated) credit ratings. Sales to the seventh customer, USEC, which was previously mentioned, represented 5.3 percent of TVA's total operating revenues in 2008. USEC's senior unsecured credit ratings are currently "CCC" with Standard & Poor's and 'Caa2' with Moody's Investors Service. As a result of USEC's credit ratings, the company has provided credit assurance to TVA, per the terms of its power contract. Outstanding accounts receivable for the top seven customers at September 30, 2008, were $554 million, or 40 percent of total outstanding accounts receivable, and at September 30, 2007, were $567 million, or 40 percent of total outstanding accounts receivable.

11. Debt

General

The TVA Act authorizes TVA to issue Bonds in an amount not to exceed $30 billion at any time. At September 30, 2008, TVA had only two types of Bonds outstanding: power bonds and discount notes. Power bonds have maturities of between one and 50 years, and discount notes have maturities of less than one year. Power bonds and discount notes are both issued pursuant to section 15d of the TVA Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution adopted by the TVA Board on October 6, 1960, as amended on September 28, 1976, October 17, 1989, and March 25, 1992 (the "Basic Resolution"). TVA Bonds are not obligations of the United States, and the United States does not guarantee the payments of principal or interest on Bonds.

Power bonds and discount notes rank on parity and have first priority of payment out of net power proceeds, which are defined as:

- the remainder of TVA's gross power revenues
  - after deducting
    - the costs of operating, maintaining, and administering its power properties, and
    - payments to states and counties in lieu of taxes, but
  - before deducting depreciation accruals or other charges representing the amortization of capital expenditures, plus
- the net proceeds from the sale or other disposition of any power facility or interest therein.

Because TVA's lease payments under its leaseback transactions are considered costs of operating, maintaining, and administering its power properties, those payments have priority over TVA's payments on the Bonds. See Note 13 — *Leaseback Obligations.* Once Net Power Proceeds have been applied to payments on power bonds and discount notes as well as any other Bonds that TVA may issue in the future that rank on parity with or subordinate to power bonds and discount notes, Section 2.3 of the Basic Resolution provides that the remaining net power proceeds shall be used only for minimum payments into the United States Treasury required by the TVA Act in repayment of and as a return on the Power Facility Appropriation Investment, investment in power assets, additional reductions of TVA's capital obligations, and other lawful purposes related to TVA's power program.

The TVA Act and the Basic Resolution each contain two bond tests: the rate test and the bondholder protection test. Under the rate test, TVA must charge rates for power which will produce gross revenues sufficient to provide funds for, among other things, debt service on outstanding Bonds. See Note 1 — *General.* Under the bondholder protection test, TVA must, in successive five-year periods, use an amount of net power proceeds at least equal to the sum of:

- the depreciation accruals and other charges representing the amortization of capital expenditures and
- the net proceeds from any disposition of power facilities

for either

- the reduction of its capital obligations (including Bonds and the Power Facility Appropriation Investment) or
- investment in power assets.

TVA must next meet the bondholder protection test for the five-year period ending September 30, 2010. See Note 9 — *Appropriation Investment.*

Short-Term Debt

The weighted average rates applicable to short-term debt outstanding in the public market as of September 30, 2008, 2007, and 2006, were 1.26 percent, 4.74 percent, and 5.21 percent, respectively. During 2008, 2007, and 2006, the maximum outstanding balances of TVA short-term borrowings held by the public were $1.6 billion, $2.8 billion, and $2.8 billion, respectively. For these same years, the average amounts (and weighted average interest rates) of TVA short-term borrowings were approximately $767 million (3.71 percent), $2.3 billion (5.17 percent), and $2.0 billion (4.47 percent), respectively.

TVA also has access to a financing arrangement with the U.S. Treasury whereby the U.S. Treasury is authorized to accept interim obligations with maturities of one year or less in an aggregate amount outstanding not to exceed $150 million. TVA may draw any portion of the authorized $150 million during the year. Interest is accrued daily at a rate determined by the United States Secretary of the Treasury each month based on the average rate on outstanding marketable obligations of the United States with maturities of one year or less. During 2008, 2007, and 2006, the daily average amounts outstanding (and average interest rates) were approximately $74 million (3.02 percent), $132 million

(5.07 percent), and $131 million (4.33 percent), respectively. In 2009, TVA and the U.S. Treasury replaced the $150 million note under which TVA previously borrowed from the U.S. Treasury with a memorandum of understanding under which TVA will have a $150 million credit facility. There are no fees other than interest on borrowings under the credit facility. TVA plans to use the U.S. Treasury credit facility as a source of liquidity, but not as a primary source of liquidity, in 2009.

TVA has short-term funding available in the form of two short-term revolving credit facilities, one of which is a $1.25 billion facility that matures on May 13, 2009, and the other of which is a $1 billion facility that matures on November 9, 2009. See Note 18 — *Credit Facility Agreements* . The interest rate on any borrowing under these facilities is variable and based on market factors and the rating of TVA's senior unsecured long-term non-credit enhanced debt. TVA is required to pay an unused facility fee on the portion of the total $2.25 billion against which TVA has not borrowed. The fee may fluctuate depending on the non-enhanced credit ratings on TVA's senior unsecured long-term debt. There were no outstanding borrowings under the facilities at September 30, 2008. TVA anticipates renewing each credit facility from time to time.

Put and Call Options

Bond issues of $2.1 billion held by the public are redeemable in whole or in part, at TVA's option, on call dates ranging from the present to 2020 and at call prices ranging from 100 percent to 106 percent of the principal amount. Fifty-eight Bond issues totaling $910 million, with maturity dates ranging from 2009 to 2028, include a "survivor's option," which allows for right of redemption upon the death of a beneficial owner in certain specified circumstances. There is no accounting difference between a "survivor's option" put and a "regular" put on any TVA put Bond.

Additionally, TVA has two issues of Putable Automatic Rate Reset Securities ("PARRS") outstanding. After a fixed-rate period of five years, the coupon rate on the PARRS may automatically be reset downward under certain market conditions on an annual basis. The coupon rate reset on the PARRS is based on a calculation. For both series of PARRS, the coupon rate will reset downward on the reset date if the rate calculated is below the coupon rate on the Bond. The calculation dates, potential reset dates, and terms of the calculation are different for each series. The coupon rate on the 1998 Series D PARRS may be reset on June 1 (annually) if the sum of the five-day average of the 30-Year Constant Maturity Treasury ("CMT") rate for the week ending the last Friday in April, plus 94 basis points, is below the then-current coupon rate. The coupon rate on the 1999 Series A PARRS may be reset on May 1 (annually) if the sum of the five-day average of the 30-Year CMT rate for the week ending the last Friday in March, plus 84 basis points, is below the then-current coupon rate. The coupon rates may only be reset downward, but investors may request to redeem their Bonds at par value in conjunction with a coupon rate reset for a limited period of time prior to the reset dates and under certain circumstances.

Due to the contingent nature of the put option on the PARRS, TVA determines whether the PARRS should be classified as long-term debt or current maturities of long-term debt by calculating the expected reset rate on the bonds. The expected reset rate is calculated using forward rates and the fixed spread for each Bond issue as noted above. If the expected reset rate is less than the coupon on the Bond, the PARRS are included in current maturities. Otherwise, the PARRS are included in long-term debt. At September 30, 2008, the expected reset rate was higher than the current coupon on each issue of PARRS; therefore, the par amount outstanding is classified as long-term debt.

The 1998 Series D PARRS issue totals $350 million, matures in June 2028, and had its first reset date in June 2003. The rate reset to 5.95 percent from 6.75 percent in June 2003, at which time $23 million of the original $575 million of 1998 Series D PARRS were redeemed at par. The rate reset again to 5.49 percent from 5.95 percent in June 2005, at which time $86 million of the 1998 Series D PARRS were redeemed at par. The rate reset once more to 5.46 percent from 5.49 percent in June 2008, at which time $108 million of the 1998 Series D PARRS were redeemed at par. The 1999 Series A PARRS issue totals $298 million, matures in May 2029, and had its first rate reset date in May 2004. The rate reset in May 2004 to 5.62 percent from 6.50 percent, and $115 million of the original $525 million of 1999 Series A PARRS were redeemed at par. The rate reset again to 5.17 percent from 5.62 percent in May 2008, at which time $102 million of the 1999 Series A PARRS were redeemed at par.

Debt Securities Activity

The table below summarizes TVA's Bond activity for the period from October 1, 2006, to September 30, 2008.

Debt Securities Activity from October 1, 2006, to September 30, 2008

	Principal Amount	
Redemptions/Maturities:	2008	2007
electronotes ®		
First quarter	$ –	$ 2
Second quarter	197	5
Third quarter	115	5
Fourth quarter	–	1
1998 Series D	7	–
1999 Series A	10	–
1999 Series A	102	–
1998 Series D	108	–
1997 Series E	100	–
2003 Series C	50	–
2001 Series D	–	75
1997 Series A	–	382
Total	$ 689	$ 470
Issues:		
electronotes ®		
First quarter	$ 41	$ 9
Second quarter	61	19
Third quarter	3	8
Fourth quarter	–	4
2008 Series A	500	–
2008 Series B	1,000	–
2008 Series C	500	–
2007 Series A	–	1,000
Total	$ 2,105	$ 1,040

Debt Outstanding

Debt outstanding at September 30, 2008, consisted of the following:

Short-Term Debt
As of September 30

CUSIP or Other Identifier	Maturity	Call/(Put) Date	Coupon Rate	2008 Par Amount	2007 Par Amount
Discount Notes (net of discount)				$ 185	$ 1,422
Current maturities of long-term debt:					
88059TBQ3	01/15/2008	01/15/2004	3.05%	–	10
88059TBS9	01/15/2008	01/15/2004	3.30%	–	40
88059TCB5	05/15/2008	05/15/2004	2.45%	–	40
880591DB5	11/13/2008		5.38%	2,000	–
88059TCW9	03/15/2009	03/15/2005	3.20%	30	–
Current maturities of long-term debt				2,030	90
Total debt due within one year, net				$ 2,215	$ 1,512

Long-Term Debt [1]
As of September 30

CUSIP or Other Identifier	Maturity	Call/(Put) Date	Coupon Rate	2008 Par Amount	2007 Par Amount
880591DB5	11/13/2008		5.375%	–	2,000
88059TCW9	03/15/2009	03/15/2005	3.200%	–	30
Maturing in 2009				–	2,030
880591DP3	04/15/2010	04/15/2007	5.125%	–	21
88059TDD0	06/15/2010	06/15/2006	4.125%	–	41
Maturing in 2010				–	62
880591DN9	01/18/2011		5.625%	1,000	1,000
88059TDQ1	05/15/2011	05/15/2007	5.250%	–	6
88059TDR9	06/15/2011	06/15/2007	5.250%	–	9
Maturing in 2011				1,000	1,015
880591DL3	05/23/2012		7.140%	29	29
880591DT6	05/23/2012		6.790%	1,486	1,486
88059TBH3	09/15/2012	09/15/2004	4.375%	–	10
Maturing in 2012				1,515	1,525
880591CW0	03/15/2013		6.000%	1,359	1,359
88059TBR1	01/15/2013	01/15/2005	4.375%	14	14
88059TBW0	03/15/2013	03/15/2005	4.000%	22	23
88059TBX8	03/15/2013	03/15/2004	4.250%	12	12
88059TCD1	06/15/2013	06/15/2004	3.500%	12	12
880591DW9	08/01/2013		4.750%	940	990
88059TCF6	07/15/2013	07/15/2005	4.350%	17	17
88059TDS7	07/15/2013	07/15/2008	5.625%	9	9
88059TEG2	04/15/2013	07/15/2009	3.500%	3	–
Maturing in 2013				2,388	2,436
88059TCL3	10/15/2013	10/15/2005	4.500%	12	12
88059TCQ2	12/15/2013	12/15/2005	4.700%	8	8
88059TDX6	02/15/2014	02/15/2008	5.250%	–	7
88059TDZ1	04/15/2014	04/15/2008	5.000%	4	4
Maturing in 2014				24	31
88059TDE8	07/15/2015	07/15/2007	4.500%	6	7
88059TBY6	04/15/2015	04/15/2005	4.600%	20	20
88059TBJ9	10/15/2014	10/15/2004	4.600%	21	21
88059TCH2	08/15/2015	08/15/2005	5.125%	33	34
88059TDB4	04/15/2015	04/15/2007	5.000%	49	50
88059TBN0	12/15/2014	12/15/2004	5.000%	54	54
880591DY5	06/15/2015		4.375%	1,000	1,000
880591ED9	11/15/2014	11/15/2008	4.800%	17	–
Maturing in 2015				1,200	1,186
88050TBK6	10/15/2015	10/15/2005	5.050%	19	19
88059TDH1	10/15/2015	10/15/2007	5.000%	27	27
88059TBL4	11/15/2015	11/15/2005	4.800%	26	26
88059TCR0	12/15/2015	12/15/2005	4.875%	11	11
88059TDK4	12/15/2015	12/15/2006	5.375%	–	10
88059TBU4	02/15/2016	02/15/2006	4.550%	8	8
88059TCV1	02/15/2016	02/15/2006	4.500%	3	3
88059TDN8	03/15/2016	03/15/2008	5.375%	–	8
88059TCC3	06/15/2016	06/15/2006	3.875%	3	3
88059TDT5	08/15/2016	08/15/2007	5.625%	–	4
88059TCJ8	09/15/2016	09/15/2006	4.950%	11	11
88059TDU2	09/15/2016	09/15/2007	5.375%	14	14

880591DS8	12/15/2016		4.875%	524	524
88059TCS8	01/15/2017	01/15/2007	5.000%	28	28
88059TDW8	01/15/2017	01/15/2008	5.250%	6	6
88059TEA5	06/15/2017	06/15/2008	5.500%	4	4
880591EA6	07/18/2017		5.500%	1,000	1,000
88059TEB3	09/15/2017	09/15/2009	5.000%	4	4

CUSIP or Other Identifier	Maturity	Call/(Put) Date	Coupon Rate	2008 Par Amount	2007 Par Amount
880591CU4	12/15/2017		6.250%	650	750
88059TCA7	05/15/2018	05/15/2004	4.750%	24	24
88059TCE9	07/15/2018	07/15/2004	4.700%	34	35
88059TCN9	11/15/2018	11/15/2006	5.125%	18	18
88059TEF4	03/15/2018	03/15/2010	4.500%	25	–
880591EC2	04/01/2018		4.500%	1,000	–
88059TCT6	01/15/2019	01/15/2005	5.000%	27	28
88059TCX7	03/15/2019	03/15/2007	4.500%	12	12
88059TDF5	08/15/2020	08/15/2008	5.000%	10	10
88059TDG3	09/15/2020	09/15/2008	4.800%	3	3
88059TDJ7	11/15/2020	11/15/2008	5.500%	11	11
88059TDL2	01/18/2021	01/15/2009	5.125%	5	5
880591DC3	06/07/2021		5.805% [2]	356	409
88859TAN1	12/15/2021	12/15/2005	6.000%	–	25
88059TAR2	01/15/2022	01/15/2006	6.125%	–	28
88059TDY4	03/15/2022	03/15/2008	5.375%	6	6
88059TAX9	04/15/2022	04/15/2006	6.125%	–	13
88059TBE0	08/15/2022	08/15/2006	5.500%	–	28
88059TBM2	11/15/2022	11/15/2006	5.000%	10	11
88059TBP5	12/15/2022	12/15/2006	5.000%	19	19
88059TEC1	10/15/2022	10/15/2008	5.500%	25	–
88059TBT7	01/15/2023	01/15/2007	5.000%	10	11
88059TBV2	02/15/2023	02/15/2007	5.000%	16	16
88059TBZ3	05/15/2023	05/15/2004	5.125%	14	14
88059TCK5	10/15/2023	10/15/2007	5.200%	13	14
88059TCP4	11/15/2023	11/15/2004	5.250%	11	12
88059TCU3	02/15/2024	02/15/2008	5.125%	8	9
88059TCY5	04/15/2024	04/15/2005	5.375%	14	14
88059TCZ2	02/15/2025	02/15/2006	5.000%	18	18
88059TDA6	03/15/2025	03/15/2009	5.000%	6	6
88059TDC2	05/15/2025	05/15/2009	5.125%	13	14
880591CJ9	11/01/2025		6.750%	1,350	1,350
88059TDM0	02/15/2026	02/15/2010	5.500%	6	7
88059TDV0	10/15/2026	10/15/2010	5.500%	9	9
880591300 [3]	06/01/2028		5.490%	350	466
88059TEE7	01/15/2028	01/15/2012	4.375%	36	–
880591409 [3]	05/01/2029		5.618%	298	410
880591DM1	05/01/2030		7.125%	1,000	1,000
880591DP4	06/07/2032		6.587% [2]	445	512
880591DV1	07/15/2033		4.700%	472	472
880591DX7	06/15/2035		4.650%	436	436
880591CK6	04/01/2036		5.980%	121	121
880591CS9	04/01/2036		5.880%	1,500	1,500
880591CP5	01/15/2038		6.150%	1,000	1,000
880591ED0	06/15/2038		5.500%	500	–
880591BL5	04/15/2042	04/15/2012	8.250%	1,000	1,000
880591DU3	06/07/2043		4.962% [2]	267	307
880591CF7	07/15/2045	07/15/2020	6.235%	140	140
880591EB4	01/15/2048		4.875%	500	–
880591DZ2	04/01/2056		5.375%	1,000	1,000
Maturing 2016-2056				14,476	13,003
Subtotal				20,603	21,288
Unamortized discounts, premiums, and other				(199)	(189)
Total long-term debt, net				$ 20,404	$ 21,099

Notes

(1) The above table includes net exchange losses from currency transactions of $138 million and $299 million at September 30, 2008 and 2007, respectively.

(2) The coupon rate represents TVA's effective interest rate.

(3) TVA PARRS, CUSIP numbers 880591300 and 880591409, may be redeemed under certain conditions. See Note 11 — *Put and*

Call Options .

12. Supplemental Cash Flow Information

Interest paid was $1,372 million in 2008, $1,425 million in 2007, and $1,422 million in 2006. These amounts differ from interest expense due to the timing of payments and interest capitalized of $17 million in 2008, $177 million in 2007, and $163 million in 2006 as a part of major capital expenditures.

In 2006 TVA had non-cash activity resulting from financing transactions of $13 million related to a gain on the repurchase of Bonds. There were no major non-cash investing or financing activities for 2007 or 2008.

Cash flows from futures contracts, forward contracts, option contracts, or swap contracts that are accounted for as hedges are classified in the same category as the item being hedged or on a basis consistent with the nature of the instrument.

13. Fair Value of Financial Instruments

TVA uses the methods and assumptions described below to estimate the fair value of each significant class of financial instrument. The fair market value of the financial instruments held at September 30, 2008, may not be representative of the actual gains or losses that will be recorded when these instruments mature or are called or presented for early redemption. The estimated values of TVA's financial instruments at September 30 are as follows:

Estimated Values of Financial Instruments
As of September 30

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 213	$ 213	$ 165	$ 165
Restricted cash and investments	106	106	150	150
Investment funds	956	956	1,169	1,169
Loans and other long-term receivables	81	81	79	79
Short-term debt, net of discount	185	185	1,422	1,422
Long-term debt (including current portion), net of discount	22,434	23,851	21,189	22,453
Leaseback obligations	1,353	1,353	1,072	1,072

Cash and Cash Equivalents, Short-Term Investments, and Short-Term Debt

Because of the short-term maturity of these instruments, the carrying amount approximates fair value.

Restricted Cash and Investments

Because of the short-term maturity of these instruments, the carrying amount approximates fair value.

Investment Funds

Information on investments by major type at September 30 is as follows:

TVA Investments By Type
As of September 30

	2008	2007
Securities held as trading	$ 951	$ 1,162
Other	5	7
Total investment funds	$ 956	$ 1,169

Gains and losses on trading securities are recognized in current earnings. The gains and losses on the nuclear decommissioning trust and the ART are subsequently reclassified to a regulatory asset account in accordance with TVA's regulatory accounting policy. The nuclear decommissioning trust had unrealized losses of $184 million in 2008, unrealized gains of $80 million in 2007, and unrealized losses of $24 million in 2006. The ART had no unrealized gains or losses during 2008 or 2007. The nuclear decommissioning trust was composed of 1,601 security and fund positions as of September 30, 2008. The ART was composed of three fund positions as of September 30, 2008.

Loans and Other Long-Term Receivables

Fair values for loans and long-term receivables are estimated by determining the present value of future cash flows using a discounted rate equal to lending rates for similar loans made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amount approximates fair value.

Long-Term Debt

Fair value of long-term debt traded in the public market is determined by multiplying the par value of the debt by the indicative market price at the Balance Sheet date.

Leaseback Obligations

Prior to 2004, TVA received approximately $945 million in proceeds by entering into leaseback transactions for 24 new peaking combustion turbine units. TVA also received approximately $389 million in proceeds by entering into a leaseback transaction for qualified technological equipment and software in 2003. Due to TVA's continuing involvement in the operation and maintenance of the leased units and equipment and its control over the distribution of power produced by the combustion turbine facilities during the leaseback term, TVA accounted for the lease proceeds of $1,334 million as financing obligations as required in accordance with SFAS No. 66, *"Accounting for Sales of Real Estate,"* and SFAS No. 98, *"Accounting for Leases."* Accordingly, the outstanding leaseback obligations of $1,029 million at September 30, 2008, and $1,072 million at September 30, 2007, are included in CURRENT PORTION OF LEASEBACK OBLIGATIONS ($41 million and $43 million, respectively) and LEASEBACK OBLIGATIONS ($987 million and $1,029 million, respectively) in TVA's 2008 and 2007 year-end Balance Sheets.

On September 30, 2008, TVA received $325 million in proceeds by entering into a leaseback transaction for the Southaven facility with Seven States Power Corporation. Due to the nature of the transaction, the carrying amount of the obligation and the fair market value are equal. The outstanding Southaven obligation of $325 million at September 30, 2008 is included in CURRENT PORTION OF LEASEBACK OBLIGATIONS ($13 million) and LEASEBACK OBLIGATIONS ($312 million) in TVA's 2008 year-end Balance Sheet.

At September 30, 2008 and 2007, the total balances of the leaseback obligations were $1,353 million and $1,072 million, respectively.

14. Benefit Plans

TVA sponsors a qualified defined benefit pension plan that covers most of its full-time employees, a qualified defined contribution plan that covers most of its full-time employees, an unfunded postretirement health care plan that provides for non-vested contributions toward the cost of certain retirees' medical coverage, other postemployment benefits such as workers' compensation, and a supplemental executive retirement plan. Following are discussions of each of these plans as well as discussions of the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

Overview of Plans and Benefits

Defined Benefit Pension Plan. TVA sponsors a defined benefit plan for most of its full-time employees that provides two benefit structures: the Original Benefit Structure and the Cash Balance Benefit Structure.

- *Original Benefit Structure*. The pension benefit for a member participating in the Original Benefit Structure is based on the member's creditable service, the member's average monthly salary for the highest three consecutive years of base pay, and a pension factor based on the member's age and years of service, less a Social Security offset.

- *Cash Balance Benefit Structure*. The pension benefit for a member participating in the Cash Balance Benefit Structure is based on credits accumulated in the member's account and the member's age. A member's account receives credits each pay period equal to 6.00 percent of his or her straight-time earnings. The account also receives monthly interest credits at a rate set at the beginning of each year equal to the change in the Consumer Price Index ("CPI") plus 3.00 percent, with the provision that the rate may not be less than 6.00 percent or more than 10.00 percent. The actual changes in the CPI for 2008 and 2007 were 3.00 percent and 3.43 percent, which resulted in interest rates of 6.00 percent and 6.43 percent, respectively.

Members of both the Original Benefit Structure and the Cash Balance Benefit Structure can also become eligible for a vested supplemental pension benefit based on age and years of service, which is designed to help retirees offset the cost of medical insurance.

The defined benefit pension plan is administered by a separate legal entity, the TVA Retirement System ("TVARS"), which is governed by its own board of directors ("TVARS Board"). Upon notification by the TVARS Board of a recommended contribution for the next fiscal year, TVA determines whether to make the recommended contribution or any contribution that may be required by the rules and regulations of TVARS.

Defined Contribution Plan. TVARS also administers a defined contribution 401(k) plan to which TVA makes matching contributions of 25 cents on the dollar (up to 1.5 percent of annual pay) for members participating in the Original Benefit Structure and of 75 cents on the dollar (up to 4.5 percent of annual pay) for members participating in the Cash Balance Benefit Structure. TVA made matching contributions of about $21 million to the plan during 2008, $21 million during 2007, and $19 million during 2006.

Supplemental Executive Retirement Plan. In 1995, TVA established a supplemental executive retirement plan ("SERP") for certain executives in critical positions to provide supplemental pension benefits tied to compensation that is not creditable under the qualified pension plan. TVA has historically funded the annual calculated expense.

Other Postretirement Benefits . TVA sponsors an unfunded postretirement benefits plan that provides for non-vested contributions toward the cost of certain eligible retirees' medical coverage. This plan formerly covered all eligible retirees participating in the TVA medical plan, and TVA's contributions were a flat dollar amount based on the participants' ages and years of service and certain payments toward the plan costs. This plan now operates on a much more limited basis, covering only certain retirees and surviving dependents who do not qualify for TVARS benefits, including the vested supplemental pension benefit.

Other Postemployment Benefits. TVA employees injured in work-related incidents are covered by the TVA's workers' compensation program for federal employees administered through the Department of Labor by the Office of Workers' Compensation Programs in accordance with the provisions of the Federal Employees' Compensation Act ("FECA"). FECA provides compensation benefits to federal employees for permanent and temporary disability due to employment-related injury or disease.

Accounting Mechanisms

Regulatory Accounting. As a regulated entity, TVA has reclassified all amounts related to unrecognized prior service costs, net actuarial gains or losses, and subsequent changes in the funded status into a regulatory asset in accordance with the provisions of SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation.*" Under this guidance, the deferral of incurred costs is allowed if the costs are probable of future recovery in customer rates. In conjunction with TVA's 2008 adoption of SFAS No. 158 and the application of SFAS No. 71, TVA deferred $973 million of unamortized prior service costs and net actuarial losses related to its pension and postretirement benefit plans that TVA management believes (1) are probable of recovery in future periods and (2) qualify for regulatory accounting treatment under SFAS No. 71.

TVA uses the projected unit credit cost method to determine the service cost and the projected benefit obligation for retirement, termination, and ancillary benefits. Under this method, a "projected accrued benefit" is calculated as of the beginning of the year and as of the end of the year for each benefit that may be payable in the future. The "projected accrued benefit" is based on the plan's accrual formula and upon service as of the beginning or end of the year, but using final average compensation, social security benefits, and other relevant factors projected to the age at which the employee is assumed to leave active service. The projected benefit obligation is the actuarial present value of the "projected accrued benefits" as of the beginning of the year for employed participants and is the actuarial present value of all benefits for other participants. The service cost is the actuarial present value of the difference between the "projected accrued benefits" as of the beginning and end of the year.

TVA utilized the corridor approach to gain/loss amortization. Differences between actuarial assumptions and actual plan results are deferred and amortized into periodic cost only when the accumulated differences exceed 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets. If necessary, the excess is amortized over the average remaining service period of active employees.

Additionally, TVA recognizes the impact of asset performance on pension expense over a three-year phase-in period through a "market-related" value of assets calculation. Since the market-related value of assets recognizes investment gains and losses over a three year period, the future value of assets will be impacted as previously deferred gains or losses are recognized. The market-related value is used in calculating expected return on plan assets and net gain or loss for pension cost determination. The net gain or loss to be amortized is derived from a comparison of the expected return on market-related value of plan assets with the actual return on plan assets. A portion of any difference between the two is reflected in the end-of-year market-related asset value and net gain or loss; the remainder is reflected in those balances in future periods.

Obligations and Funded Status

The changes in plan obligations, assets, and funded status for the years ended September 30 were as follows:

Obligations and Funded Status
As of September 30

	Pension Benefits		Other Postretirement Benefits	
	2008	**2007**	**2008**	**2007**
Change in benefit obligation				
Benefit obligation at beginning of year	$ 8,642	$ 8,646	$ 464	$ 451
Service cost	110	121	5	5
Interest cost	522	495	28	26
Plan participants' contributions	34	35	78	77
Amendments	3	5	–	–
Actuarial (gain) / loss	(708)	(183)	25	2
Net transfers from variable fund/401(k) plan	7	11	–	–
Expenses paid	(5)	(4)	–	–
Benefits paid	(525)	(484)	(102)	(97)
Benefit obligation at end of year	8,080	8,642	498	464
Change in plan assets				
Fair value of plan assets at beginning of year	7,977	7,328	–	–
Actual return on plan assets	(1,465)	1,013	–	–
Plan participants' contributions	34	35	78	77
Net transfers from variable fund/401(k) plan	7	11	–	–
Employer contributions	165	78	24	20
Expenses paid	(5)	(4)	–	–
Benefits paid	(525)	(484)	(102)	(97)
Fair value of plan assets at end of year	6,188	7,977	–	–
Funded status	$ (1,892)	$ (665)	$ (498)	$ (464)

The effect of plan amendments disclosed in the table above refers to the supplemental executive retirement plan, whereby additional participants were added to the plan in each of the years.

Amounts recognized in the Balance Sheet at September 30 consist of:

Obligations and Funded Status
Recognized Amounts
As of September 30

	Pension Benefits		Other Postretirement Benefits	
	2008	**2007**	**2008**	**2007**
Regulatory assets	$ 2,120	$ 831	$ 157	$ 142
Accrued liabilities	(5)	(3)	(29)	(24)
Other (long-term) liabilities	(1,887)	(662)	(469)	(440)

Unrecognized amounts included in regulatory assets yet to be recognized as components of accrued benefit cost at September 30 consist of:

Obligations and Funded Status
Unrecognized Amounts
As of September 30

	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
Unrecognized prior service cost	$ 214	$ 248	$ 29	$ 34
Unrecognized net loss	1,906	583	128	108
Total regulatory assets	$ 2,120	$ 831	$ 157	$ 142

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets at September 30, 2008 and 2007, were as follows:

Projected Benefit Obligations in Excess of Plan Assets
As of September 30

	2008	2007
Projected benefit obligation	$ 8,080	$ 8,642
Accumulated benefit obligation	7,870	8,312
Fair value of plan assets	6,188	7,977

The components of net periodic benefit cost and other amounts recognized as changes in regulatory assets for the years ended September 30 were as follows:

Components of Net Periodic Benefit Cost
For the years ended of September 30

	Pension Benefits			Other Postretirement Benefits		
	2008	2007	2006	2008	2007	2006
Components of net periodic benefit cost						
Service cost	$ 110	$ 122	$ 128	$ 5	$ 5	$ 9
Interest cost	522	493	443	28	26	29
Expected return on plan assets	(608)	(571)	(490)	–	–	–
Amortization of prior service cost	37	37	37	5	5	5
Recognized net actuarial loss	41	83	133	5	6	15
Total net periodic benefit cost	$ 102	$ 164	$ 251	$ 43	$ 42	$ 58

The amounts in the regulatory asset that are expected to be recognized as components of net periodic benefit cost during the next fiscal year are as follows:

Regulatory Asset
As of September 30, 2008

	Pension Benefits	Other Postretirement Benefits	Total
Prior service cost	$ 36	$ 5	$ 41
Net actuarial loss	14	7	21

Plan Assumptions

TVA's reported costs of providing the plan benefits are impacted by numerous factors including the provisions of the plans, changing employee demographics, and various assumptions, the most significant of which are noted below.

Components Recognized as Regulatory Assets
As of September 30

	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
Assumptions utilized to determine benefit obligations at September 30				
Discount rate	7.50%	6.25%	7.50%	6.25%
Expected return on plan assets	8.00%	8.75%	N/A	N/A
Rate of compensation increase	3.3% – 10.1%	3.3% – 10.1%	N/A	N/A
Initial health care cost trend rate	N/A	N/A	8.00%	8.00%
Ultimate health care cost trend rate	N/A	N/A	5.00%	5.00%
Ultimate trend rate is reached in year beginning	N/A	N/A	2014	2013
Assumptions utilized to determine net periodic benefit cost for the years ended September 30				
Discount rate	6.25%	5.90%	6.25%	5.90%
Expected return on plan assets	8.75%	8.75%	N/A	N/A
Rate of compensation increase	3.3% – 10.1%	3.3% – 10.1%	N/A	N/A
Initial health care cost trend rate	N/A	N/A	8.00%	8.50%
Ultimate health care cost trend rate	N/A	N/A	5.00%	5.00%
Ultimate trend rate is reached in year beginning	N/A	N/A	2013	2013

Discount Rate. In the case of selecting an assumed discount rate, TVA reviews market yields on high-quality corporate debt and long-term obligations of the U.S. Treasury and endeavors to match, through the use of a proprietary bond portfolio, instrument maturities with the maturities of its pension obligations in accordance with the prevailing accounting standards. Additionally, TVA looks at published pension spot yield curves and applies expected cash flows to the curve. Based on recent market trends in all these data points, TVA increased its discount rate from 5.90 percent and 6.25 percent at the end of 2006 and 2007, respectively, to 7.50 percent at the end of 2008.

Rate of Return. In determining its expected long-term rate of return on pension plan assets, TVA reviews past long-term performance, asset allocations, and long-term inflation assumptions. TVA utilized a rate of return of 8.75 percent at the end of 2007. TVA adjusted the expected rate in 2008 based on revisions to future expected returns as provided by third party professional asset managers. As of 2008, the expected rate of return was 8.0 percent. The actual rate of return for the year ending September 30, 2008, was a decrease of 19 percent.

Compensation Increases . This assumption is based on the results obtained from an actual company experience study performed during the most recent six years for retirees as well as other plan participants. TVA obtained an updated study in 2008 and determined that no changes in this assumption were required.

Mortality. Mortality assumptions are based on the results obtained from an actual company experience study performed during the most recent six years for retirees as well as other plan participants. TVA obtained an updated study in 2008 and, accordingly, adjusted the mortality rates from the 1983 Group Annuity Mortality Tables to the RP-2000 Mortality Tables.

Health Care Cost Trends. TVA reviews actual recent cost trends and projected future trends in establishing health care cost trend rates. Based on this review process, TVA did not reset its health care cost trend rate assumption used in calculating the 2008 and 2007 accumulated postretirement benefit obligations. The assumed health care trend rate used for 2008 and 2007 was 8.0 percent. No change was made due to consistent actual performance in the plan. In addition, an 8.5 percent trend rate was used during 2006. The 2008 health care cost trend rate of 8.0 percent is assumed to gradually decrease each successive year until it reaches a five percent annual increase in health care costs in the year beginning October 1, 2014, and beyond.

Sensitivity of Costs to Changes in Assumptions. The following chart reflects the sensitivity of pension cost to changes in certain actuarial assumptions:

Sensitivity of Costs to Changes in Pension Benefit Assumptions

Actuarial Assumption	Change in Assumption	Impact on 2009 Pension Cost	Impact on 2008 Projected Benefit Obligation
		(Increase in millions)	
Discount rate	(0.25%)	$ 14	$ 195
Rate of return on plan assets	(0.25%)	17	NA

Each fluctuation above assumes that the other components of the calculation are held constant and excludes any impact for unamortized actuarial gains or losses.

The following chart reflects the sensitivity of postretirement benefit cost to changes in the health care trend rate:

Sensitivity to Components of Other Postretirement Benefits Plan
As of September 30, 2008

	1% Increase	1% Decrease
Effect on total of service and interest cost components	$ 4	$ (5)
Effect on end-of-year accumulated postretirement benefit obligation	59	(60)

Each fluctuation above assumes that the other components of the calculation are held constant and excludes any impact for unamortized actuarial gains or losses.

Plan Investments

The qualified defined benefit pension plan, which includes the Original Benefit Structure and the Cash Balance Benefit Structure, is the only plan that includes qualified plan assets. The plan assets are primarily stocks and bonds. TVARS targets an asset allocation of 65 percent equity securities and 35 percent fixed income securities. Under its asset allocation policy of 65 percent equity holdings, 25 percent may be non-U.S. equity holdings, five percent may be private equity holdings or other similar alternative investments, and five percent may be private real estate holdings. Of the 35 percent fixed income securities, 15 percent may be alternative fixed income strategies and five percent may be high yield securities. The TVARS asset allocation policy includes a permissible three percent deviation from these target allocations. The TVARS Board can take action, as appropriate, to rebalance the system's assets consistent with the asset allocation policy. For 2008 and 2007, the asset holdings of the system included the following:

Asset Holdings of the TVARS
As of September 30

Asset Category	Plan Assets at September 30 2008	2007
U.S. equity securities	32%	38%
Non-U.S. equity securities	21%	22%
Private equity holdings or similar alternative investments	6%	4%
Private real estate holdings	2%	–
Fixed income securities	32%	30%
High yield securities	7%	6%
Total	100%	100%

Cash Flows

Estimated Future Benefit Payments. The following table sets forth the estimated future benefit payments under the benefit plans.

Estimated Future Benefit Payments
As of September 30, 2008

	Pension Benefits	Other Postretirement Benefits
2009	$ 652	$ 30
2010	650	34
2011	661	38
2012	670	40
2013	674	42
2014 - 2018	3,447	222

Plan Contributions . TVA expects to contribute $5 million to its supplemental executive retirement plan and $30 million to its other postretirement benefit plans in 2009. TVA made a contribution to the defined benefit pension plan on September 30, 2008 of $85 million that constitutes the amount that was expected to be contributed in 2009.

Other Postemployment Benefits

Postemployment benefit cost estimates are revised to properly reflect changes in actuarial assumptions made at the end of the year. In accordance with SEC recommendations related to the selection of discount rates, TVA utilizes a discount rate determined by reference to the U.S. Treasury Constant Maturities rate for a 10-year maturity. For 2008, TVA has determined to utilize a discount rate of 3.85 percent representing the risk-free rate corresponding to the U.S. Treasury Constant Maturities rate for a 10-year maturity. Use of the 10-year maturity corresponds to calculated average durations of TVA's future estimated postemployment claims payments. The use of a 3.85 percent discount rate resulted in the recognition of 2008 annual expense of approximately $65 million and an unpaid benefit obligation of about $434 million at year end. TVA utilized a discount rate of 4.59 percent and 4.64 percent in 2007 and 2006, respectively. The use of these discount rates resulted in expense and unpaid benefit obligations of $49 million and $406 million, respectively, for 2007 and expense and unpaid benefit obligations of $44 million and $413 million, respectively, for 2006.

Medicare Prescription Drug, Improvement and Modernization Act of 2003

In 2006, Medicare began providing prescription drug coverage to Medicare-eligible beneficiaries under Medicare Part D. Under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, which created Medicare Part D, employers that provide retiree prescription drug coverage, which is "actuarially equivalent" to standard coverage under Medicare Part D, may receive retiree drug subsidies for retirees who enroll in the employer's retiree prescription drug plan instead of Medicare Part D. TVA determined that its retiree prescription drug coverage did not qualify for retiree drug subsidies and accordingly has not included or utilized any manner of subsidy in the determination of APBO or

postretirement benefit cost, for the current or prior periods, in accordance with the requirements contained within the FSP FAS 106-2, "*Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* ." After analyzing a number of options available to plan sponsors for integration with the new Medicare Part D, TVA elected to provide an employer-sponsored Part D prescription drug plan ("PDP"), with alternative coverage over and above Medicare standard Part D coverage, for Medicare-eligible retirees who participate in TVA's Medicare supplement. By providing an employer-sponsored PDP, any Medicare subsidies will be passed through to retirees in the form of lower participant premiums and should not affect TVA's cost of providing prescription drug coverage.

15. Commitments and Contingencies

Commitments

As of September 30, 2008, the amounts of contractual cash commitments maturing in each of the next five years and beyond are shown below:

Commitments and Contingencies
Payments due in the year ending September 30

	2009	2010	2011	2012	2013	Thereafter	Total
Debt	$ 2,215	$ –	$ 1,000	$ 1,514	$ 2,388	$ 15,563	$ 22,680[1]
Lease obligations							
Capital	58	58	54	6	3	337	516
Non-cancelable operating	64	60	51	43	37	207	462
Purchase obligations							
Power	220	236	249	232	177	6,092	7,206
Fuel	1,184	787	603	398	327	863	4,162
Other	121	30	23	25	18	100	317
Total	$ 3,862	$ 1,171	$ 1,980	$ 2,218	$ 2,950	$ 23,162	$ 35,343

Notes

(1) Does not include noncash items of foreign currency valuation loss of $138 million and net discount on sale of Bonds of $199 million.

In addition to the cash requirements above, TVA has contractual obligations in the form of revenue discounts related to energy prepayments. See Note 1 — *Energy Prepayment Obligations.*

Energy Prepayment Obligations
Payments Due in the Year Ending September 30

	2009	2010	2011	2012	2013	Thereafter	Total
Energy Prepayment Obligations	$ 105	$ 105	$ 105	$ 105	$ 102	$ 511	$ 1,033

Debt. At September 30, 2008, TVA had outstanding discount notes of $185 million and long-term debt (including current maturities) at varying maturities and interest rates of $22.5 billion for total outstanding indebtedness of $22.7 billion. See Note 11.

Leases . TVA leases certain property, plant, and equipment under agreements with terms ranging from one to 30 years. Obligations under capital lease agreements in effect at September 30, 2008, totaled $58 million for 2009, $58 million for 2010, $54 million for 2011, $6 million for 2012, $3 million for 2013, and an aggregate of $337 million thereafter, for a total commitment of $516 million. Of this amount, $55 million represents the cost of financing. Obligations under non-cancelable operating lease agreements (primarily related to facilities and equipment) in effect at September 30, 2008, totaled $64 million for 2009, $60 million for 2010, $51 million for 2011, $43 million for 2012, $37 million for 2013, and an aggregate of $207 million thereafter for a total commitment of $462 million. TVA's rental expense for operating leases was $63 million in 2008, $65 million in 2007, and $44 million in 2006.

During the third quarter of 2007, TVA entered into an operating lease agreement and various related contracts for the Caledonia combined cycle facility located near Columbus, Mississippi, with a commencement date of July 1, 2007. The lease agreement has a 15-year term expiring on February 28, 2022. The Caledonia facility consists of three combined cycle units with a summer net capability of 768 megawatts. A conversion services agreement providing for power purchases from the Caledonia facility was terminated as of July 1, 2007, the lease commencement date, and dispatch control was shifted to TVA on July 3, 2007. Under the lease, TVA assumed plant operations in December 2007. The lease agreement also includes an end-of-term purchase option.

Purchase of Southaven Combined Cycle Facility and Subsequent Sale to Seven States Power Corporation. On May 9, 2008, TVA completed the purchase, as part of a bankruptcy auction process, of a three-unit, 792-megawatt summer net capability combined cycle combustion-turbine facility located in Southaven, Mississippi, owned by Southaven Power. See Note 4 — *Asset Acquisitions and Dispositions* .

Power Purchase Obligations. TVA has contracted with various independent power producers and power distributor customers for additional capability to be made available to TVA. In total, these agreements provide 2,789 megawatts of summer net capability and 27 megawatts of capability from renewable resources that are not included in the determination of summer net capability. The total financial commitment for non-renewable power supply contracts is approximately $7 billion. Costs under TVA's power purchase agreements are included in the Statements of Income for 2008, 2007, and 2006 as FUEL AND PURCHASED POWER expense and are expensed as incurred in accordance with the normal purchases and sales exemption described in SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities,"* as amended.

Certain contracts with independent power producers qualify as operating leases in accordance with the requirements of EITF No. 01-08, " *Determining Whether an Arrangement Contains a Lease."* In accordance with SFAS No. 13, " *Accounting for Leases,"* variable costs associated with these contracts meet the definition of contingent rentals. Amounts under these contracts qualifying as contingent rentals during 2008 amounted to $96 million. In accordance with the requirements of EITF No. 98-09, " *Accounting for Contingent Rent"* , TVA accrues contingent rentals when the achievement of the event that triggers the contingent rental expense is probable. Because of the uncertainty associated with future power demand, TVA accrues contingent rentals under these arrangements as power is purchased.

Under the Public Utility Regulatory Policies Act of 1978 as amended by the Energy Policy Acts of 1992 and 1995, TVA is obligated to purchase power from qualifying facilities. At September 30, 2008, there were six suppliers, with a combined capacity of 903 megawatts, which qualify under this program.

TVA, along with others, contracted with the Southeastern Power Administration ("SEPA") to obtain power from eight U.S. Army Corp of Engineers hydroelectric facilities on the Cumberland River system. The agreement with SEPA can be terminated upon three years' notice, but this notice of termination may not become effective prior to June 30, 2017. The contract originally required SEPA to provide TVA an annual minimum of 1,500 hours of power for each megawatt of TVA's 405 megawatt allocation, and all surplus power from the Cumberland River system. Because hydroelectric production has been reduced at two of the hydroelectric facilities on the Cumberland River System (Wolf Creek and Center Hill Dams) and because of reductions in the summer stream flow on the Cumberland River, SEPA declared "force majeure" on February 25, 2007. SEPA then instituted an emergency operating plan that:

- Eliminates its obligation to provide any affected customer (including TVA) with a minimum amount of power;
- Provides for all affected customers (except TVA) to receive a pro rata share of a portion of the gross hourly generation from the eight Cumberland River hydroelectric facilities;
- Provides for TVA to receive all of the remaining hourly generation (minus station service for those facilities);
- Eliminates the payment of demand charges by customers (including TVA) since there is significantly reduced dependable capacity on the Cumberland River system; and
- Increases the rate charged per kilowatt-hour of energy received by SEPA's customers (including TVA), because SEPA is legally required to charge rates that cover its costs.

It is unclear how long the emergency operating plan will remain in effect.

Fuel Purchase Obligations. TVA has approximately $1.9 billion in long-term fuel purchase commitments ranging in terms of up to 11 years primarily for the purchase and transportation of coal and approximately an additional $2.3 billion of long-term commitments ranging in terms of up to 10 years for the purchase of enriched uranium and fabrication of nuclear fuel assemblies.

Other Obligations. Other obligations of $317 million consist of contracts as of September 30, 2008, for goods and services primarily related to capital projects as well as other major recurring operating costs.

Bear Creek Dam. Bear Creek Dam, a small, non-generating dam in northern Alabama, is experiencing foundation problems as evidenced by seepage through the foundation of the dam. An Environmental Impact Statement was completed in 2007, which concluded the preferred alternative is to repair the dam. The total estimated cost for repair is $35 million. Site work to mitigate the problem began in 2007 and is scheduled to be completed in 2009. At September 30, 2008, the repair work was on schedule and on budget.

Contingencies

Nuclear Insurance . The Price-Anderson Act provides a layered framework of protection to compensate for losses arising from a nuclear event. For the first layer, all NRC nuclear plant licensees, including TVA, purchase $300 million of nuclear liability insurance from American Nuclear Insurers for each plant with an operating license. Funds for the second layer, the Secondary Financial Program, would come from an assessment of up to $112 million from the licensees of each of the 104 NRC licensed reactors in the United States. The assessment for any nuclear accident would be limited to $18 million per year per reactor. American Nuclear Insurers, under a contract with the NRC, administers the Secondary Financial Program. With its six licensed units, TVA could be required to pay a maximum of $671 million per nuclear incident, but it would have to pay no more than $105 million per incident in any one year. When the contributions of the nuclear plant licensees are added to the insurance proceeds of $300 million, over $12 billion (includes a five percent surcharge for legal expenses) would be available. Under the Price-Anderson Act, if the first two layers are exhausted, Congress is required to take action to provide additional funds to cover the additional losses.

TVA carries property, decommissioning, and decontamination insurance of $4.6 billion for its licensed nuclear plants, with up to $2.1 billion available for a loss at any one site, to cover the cost of stabilizing or shutting down a reactor after an accident. Some of this insurance, which is purchased from Nuclear Electric Insurance Limited ("NEIL"), may require the payment of retrospective premiums up to a maximum of approximately $72 million.

TVA purchases accidental outage (business interruption) insurance for TVA's nuclear sites from NEIL. In the event that an accident covered by this policy takes a nuclear unit offline or keeps a nuclear unit offline, NEIL will pay TVA, after a waiting period, an indemnity (a set dollar amount per week) up to a maximum indemnity of $490 million per unit. This insurance policy may require the payment of retrospective premiums up to a maximum of approximately $30 million.

Decommissioning Costs. Provision for decommissioning costs of nuclear generating units is based on options prescribed by NRC procedures to dismantle and decontaminate the facilities to meet NRC criteria for license termination.

TVA recognizes as incurred all obligations related to closure and removal of its nuclear units. The liability for closure is measured as the present value of the weighted estimated cash flows required to satisfy the related obligation and discounted at the credit adjusted rate of interest in effect at the time the liability was actually incurred or originally accrued. The initial liability calculation was recorded as a decommissioning liability with an offsetting decommissioning asset. Subsequent earnings from decommissioning fund investments, amortization expense of the decommissioning asset, and accretion expense on the decommissioning liability are deferred in accordance with SFAS No. 71, *"Accounting for the Effects of Certain Types of Regulation,"* and recorded as a change in a corresponding regulatory asset.

At September 30, 2008, the present value of the estimated future decommissioning cost of $1.7 billion was included in ASSET RETIREMENT OBLIGATIONS , and the unamortized regulatory asset of $764 million was included in OTHER REGULATORY ASSETS. The actual decommissioning costs may vary from the derived estimates because of, among other things, changes in the assumed dates of decommissioning, changes in regulatory requirements, changes in technology, and changes in the cost of labor, materials, and equipment. Utilities that own and operate nuclear plants are required to use different procedures in calculating nuclear decommissioning costs under SFAS No. 143 than those that are used in calculating nuclear decommissioning costs when reporting to the NRC. The two sets of procedures produce different estimates for the costs of decommissioning primarily because of the difference in the discount rates used to calculate the present value of decommissioning costs. See Note 5.

TVA maintains a nuclear decommissioning trust to provide funding for the ultimate decommissioning of its nuclear power plants. The fund is invested in securities generally designed to achieve a return in line with overall equity market performance. The assets of the fund are invested in debt and equity securities and certain derivative instruments. These derivative instruments are used across various asset classes to achieve a desired investment structure and were comprised of 2,652 contracts with market value losses of $1 million at September 30, 2008. These contracts include futures, forwards, options, options on futures, swap agreements, and options on swap agreements. Investments held in the decommissioning fund are stated at fair value, which is determined by the trustee of the fund. Futures and options on

futures positions are marked to market on a daily basis. The swap agreements are marked to market on a monthly basis. The assets of the fund as of September 30, 2008, totaled $845 million including total losses of $241 million, of which $184 million was unrealized. The assets of the fund as of September 30, 2007, totaled $1.1 billion and reflected total gains of $150 million, of which $80 million was unrealized. The balance as of September 30, 2008, was less than the present value of the estimated future nuclear decommissioning costs under the NRC methodology and under SFAS No. 143. TVA monitors the monetary value of its nuclear decommissioning trust and believes that, over the long term and before cessation of nuclear plant operations and commencement of decommissioning activities, adequate funds from investments will be available to support decommissioning. TVA's nuclear power units are currently authorized to operate until 2020-2036, depending on the unit. It may be possible to extend the operating life of some of the units with approval from the NRC.

Environmental Matters. TVA's activities are subject to certain federal, state, and local environmental statutes and regulations. Major areas of regulation affecting TVA's activities include air quality control, water quality control, and management and disposal of solid and hazardous wastes. Looking to the future, regulations in all of these areas are expected to become more stringent along with increased emphasis on dealing with climate change, expanding renewable generation alternatives, and encouraging efficient use of electricity

Due to the increasing level and complexity of environmental requirements and expectations, TVA completed a new, high-level, environmental policy to align with and execute the direction in the 2007 TVA Strategic Plan. The final TVA Environmental Policy was approved by the TVA Board on May 19, 2008 and is an integrated framework which provides policy-level guidance to carry out TVA's mission by providing cleaner, affordable energy, sustainable economic development, and proactive environmental stewardship. The TVA Environmental Policy sets out environmental objectives and critical success factors in six environmental dimensions: climate change mitigation, air quality improvement, water resource protection and improvement, waste minimization, sustainable land use, and natural resource management.

TVA has incurred and expects to continue to incur substantial capital and operating and maintenance costs in order to comply with evolving environmental requirements primarily associated with, but not limited to, the operation of TVA's 59 coal-fired generating units. It is virtually certain that environmental requirements placed on the operation of these generating units will continue to become more restrictive. Litigation over emissions from coal-fired generating units is also occurring, including litigation against TVA. See *Legal Proceedings* .

The total cost of compliance with future clean air regulations cannot reasonably be determined at this time because of the unknowns and uncertainties surrounding emerging EPA regulations, resultant compliance strategies, and the potential for the development of new emission control technologies, litigation, and future amendments to the Clean Air Act. However, TVA does estimate that spending on emission controls for conventional pollutants in the decade beginning in 2011 could cost between $3.0 billion to $3.7 billion. There could be other substantial costs if reductions of carbon dioxide ("CO_2") are mandated. Predicting how and when CO_2 may be regulated is very difficult, even more so than the future regulation of other substances. TVA will continue to monitor this issue and will assess and respond to potential financial impacts as they become more certain.

TVA's total cost related to emission reduction regulatory programs for sulfur dioxide, nitrogen oxide, and particulates from 1977 through 2010 is expected to reach $5.5 billion, $5.1 billion of which had already been spent as of September 30, 2008.

Liability for releases and cleanup of hazardous substances is primarily regulated by the federal Comprehensive Environmental Response, Compensation, and Liability Act, and other federal and parallel state statutes. In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances over the years. TVA is aware of alleged hazardous-substance releases at 10 non-TVA areas for which it may have some liability. TVA has reached agreements with EPA to settle its liability at two of the non-TVA areas for a total of less than $23,000. There have been no recent assertions of TVA liability for five of the non-TVA areas, and there is little or no known evidence that TVA contributed any significant quantity of hazardous substances to these five sites. There is evidence that TVA sent materials to the remaining three non-TVA areas: the David Witherspoon site in Knoxville, Tennessee, the Ward Transformer site in Raleigh, North Carolina, and the General Waste Products Site in Evansville, Indiana. As discussed below, TVA is not able at this time to estimate its liability related to these sites.

The Witherspoon site is contaminated with radionuclides, polychlorinated biphenyls ("PCBs"), and metals. DOE has admitted to being the main contributor of materials to the Witherspoon site and is currently performing clean-up activities. DOE claims that TVA sent equipment to be recycled at this facility, and there is some supporting evidence for the claim. However, TVA believes it sent only a relatively small amount of equipment and that none of it was radioactive. DOE has asked TVA to "cooperate" in completing the cleanup, but it has not provided to TVA any evidence of TVA's percentage share of the contamination.

The Ward Transformer site is contaminated by PCBs from electrical equipment. EPA and a working group of potentially responsible parties (the "PRP Work Group") have provided documentation showing that TVA sent a limited amount of equipment containing PCBs to the site in 1974. The PRP Work Group is cleaning up on-site contamination in accordance with an agreement with EPA. The cleanup effort has been divided into four areas: two phases of soil cleanup; cleanup of off-site contamination in the downstream drainage basin; and supplemental groundwater remediation. The first phase of soil cleanup is underway, and the high-end cost estimate for this work is about $66 million. There are no reliable estimates for the second phase of soil cleanup or the supplemental groundwater remediation. EPA has selected a cleanup plan for the downstream drainage basin with a present worth cost estimate of $6.1 million.

TVA understands that the EPA has incurred approximately $3 million in past response costs and the PRP Work Group has reimbursed EPA approximately $725,000 of those costs. The PRP Work Group plans to propose a cost allocation schedule which it will use as the basis for offering settlements to PRPs for the first phase of soil cleanup. It plans to sue PRPs who do not settle. There also may be natural resource damages liability at this site, but TVA is not aware of any estimated amount for any such damages. TVA has a potential defense that it only sent useful equipment to Ward and thus is not liable for arranging for disposal of a hazardous substance at the site. This defense is highly fact specific and not likely to be accepted by the PRP Work Group or EPA.

General Waste Products was a scrap metal salvage yard that operated from the 1930s until 1998. The original defendants in a CERCLA action have filed a third party complaint against TVA and others seeking cost contribution for cleanup of contamination from lead batteries and PCB transformers at the facility. There is evidence that TVA sent scrap metal to the facility, but TVA has not found any records indicating that it sent batteries or PCB equipment. There are two cleanup sites at the facility. TVA has been informed that the first site has been cleaned up at a cost of $3.2 million, and cleanup estimates for the second site range from $2 million to $7 million. TVA's allocated share of the cleanup costs, if any, is expected to be relatively small.

TVA operations at some TVA facilities have resulted in oil spills and other contamination TVA plans to address, and TVA expects to incur costs of about $15 million for environmental work related to decommissioning of the Watts Bar Fossil Plant.

As of September 30, 2008, TVA's estimated liability for cleanup and similar environmental work for those sites for which sufficient information is available to develop a cost estimate (primarily the TVA sites) is approximately $18 million on a non-discounted basis, and is included in OTHER LIABILITIES on the Balance Sheet.

Legal Proceedings

TVA is subject to various legal proceedings and claims that have arisen in the ordinary course of business. These proceedings and claims include the matters discussed below. In accordance with SFAS No. 5, *"Accounting for Contingencies,"* TVA had accrued approximately $46 million and $3 million with respect to the proceedings described below as of September 30, 2008 and 2007, respectively, as well as approximately $5 million and $4 million as of September 30, 2008, and 2007, respectively, with respect to other proceedings that have arisen in the normal course of TVA's business. TVA recognized $20 million, $4 million, and $24 million in 2008, 2007, and 2006, respectively, of expense by increasing accruals related to legal proceedings. No assurance can be given that TVA will not be subject to significant additional claims and liabilities. If actual liabilities significantly exceed the estimates made, TVA's results of operations, liquidity, and financial condition could be materially adversely affected.

Global Warming Cases, Southern District of New York . On July 21, 2004, two lawsuits were filed against TVA in the United States District Court for the Southern District of New York alleging that global warming is a public nuisance and that CO_2 emissions from fossil-fuel electric generating facilities should be ordered abated because they contribute to causing the nuisance. The first case was filed by various states (California, Connecticut, Iowa, New Jersey, New York, Rhode Island, Vermont, and Wisconsin) and the City of New York against TVA and other power companies. The second case, which alleges both public and private nuisance, was filed against the same defendants by Open Space Institute, Inc., Open Space Conservancy, Inc., and the Audubon Society of New Hampshire. The plaintiffs do not seek monetary damages, but instead seek a court order requiring each defendant to cap its CO_2 emissions and then reduce these emissions by an unspecified percentage each year for at least a decade. In September 2005, the district court dismissed both lawsuits because they raised political questions that should not be decided by the courts. The plaintiffs appealed to the United States Court of Appeals for the Second Circuit ("Second Circuit"). Oral argument was held before the Second Circuit on June 7, 2006. On June 21, 2007, the Second Circuit directed the parties to submit letter briefs by July 6, 2007, addressing the impact of the Supreme Court's decision in *Massachusetts v. EPA* , 127 S.Ct. 1438 (2007), on the issues raised by the parties. On July 6, 2007, the defendants jointly submitted their letter brief. The Second Circuit is deliberating on its decision.

Case Involving Alleged Violations of the New Source Review Regulations at Bull Run Fossil Plant . The National Parks Conservation Association, Inc. ("NPCA"), and the Sierra Club, Inc. ("Sierra Club") filed suit against TVA on February 13, 2001, in the United States District Court for the Eastern District of Tennessee, alleging that TVA did not comply with the new source review ("NSR") requirements of the CAA when TVA repaired its Bull Run Fossil Plant ("Bull Run"), a coal-fired electric generating facility located in Anderson County, Tennessee. In March 2005, the district court granted TVA's motion to dismiss the lawsuit on statute of limitation grounds. The plaintiffs' motion for reconsideration was denied, and they appealed to the United States Court of Appeals for the Sixth Circuit ("Sixth Circuit"). Friend of the court briefs supporting the plaintiffs' appeal were filed by New York, Connecticut, Illinois, Iowa, Maryland, New Hampshire, New Jersey, New Mexico, Rhode Island, Kentucky, Massachusetts, and Pennsylvania. Several Ohio utilities filed a friend of the court brief supporting TVA. A panel of three judges issued a decision reversing the district court's dismissal on March 2, 2007. TVA's request that the full Sixth Circuit rehear the appeal was denied. The district court trial previously scheduled for September 2, 2008, was postponed, and the district court instead heard oral arguments on the parties' motions for summary judgment on that date. The trial has not yet been rescheduled. TVA is already installing or has installed the control equipment that the plaintiffs seek to require TVA to install in this case, and it is unlikely that an adverse decision will result in substantial additional costs to TVA at Bull Run. An adverse decision, however, could lead to additional litigation and could cause TVA to change its emission control strategy and increase costs. It is uncertain whether there would be significant increased costs to TVA.

Case Involving Opacity at Colbert Fossil Plant . On September 16, 2002, the Sierra Club and the Alabama Environmental Council filed a lawsuit in the United States District Court for the Northern District of Alabama alleging that TVA violated CAA opacity limits applicable to Colbert Fossil Plant ("Colbert") between July 1, 1997, and June 30, 2002. The plaintiffs seek a court order that could require TVA to incur substantial additional costs for environmental controls and pay civil penalties of up to approximately $250 million. After the court dismissed the complaint (finding that the challenged emissions were within Alabama's two percent de minimis rule, which provided a safe harbor if nonexempt opacity monitor readings over 20 percent did not occur more than two percent of the time each quarter), the plaintiffs appealed the district court's decision to the United States Court of Appeals for the Eleventh Circuit ("Eleventh Circuit"). On November 22, 2005, the Eleventh Circuit affirmed the district court's dismissal of the claims for civil penalties but held that the Alabama de minimis rule was not applicable because Alabama had not yet obtained Environmental Protection Agency ("EPA") approval of that rule. The case was remanded to the district court for further proceedings. On April 5, 2007, the plaintiffs moved for summary judgment. TVA opposed the motion and moved to stay the proceedings. On April 12, 2007, EPA proposed to approve Alabama's de minimis rule subject to certain changes. On July 16, 2007, the district court denied TVA's motion to stay the proceedings pending approval of Alabama's de minimis rule. Oral argument on the plaintiffs' motion for summary judgment was held on August 16, 2007. On August 27, 2007, the district court granted the plaintiffs' motion for summary judgment, finding that TVA had violated the CAA at Colbert. The district court held that, while TVA had achieved 99 percent compliance on Colbert Units 1-4 and 99.5 percent compliance at Colbert Unit 5, TVA had exceeded the 20 percent opacity limit (measured in six-minute intervals) more than 3,350 times between January 3, 2000, and September 30, 2002. The district court ordered TVA to submit a proposed remediation plan, which TVA did on October 26, 2007. The plaintiffs responded to TVA's proposed plan, and the district court held a hearing on the plan on December 15, 2008. EPA has approved Alabama's de minimis rule, which will become effective in 2009.

In addition to Colbert, TVA has another coal-fired power plant in Alabama, Widows Creek Fossil Plant ("Widows Creek"), which has a summer net capability of 1,508 megawatts. Since the operation of Widows Creek must meet the same opacity requirements, this plant may be affected by the decision in this case. The recently approved de minimis rule change helps reduce the chances of an adverse effect on Widows Creek from the district court decision.

Case Brought by North Carolina Alleging Public Nuisance . On January 30, 2006, North Carolina filed suit against TVA in the United States District Court for the Western District of North Carolina alleging that TVA's operation of its coal-fired power plants in the States of Tennessee, Alabama, and Kentucky constitute public nuisances. North Carolina is asking the court to impose caps on emissions of certain pollutants from TVA's coal-fired plants that North Carolina considers to be equivalent to caps on emissions imposed by North Carolina law on North Carolina's two largest electric utilities. The imposition of such caps could require TVA to install more pollution controls on a faster schedule than required by federal law. The trial in this case was completed on July 30, 2008. The parties submitted their post-trial filings on September 15, 2008, and a decision will follow at a later time.

Case Arising out of Hurricane Katrina . In April 2006, TVA was added as a defendant to a class action lawsuit brought in the United States District Court for the Southern District of Mississippi by 14 residents of Mississippi allegedly injured by Hurricane Katrina. The plaintiffs sued seven large oil companies and an oil company trade association, three large chemical companies and a chemical trade association, and 31 large companies involved in the mining and/or burning of coal, including TVA and other utilities. The plaintiffs allege that the defendants' greenhouse gas emissions contributed to global warming and were a proximate and direct cause of Hurricane Katrina's increased destructive force. The plaintiffs

are seeking monetary damages among other relief. TVA has moved to dismiss the complaint on grounds that TVA's operation of its coal-fired plants is not subject to tort liability due to the discretionary function doctrine. The district court dismissed the case on the grounds that the plaintiffs lacked standing. The plaintiffs appealed the dismissal to the United States Court of Appeals for the Fifth Circuit, and oral argument was held before a three judge panel in July 2008. A judge on the panel subsequently recused himself from the case, and the case was reargued during the week of November 3, 2008.

East Kentucky Power Cooperative Transmission Case . In April 2003, Warren Rural Electric Cooperative Corporation ("Warren") notified TVA that it was terminating its power contract with TVA. Warren then entered into an arrangement with East Kentucky Power Cooperative ("East Kentucky") under which Warren would become a member of East Kentucky, and East Kentucky would supply power to Warren after its power contract with TVA expires in 2009. East Kentucky asked to interconnect its transmission system with the TVA transmission system in three places that are currently delivery points through which TVA supplies power to Warren. TVA did not agree and East Kentucky asked FERC to order TVA to provide the interconnections. In January 2006, FERC issued a final order directing TVA to interconnect its transmission facilities with East Kentucky's system at three locations. TVA appealed the FERC order in the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") seeking review of this order on the grounds that this order violated the anti-cherrypicking provision. On January 10, 2007, TVA and Warren executed an agreement under which Warren rescinded its notice of termination. FERC terminated the proceeding but did not vacate its previous order. On January 17, 2008, TVA filed an unopposed motion to dismiss the D.C. Circuit appeal as moot. The D.C. Circuit dismissed the case on January 29, 2008 .

Case Involving AREVA Fuel Fabrication . On November 9, 2005, TVA received two invoices totaling $76 million from Framatome ANP Inc., which subsequently changed its name to AREVA NP Inc. ("AREVA"). AREVA asserted that it was the successor to the contract between TVA and Babcock and Wilcox Company ("B&W") under which B&W would provide fuel fabrication services for TVA's Bellefonte Nuclear Plant. AREVA's invoices were based upon the premise that the contract required TVA to buy more fuel fabrication services from B&W than TVA actually purchased. In September 2006, TVA received a formal claim from AREVA which requested a Contracting Officer's decision pursuant to the Contract Disputes Act of 1978 and reduced the amount sought to $26 million. On April 13, 2007, the Contracting Officer issued a final decision denying the claim. On April 19, 2007, AREVA filed suit in the United States District Court for the Eastern District of Tennessee, reasserting the $26 million claim and alleging that the contract required TVA to purchase certain amounts of fuel and/or to pay a cancellation fee. TVA filed its answer to the complaint on June 15, 2007. AREVA subsequently raised its claim to $48 million. Trial on the question of liability was scheduled to begin on September 22, 2008, but has been reset for April 20, 2009. A second trial on the question of damages will be held later, if necessary. TVA and AREVA have negotiated the terms of a settlement agreement. This agreement is contingent on approval by the TVA Board. The parties have scheduled a meeting with an independent third-party on December 16, 2008, to review the proposed settlement agreement.

Notification of Potential Liability for Ward Transformer Site . The Ward Transformer site is contaminated by PCBs from electrical equipment. EPA and a working group of potentially responsible parties (the "PRP Work Group") have provided documentation showing that TVA sent a limited amount of equipment containing PCBs to the site in 1974. The PRP Work Group is cleaning up on-site contamination in accordance with an agreement with EPA. The cleanup effort has been divided into four areas: two phases of soil cleanup; cleanup of off-site contamination in the downstream drainage basin; and supplemental groundwater remediation. The first phase of soil cleanup is underway, and the high-end cost estimate for this work is about $66 million. There are no reliable estimates for the second phase of soil and cleanup or the supplemental groundwater remediation, although EPA has selected a cleanup plan for the downstream drainage basin with a present worth cost estimate of $6 million. TVA understands that EPA has incurred approximately $3 million in past response costs, and the PRP Work Group has reimbursed EPA approximately $725,000 of those costs. The PRP Work Group plans to propose a cost allocation schedule which it will use as the basis for offering settlements to PRPs for the first phase of soil cleanup. It plans to sue PRPs who do not settle. There also may be natural resource damages liability at this site, but TVA is not aware of any estimated amount for any such damages. TVA has a potential defense that it only sent useful equipment to Ward and thus is not liable for arranging for disposal of a hazardous substance at the site.

Case Involving the General Waste Products Sites . In July 2008, a third-party complaint under CERCLA was filed against TVA in the District Court for the Southern District of Indiana, alleging that TVA, and several other defendants, disposed of hazardous materials at the General Waste Products sites in Evansville, Indiana. TVA was named in the complaint based on allegations that TVA arranged for the disposal of contaminated materials at the sites. The other third-party defendants are General Waste Products, General Electric Company, Indianapolis Power and Light, National Tire and Battery, Old Ben Coal Co., Solar Sources Inc., Whirlpool, White County Coal, PSI, Tell City Electric Department, Frontier Kemper, Speed Queen, Allan Trockman (the former operator of the site), and the City of Evansville. This action was

brought by the Evansville Greenway PRP Group, a group of entities who are currently being sued in the underlying case for disposing of hazardous materials at the sites, in order to require the third-party defendants to contribute to, or pay for, the remediation of the sites. The complaint also includes a claim under state law against the defendants for the release of hazardous materials. TVA has found no records indicating that it arranged for disposal of these types of hazardous substances at the sites. TVA filed its answer to the complaint on October 29, 2008.

Completion of Browns Ferry Unit 1, Team Incentive Fee Pool Claims . Under the contracts for the restart of TVA's Browns Ferry Unit 1, TVA and two engineering and construction contractors, Bechtel Power Corporation ("Bechtel") and Stone & Webster Construction, Inc. ("Stone and Webster"), are to share in a team incentive fee pool funded from cost savings based on underruns in the budgets for their respective work scopes. The contracts provide that the fee pool could not exceed $100 million regardless of the actual savings involved, and the savings would be allocated as follows: 90 percent of the first $40 million would be given to the contractors, and any amount over $40 million would be split equally among TVA and the two contractors. Thus, if the maximum cost savings of $100 million had been attained, each contractor's payment from this pool would have been $38 million, for a total payout under both contracts of $76 million with the remaining $24 million being credited to TVA. The contractors have taken the position that they should each receive the maximum payment. In 2008, Bechtel agreed to settle its team incentive fee claim for a payment of $15 million, conditioned upon Bechtel receiving an additional payment equal to any amount over $15 million that Stone and Webster receives in resolution of its team incentive fee claim. TVA and Stone and Webster mediated the team incentive fee claim (as well as other claims) in May 2008 and discussions with Stone and Webster are continuing . On August 20, 2008, the TVA Board approved a proposed settlement with Stone and Webster, contingent on Stone and Webster agreeing to certain conditions. Stone and Webster has not agreed to the conditions. It is reasonably possible that TVA could incur some potential liability in excess of the amount previously calculated by TVA, and TVA has created a reserve for the additional amount.

Paradise Fossil Plant Clean Air Act Permit . On December 21, 2007, the Sierra Club, the Center for Biological Diversity, Kentucky Heartwood, and Hilary Lambert filed a petition with EPA raising objections to the conditions of TVA's current CAA permit at the Paradise Fossil Plant ("Paradise"). Among other things, the petitioners allege that activities at Paradise triggered the NSR requirements for NO_x and that the monitoring of opacity at Units 1 and 2 of the plant is deficient. The current permit continues to remain in effect. It is unclear whether or how the plant's permit might be modified as a result of this proceeding.

Employment Proceedings . TVA is engaged in various administrative and legal proceedings arising from employment disputes. These matters are governed by federal law and involve issues typical of those encountered in the ordinary course of business of a utility. They may include allegations of discrimination or retaliation (including retaliation for raising nuclear safety or environmental concerns), wrongful termination, and failure to pay overtime under the Fair Labor Standards Act. Adverse outcomes in these proceedings would not normally be material to TVA's results of operations, liquidity, and financial condition, although it is possible that some outcomes could require TVA to change how it handles certain personnel matters or operates its plants.

Information Request from EPA . On April 25, 2008, TVA received a request from EPA under section 114 of the CAA requesting extensive information about projects at and the operations of 14 of TVA's 59 coal-fired units. These 14 units are located in the States of Alabama, Kentucky, and Tennessee. This request for information is similar to but broader than section 114 requests that other companies have received during EPA's NSR enforcement initiative. TVA has responded to this request. EPA's request could be the first step in an administrative proceeding against TVA that could then result in litigation in the courts.

Notice of Violation at Widows Creek Unit 7 . On July 16, 2007, TVA received a Notice of Violation ("NOV") from EPA alleging that TVA failed to properly maintain ductwork at Widows Creek Unit 7 and other violations. TVA repaired the ductwork in 2005. While the NOV does not set out an administrative penalty, it is likely that EPA may seek a monetary sanction through giving up emission allowances, paying an administrative penalty, or both. TVA and the State of Alabama entered into an agreed order in which TVA agreed to pay the state $100,000. TVA is unable to estimate the amount of potential monetary sanctions from EPA for which TVA may be liable in connection with the NOV.

Administrative Proceeding Regarding Bellefonte Nuclear Plant Units 3 and 4 . TVA submitted its COLA to NRC for Bellefonte Nuclear Plant ("Bellefonte") Units 3 and 4 in October 2007. If approved, the license to build and operate the plant would be issued to TVA. Obtaining the necessary license would give TVA more certainty about the cost and schedule of a nuclear option for future decisions. The COLA for two AP1000 reactors at Bellefonte was officially docketed by NRC on January 18, 2008, indicating the NRC found it complete and technically sufficient to support NRC's more detailed reviews.

On June 6, 2008, a joint petition for intervention and a request for a hearing submitted to the NRC by the Bellefonte Efficiency and Sustainability Team, the Blue Ridge Environmental Defense League, and the Southern Alliance for Clean Energy. The petition raised 19 potential contentions with respect to TVA's COLA. Both TVA and the NRC staff opposed the admission of the petitioners' proposed contentions, and, as a result, the admission of the petitioners as parties to the proceeding. Additionally, TVA opposed the admission of one of the petitioners to the proceeding on the grounds that it lacked standing. The Atomic Safety and Licensing Board presiding over the proceeding subsequently denied standing to one of the petitioners and accepted four of the 19 contentions submitted by the remaining two petitioners. A hearing on these admitted contentions will be conducted in the future. The admitted contentions involve questions about the estimated costs of the new nuclear plant, the storage of low-level radioactive waste, and the impact of the facility's operations, in particular the plant intake, on aquatic species. Other COLA applicants have received similar petitions raising similar potential contentions.

The TVA Board has not made a decision to construct new plant units at the Bellefonte site, and TVA continues to evaluate all nuclear generation options at the site.

Significant Litigation to Which TVA Is Not a Party . On April 2, 2007, the Supreme Court issued an opinion in the case of *United States v. Duke Energy*, vacating the ruling of the United States Court of Appeals for the Fourth Circuit ("Fourth Circuit") in favor of Duke Energy and against EPA in EPA's NSR enforcement case against Duke Energy. The NSR regulations apply primarily to the construction of new plants but can apply to existing plants if a maintenance project (1) is "non-routine" and (2) increases emissions. The Supreme Court held that under EPA's Prevention of Significant Deterioration regulations, increases in annual emissions should be used for the test, not hourly emissions as utilities, including TVA, have argued should be the standard. Annual emissions can increase when a project improves the reliability of plant operations and, depending on the time period over which emission changes are calculated, it is possible to argue that almost all reliability projects increase annual emissions. Neither the Supreme Court nor the Fourth Circuit addressed what the "routine" project test should be. The United States District Court for the Middle District of North Carolina had ruled for Duke Energy on this issue, holding that "routine" must take into account what is routine in the industry and not just what is routine at a particular plant or unit as EPA has argued. EPA did not appeal this ruling. On October 5, 2007, EPA filed a motion with the United States District Court for the Middle District of North Carolina asking that court to vacate its entire prior ruling, including the portion relating to the test for "routine" projects.

TVA is currently involved in an NSR case involving Bull Run, which is discussed in more detail above. The Supreme Court's rejection of the hourly standard for emissions testing could undermine one of TVA's defenses in the Bull Run case, although TVA has other available defenses. Environmental groups and North Carolina have given TVA notice in the past that they may sue TVA for alleged NSR violations at a number of TVA units. The Supreme Court's decision could encourage such suits, which are likely to involve units where emission control systems such as scrubbers and selective catalytic reduction systems are not installed, under construction, or planned to be installed in the relatively near term.

Significant Litigation to Which TVA Is Not a Party, Case Involving North Carolina's Petition to EPA . In 2005, North Carolina petitioned EPA under Section 126 of the CAA to impose additional emission reduction requirements for SO_2 and NO_x on coal-fired power plants in 13 states, including the states where TVA's coal-fired power plants are located. In March 2006, EPA denied the North Carolina petition primarily on the basis that CAIR remedies the problem. In June 2006, North Carolina filed a petition for review of EPA's decision with the D.C. Circuit. On October 1, 2007, TVA filed a friend of the court brief in support of EPA's decision to deny North Carolina's Section 126 petition. The D.C. Circuit ordered the parties, including TVA, to file new briefs in the case and to address what should happen if the court vacates CAIR.

16. Related Parties

TVA is a wholly-owned corporate agency of the federal government, and because of this relationship, TVA's revenues and expenses are included as part of the federal budget. TVA's purpose and responsibilities as an agency are described under the "Other Agencies" section of the federal budget.

TVA currently receives no appropriations from Congress and funds its business using generated power system revenues, power financings, and other revenues. TVA is a source of cash to the federal government. Until TVA meets its remaining obligation to pay $110 million of the Power Facility Appropriation Investment under the TVA Act, TVA will continue to repay a portion of the Power Facility Appropriation Investment in the TVA power system. TVA will also continue to pay a return on the outstanding balance of this investment indefinitely. See Note 9 — *Appropriation Investment.*

TVA has access to financing arrangements with the U.S. Treasury, whereby the U.S. Treasury is authorized to accept interim obligations with maturities of one year or less in an aggregate amount outstanding not to exceed $150 million. There was no outstanding balance at September 30, 2008 or 2007 related to the financing arrangement. In 2009, TVA and the U.S. Treasury replaced the $150 million note under which TVA previously borrowed from the U.S. Treasury with a memorandum of understanding under which TVA has a $150 million credit facility.

In the normal course of business, TVA contracts with other federal agencies for sales of electricity and other services. Transactions with agencies of the federal government were as follows:

	Related Party Transactions For the years ended, or as of, September 30		
	2008	2007	2006
Sales of electricity services	$ 187	$ 188	$ 181
Other revenues	42	47	24
Other expenses	231	237	226
Receivables at September 30	19	19	21
Payables at September 30	60	126	123
Return on Power Facility Appropriation Investment	20	20	18
Repayment of Power Facility Appropriation Investment	20	20	20

17. Unaudited Quarterly Financial Information

A summary of the unaudited quarterly results of operations for the years 2008 and 2007 follows. This summary should be read in conjunction with the audited financial statements appearing herein. Results for interim periods may fluctuate as a result of seasonal weather conditions, changes in rates, and other factors. The increased net income in the fourth quarter of 2008 was primarily due to a one-time decrease to depreciation, amortization, and accretion expense for a change in accounting for non-nuclear asset retirement obligations of $350 million. See Note 6 — *Non-Nuclear Decommissioning Costs* .

Unaudited Quarterly Financial Information

	2008				
	First	Second	Third	Fourth	Total
Operating revenues	$ 2,360	$ 2,518	$ 2,552	$ 2,952	$ 10,382
Operating expenses	2,012	2,041	2,111	2,034	8,198
Operating income	348	477	441	918	2,184
Net income	8	135	100	574	817

	2007				
	First	Second	Third	Fourth	Total
Operating revenues	$ 2,126	$ 2,259	$ 2,265	$ 2,676	$ 9,326
Revenue capitalized during pre-commercial plant operations	–	–	23	34	57
Operating expenses	1,785	1,875	1,837	2,229	7,726
Operating income	341	384	405	413	1,543
Net income	70	111	214	28	423

18. Subsequent Events

Debt

In October 2008, TVA issued $15 million of electronotes ® with an interest rate of 5.00 percent which mature in 2024 and are callable beginning in 2012.

In November 2008, TVA issued $7 million of electronotes ® with an interest rate of 5.25 percent which mature in 2029 and are callable beginning in 2013.

On November 13, 2008, TVA redeemed $2 billion of a maturing power bond which had a coupon of 5.38 percent.

In December 2008, TVA issued $18 million of electronotes ® with an interest rate of 5.00 percent which mature in 2029 and are callable beginning in 2013.

Credit Facility Agreements

The $150 million note with U.S. Treasury expired at the end of 2008. In December 2008, TVA and the U.S. Treasury replaced the $150 million note with a memorandum of understanding under which TVA will have a $150 million credit facility. TVA plans to use the U.S. Treasury credit facility as a source of liquidity, but not as a primary source of liquidity, in 2009.

In November 2008, TVA renewed the national bank credit facility with the November 10, 2008 maturity date. The new maturity date for this credit facility is November 9, 2009. When TVA renewed its November maturity credit facility, TVA reduced the amount of the facility from $1.25 billion to $1 billion. Management believes that TVA's liquidity position has not materially changed with the reduced amount of the November maturity credit facility.

Impacts of Recent Financial Market Conditions on Investment Portfolios

Financial markets have experienced significant uncertainty in recent months due to deteriorating economic conditions. The uncertainty has resulted in significantly lower market valuations for many investments. TVA's investment portfolios contain a variety of diversified investments, including securities directly impacted by these events. The impact of these events on TVARS and nuclear decommissioning trust investment portfolios is reflected in changes in these portfolio values from September 30, 2008, to November 30, 2008, which are outlined in the following table:

Summary of Impacts of Recent Financial Market Conditions on Investment Portfolios

	2008			
	September 30*	October 31*	November 30*	Percent Change From November 30, 2008 to September 30, 2008
Retirement System	$ 6,188	$ 5,298	$ 4,973	(18)%
Nuclear Decommissioning Trust	845	688	639	(24)%

* Investment balances at September 30, 2008, as reported in Notes 14 and 15. Investment balances at October 31, 2008, are based on final trustee statements, and investment balances at November 30, 2008, are based on preliminary trustee balances.

During the period of September 30, 2008, through November 30, 2008, the change in the Standard & Poor's 500 benchmark index was a decrease of 23 percent.

As a result of an unprecedented inversion of the swap yield curve and volatility in global financial markets, coupled with a decrease in swap rates to historically low rates, beginning December 1, 2008, TVA was required to post collateral with a counterparty under the terms of the 2003A Swaption agreement. At November 30, 2008, the value of the 2003A Swaption was such that TVA posted $343 million with a custodian for benefit of the counterparty.

Summary of Impacts of Recent Commodity Market Conditions

The commodity markets have also experienced volatility in recent months. The changes in these prices from September 30, 2008, to November 30, 2008, are outlined in the following table:

Commodity Pricing Table

Commodity	Prices As of November 30, 2008	Prices As of September 30, 2008	Percent Change
Natural Gas (Henry Hub, $/mmBtu)	$ 6.71	$ 9.01	(26)%
Fuel Oil (Gulf Coast, $/mmBtu)	12.20	21.38	(43)%
Coal (FOB mine $/ton)	58.76	48.13	22%
Electricity (Into-TVA, $/MWh)			
On-Peak (5 days x 16 hours)	38.00	70.95	(46)%
Off-Peak (5 days x 8 hours)	34.75	38.40	(10)%

Renewable Energy Request for Proposal

In December 2008, TVA issued a request for proposal ("RFP") seeking proposals which may result in TVA obtaining both dispatchable capacity and as-available energy from renewable energy sources, clean energy sources, or sources that are considered to be both renewable and clean energy sources.

- The RFP seeks proposals for the supply to TVA of up to a total of 500 megawatts of dispatchable capacity capable of being delivered by June 1, 2009, increasing to up to a total of 750 megawatts of dispatchable capacity capable of being delivered as of June 1, 2010, and further increasing to up to a total of 1,000 megawatts of dispatchable capacity capable of being delivered as of June 1, 2011.

- In addition, the RFP seeks proposals for the supply to TVA of up to a total of 500 megawatts of as-available energy capable of being delivered by June 1, 2009, increasing to up to a total of 750 megawatts of as-available energy capable of being delivered as of June 1, 2010, and further increasing to up to a total of 1,000 megawatts of as-available energy capable of being delivered as of June 1, 2011.

TVA expects to receive proposals in response to the RFP in January 2009.

REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors of Tennessee Valley Authority

We have audited the accompanying balance sheet of Tennessee Valley Authority as of September 30, 2008, and the related statements of income, changes in proprietary capital, and cash flows for the year then ended. Our audit also included the financial statement schedule listed in the Index at Item 15(a) for the year ended September 30, 2008. These financial statements and schedule are the responsibility of Tennessee Valley Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tennessee Valley Authority at September 30, 2008 and the consolidated results of its operations and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles. Also, in our opinion the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein for the year ended September 30, 2008.

/s/ Ernst & Young, LLP
Chattanooga, Tennessee
December 15, 2008

To the Board of Directors of Tennessee Valley Authority:

In our opinion, the accompanying balance sheet and the related statements of income, of changes in proprietary capital and of cash flows present fairly, in all material respects, the financial position of Tennessee Valley Authority at September 30, 2007, and the results of its operations and its cash flows for each of the two years in the period ended September 30, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, effective September 30, 2006, Tennessee Valley Authority adopted Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations--an Interpretation of FASB Statement No. 143.*

/s/ PricewaterhouseCoopers LLP
Atlanta, Georgia
December 10, 2007, except with respect to the matter disclosed in Note 2 of the Tennessee Valley Authority Form 10-K/A Amendment No. 2 as to which the date is November 21, 2008

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not Applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

An evaluation has been performed under the supervision of TVA management (including the president and chief executive officer) and members of the disclosure control committee (including the chief financial officer and the vice president and controller) of the effectiveness of the design and operation of TVA's disclosure controls and procedures as of September 30, 2008. Based on that evaluation, the president and chief executive officer and members of the disclosure control committee (including the chief financial officer and the vice president and controller) concluded that TVA's disclosure controls and procedures were not effective as of September 30, 2008, to ensure that information required to be disclosed in reports TVA files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms solely because as of September 30, 2008, TVA had not yet filed its quarterly report on Form 10-Q for the quarter ended June 30, 2008. TVA was unable to file this quarterly report in a timely manner because at the time the report was due, TVA was in the process of restating previously filed financial statements to correct errors in TVA's estimates of unbilled revenue.

Internal Control Over Financial Reporting

(a) Management's Annual Report on Internal Control Over Financial Reporting

TVA's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act Rule 13a-15(f) for TVA. TVA's internal control over financial reporting is designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. Because of the inherent limitations in all control systems, TVA management believes that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met and that all control issues and instances of fraud, if any, within a company can be detected.

TVA's management evaluated the design and effectiveness of TVA's internal control over financial reporting as of September 30, 2008 based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that TVA's internal control over financial reporting was effective as of September 30, 2008.

This Annual Report does not include an attestation report of TVA's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by TVA's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit TVA to provide only management's report in this Annual Report.

(b) Changes in Internal Control over Financial Reporting

During the most recent fiscal quarter, there were changes in TVA's internal control over financial reporting that materially affected, or are reasonably likely to materially affect, TVA's internal control over financial reporting. In particular, during the fourth quarter of 2008 and prior to TVA's filing of its quarterly report on Form 10-Q for the quarter ended June 30, 2008, TVA both identified and remediated a material weakness in internal controls related to TVA's unbilled revenue estimates.

Identification of Material Weakness. TVA management identified a material weakness in internal controls related to TVA's unbilled revenue estimates. The estimation process implemented in September 2006 utilized the distributors' average rates and an estimate of the number of days of revenue outstanding to reflect the delay in reporting the end-use sales to TVA ("days outstanding"). The number of days outstanding was derived using a procedure similar to a cross-correlation calculation that compared the monthly retail load to the monthly wholesale load. The intent was to reflect in the unbilled estimate the end-use sales that would be reported that month by distributors plus any remaining sales that would not be reported until the following month due to the delay between wholesale delivery and end-use reporting.

TVA has determined that the process implemented in September 2006 overestimated the days outstanding and that this overestimation resulted in an error in recording unbilled revenue and unbilled receivables. The previous unbilled process also failed to consider the annual true-up of each distributor's reported distribution losses. The annual true-up reconciles total end-use kilowatt-hour ("kWh") sales and revenue reported by each distributor with the kWh sales recorded for each distributor at wholesale.

Remediation of Material Weakness. TVA has used a new process for estimating unbilled revenue for periods presented in this Annual Report. This process carries over only the portion of sales from the distributor's meter read date to the month-end. Those sales, along with the current month sales, are then priced at rates based on each distributor's customer and product mix. Additionally, the true-up component has been added to the unbilled calculation to reflect any timing differences that occur between the retail and wholesale billing cycles.

ITEM 9B. OTHER INFORMATION

Approval of 2009 Winning Performance Balanced Scorecard

During its December 11, 2008, public meeting, the TVA Board approved TVA's 2009 Winning Performance Balanced Scorecard, which is used to determine the annual incentive of all participants in the Executive Annual Incentive Plan ("EAIP"), as well as all other TVA employees who participate in TVA's Winning Performance Team Incentive Plan. EAIP participants include Tom D. Kilgore, Kimberly S. Greene, William R. Campbell, William R. McCollum, Jr., and Ashok S. Bhatnagar (the "Named Executive Officers"). The performance measures, weights, and goals which will be used to determine payouts for the EAIP are set forth below:

TVA's 2009 Winning Performance Measures

		Goals		
Performance Measure	**Weight**	**Threshold**	**Target**	**Maximum**
TVA Connection Point Interruptions (Interruptions/Connection Point)	20%		1.12	0.78
TVA Net Cash Flow From Operations less Investing ($ Millions)	35%	Budget less Revenue Adjustment	Budget	Exceed Budget by $50M
TVA Demand Reduction ($/kW Reduced)	10%	643	611	582
TVA Equivalent Availability Factor – Coal, Combined Cycle & Nuclear (Percent)	35%	85.8	87.1	88.0

The 2009 TVA Winning Performance Balanced Scorecard represents 30 percent of the potential payout under the EAIP for 2009 for the Named Executive Officers. Of the remaining 70 percent, (1) 30 percent is tied, in the case of Mr. Campbell and Mr. Bhatnagar, to the performance of their respective business units or, in the case of Mr. Kilgore, Ms. Greene, and Mr. McCollum, to a composite average of the performance of all TVA business units, (2) 30 percent is tied to the achievement of individual goals, and (3) 10 percent is tied to the assessment of the executive's performance during 2009 by the Chief Executive Officer or, in the case of Mr. Kilgore, by the TVA Board.

Awards earned under the EAIP for 2009 will be calculated as the product of (1) base salary, (2) the annual incentive opportunity, and (3) the percent of opportunity achieved. For 2009, the base salary and annual incentive opportunity are $850,000 and 100 percent for Mr. Kilgore, $525,000 and 70 percent for Ms. Greene, $493,218 and 75 percent for Mr. Campbell, $745,514 and 70 percent for Mr. McCollum, and $456,246 and 60 percent for Mr. Bhatnagar, and the percent of opportunity achieved for each Named Executive Officer is determined in accordance with the methodology described in the preceding paragraph.

The TVA Board has reserved to itself the authority to approve an adjustment to payout levels generated by the 2009 Winning Performance Balanced Scorecard results if the TVA Board determines such adjustments are warranted.

Changes to Executive Long Term-Incentive Plan

During its December 11, 2008, public meeting, the TVA Board revised TVA's Executive Long-Term Incentive Plan (the "ELTIP") by adding a non-fuel operations and maintenance metric for the performance cycles ending on or after September 30, 2011. This metric deals with non-fuel operations and maintenance costs, which represent a controllable component of TVA's costs. The targets for this metric are as follow:

- The threshold goal will be based on improvement over the last performance cycle,
- The target goal is TVA ranking at or above the 50th percentile of the peer group utilities' benchmark performance, and
- The maximum performance goal is TVA ranking at or above the 75th percentile of the peer group utilities' benchmark performance.

The other performance metrics remain unchanged. For a discussion of these metrics and the general terms of ELTIP (see Item 11, Executive Compensation — *Compensation Discussion and Analysis)* .

The TVA Board has reserved to itself the authority to review TVA results and peer group comparison at the end of any ELTIP performance cycle and to approve adjustments in ELTIP payouts if the TVA Board determines such adjustments are warranted.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors

TVA is administered by a board of nine part-time members appointed by the President of the United States with the advice and consent of the Senate. The Chairman of the TVA Board is selected by the members of the TVA Board.

The TVA Board at December 16, 2008, consisted of the following individuals with their ages and terms of office provided:

Directors	Age	Year Appointed	Year Term Expires
William B. Sansom, Chairman	67	2006	2009
Bishop William Graves	72	2008	2012
Donald R. DePriest	69	2006	2009
Howard A. Thrailkill	69	2006	2010
Dennis C. Bottorff	64	2006	2011
Robert M. Duncan	57	2006	2011
Thomas C. Gilliland	60	2008	2011

There are currently two vacant positions on the TVA Board, and President Bush has nominated Susan Richardson Williams and Michael B. Bemis to fill these positions.

Mr. Sansom of Knoxville, Tennessee, joined the TVA Board in March 2006 and was elected Chairman by the TVA Board in March 2006. He is Chairman and Chief Executive Officer of The H.T. Hackney Co., a diversified company involved in wholesale grocery, gas and oil, and furniture manufacturing, and has held that position since 1983. Since 1995, Mr. Sansom has also been a director of Astec Industries, Inc., a corporation based in Chattanooga, Tennessee, that manufactures equipment and components used in road construction, and since 1984, he has been a director at First Horizon National Corporation, a Memphis, Tennessee, bank holding company. In 2006, he was named a director of Mid-America Apartment Communities, Inc., a real estate investment trust with ownership interests in apartment homes. From 1994 to 2006, he was a director of Martin Marietta Materials, Inc., a company based in Raleigh, North Carolina, that supplies minerals, chemicals, and composites for various industries.

Bishop Graves of Memphis, Tennessee, served on the TVA Board from October 2006 to December 2007 and was reappointed to the TVA Board in June 2008. He has been presiding Bishop of the Christian Methodist Episcopal Church in Memphis, Tennessee since being elected at the 2006 General Conference held in June to July 2006. Previously, he was pastor of the Phillips Temple CME Church of Los Angeles, California. He is the immediate Past President of the Board of the National Congress of Black Churches, and from September 1993 to July 2004 Bishop Graves was a member of the Board of Memphis Light, Gas and Water, a TVA distributor customer.

Mr. DePriest of Columbus, Mississippi, joined the TVA Board in March 2006. He is Chairman of MCT Investors L.P. an Alexandria, Virginia, venture capital firm that he founded in 1987 and that develops telecommunications and healthcare ventures. He has founded other companies, including Boundary Healthcare Products Corporation in 1987, where he served as Chairman until 1992. He also founded Charisma Communications Corporation in 1982, a telecommunications company, where he served as Chairman and President.

Mr. Thrailkill of Huntsville, Alabama, joined the TVA Board in March 2006. He retired in September 2005 as President and Chief Operating Officer of Adtran, Inc., in Huntsville, which supplies equipment for telecommunications service providers and corporate end-users. He joined Adtran, Inc., in 1992.

Mr. Bottorff of Nashville, Tennessee, joined the TVA Board in March 2006. Since January 2001, he has served as Partner of Council Ventures, a venture capital firm. He was Chairman of AmSouth Bancorporation until his retirement in 2001 and from 1991 to 1999 was Chief Executive Officer of First American Bank. He served as a director of Dollar General, a variety store company, from 1998 until its sale in 2007. In addition, he is a director of Ingram Industries, a privately held provider of wholesale distribution, inland marine transportation, and insurance services; a director of Benefit Informatics, a company which provides information used to improve the quality and reduce the cost of health care; and a member of the Board of Trustees of Vanderbilt University.

Mr. Duncan of Inez, Kentucky, joined the TVA Board in March 2006. He is the Chairman, Chief Executive Officer, and Director of Inez Deposit Bank, FSB in Louisa, Kentucky (since April 1984, with a one-year leave of absence from 1989 to 1990 to serve as Assistant Director of Public Liaison in the White House); Chairman, Chief Executive Officer, and Director of Inez Deposit Bank in Inez, Kentucky (since September 1974 with a one-year leave of absence); Chairman, Chief Executive Officer, and Director of Community Holding Company, a single-bank holding company (since 1984 with a one-year leave of absence); Chairman, Chief Executive Officer, and Director of Community Thrift Holding Company, a unitary thrift holding company (since 1999); and Chairman of the Republican National Committee since (January 2007). From 1998 to 2007, Mr. Duncan was the Chairman of the Big Sandy Regional Industrial Development Authority, which manages industrial parks in five eastern Kentucky counties, and he is also the Secretary for the Highlands Regional Medical Center in Prestonburg, Kentucky, which manages a regional hospital.

Mr. Gilliland of Blairsville, Georgia, joined the Board in March 2008. From April 1994 to January 2008, Mr. Gilliland served as Executive Vice President, Secretary, General Counsel, and Director of United Community Banks, Inc., a bank holding company with assets of approximately $8.0 billion.

Ms. Williams of Knoxville, Tennessee, age 63, served on the TVA Board from March 2006 to December 2007. She has been nominated for a second term. Since June 2004, she has been the owner of Susan Williams Public Affairs in Knoxville, Tennessee, and is affiliated with SRW & Associates, where, along with five other independent contractors involved with SRW & Associates, she provides public relations consulting services for various clients. From 1999 to 2004, she managed the Knoxville, Tennessee, office of the Ingram Group, a statewide public-relations firm.

Mr. Bemis of Madison, Mississippi, age 61, has been nominated by the Honorable George W. Bush, the President of the United States, to a position on the TVA Board. He is the former president of Exelon Energy Delivery, a position he held from August 2002 to September 2004. He has also been a senior vice president of Exelon Corp., and president of Exelon Power. Other companies at which he has held executive positions include Master Graphics Inc.; Entergy Corp.; Louisiana Power & Light; and Mississippi Power & Light.

Executive Officers

TVA's executive officers as of December 16, 2008, their titles, their ages, and the date their employment with TVA commenced are as follows:

Executive Officers	Title	Age	Employment Commenced
Tom D. Kilgore	President and Chief Executive Officer	60	2005
Kimberly S. Greene	Chief Financial Officer & Executive Vice President, Financial Services	42	2007
William R. McCollum, Jr.	Chief Operating Officer	57	2007
Maureen H. Dunn	Executive Vice President and General Counsel	59	1978
William R. Campbell	Chief Nuclear Officer and Executive Vice President	57	2007
John E. Long, Jr.	Chief Administrative Officer and Executive Vice President, Administrative Services	56	1980
Kenneth R. Breeden	Executive Vice President, Customer Resources	60	2004
Robin E. Manning	Executive Vice President, Power System Operations	52	2008
Preston D. Swafford	Executive Vice President, Fossil Power Group	48	2006
Van M. Wardlaw	Executive Vice President, Power Supply and Fuels	48	1982
Ashok S. Bhatnagar	Senior Vice President, Nuclear Generation Development and Construction	52	1999
Peyton T. Hairston, Jr.	Senior Vice President, Corporate Responsibility and Diversity	53	1993
Janet C. Herrin	Senior Vice President, River Operations	54	1978
John M. Hoskins	Senior Vice President and Treasurer	53	1978
Donald E. Jernigan	Senior Vice President, Nuclear Operations	52	2008
Anda A. Ray	Senior Vice President, Office of Environment and Research	52	1983
Emily J. Reynolds	Senior Vice President, Communications, Government and Valley Relations	52	2007
John J. McCormick, Jr.	Senior Vice President, Fossil Operations	47	2007
John M. Thomas, III	Vice President and Controller	45	2005

Mr. Kilgore was named President and Chief Executive Officer in October 2006 after having served as President and Chief Operating Officer since joining TVA in March 2005. He previously served as President and Chief Executive Officer of Progress Energy Ventures, a subsidiary of Progress Energy Company created to manage various operations of Progress Energy Company, including fuel extraction and energy marketing, from April 2000 to February 2005. Prior to taking that position, Mr. Kilgore had been Senior Vice President of Power Operations for Carolina Power & Light (which became Progress Energy) since August 1998. From 1991 to 1998, Mr. Kilgore was President and Chief Executive Officer of Oglethorpe Power Corporation in Atlanta, Georgia.

Ms. Greene was named Chief Financial Officer and Executive Vice President, Financial Services in September 2007. Ms. Greene previously served as Senior Vice President, Finance, and Treasurer at Southern Company Services, an energy company, from July 2003 to September 2007, where she was responsible for financial planning and analysis, capital markets and leasing, treasury, and investor relations. From July 2002 to July 2003, Ms. Greene was director of portfolio management for Southern Company Generation and Energy Marketing.

Mr. McCollum joined TVA in May 2007 as Chief Operating Officer. Prior to joining TVA, Mr. McCollum was Executive Vice President and Chief Regulated Generation Officer at Duke Energy Corporation, an energy company, from October 2006 to May 2007. Mr. McCollum had been with Duke Energy Corporation (and its predecessor) since 1974 and held a variety of leadership positions there, including Group Vice President, Regulated Fossil-Hydro Generation (from April 2006 to October 2006), Vice President, Strategic Planning and Business Development (from January 2005 to April 2006), and Vice President, Nuclear Support (from November 2002 to December 2004).

Ms. Dunn joined TVA as an attorney in May 1978, assumed the position of Assistant General Counsel in September 1986, and assumed the position of Executive Vice President and General Counsel in January 2001.

Mr. Campbell joined TVA as Chief Nuclear Officer and Executive Vice President in May 2007. Mr. Campbell served as Executive Vice President, Engineering and Projects for Entergy Operations, Inc. ("Entergy"), an energy company, from February 2007 to May 2007. In that capacity, he was responsible for engineering, technical support, and project management functions for all regulated and non-regulated Entergy nuclear units. Mr. Campbell served as Senior Vice President and Chief Operating Officer of Entergy from February 2003 to February 2007, and was responsible for the operation of all Entergy regulated nuclear units. He also served as Vice President, Engineering, of Entergy from June 2000 to February 2003.

Mr. Long was named Executive Vice President, Administrative Services as well as Chief Administrative Officer in September 2005. From October 2000 to September 2005, he was Executive Vice President, Human Resources. Mr. Long joined TVA in 1980 as a Personnel Officer in the Engineering Design Organization and has held various Human Resources positions within TVA. From 1992 to 2005, he served on the TVA Retirement System Board.

Mr. Breeden was named Executive Vice President, Customer Resources in September 2006 after having served as Executive Vice President, Customer Service and Marketing since joining TVA in August 2004. From March 2002 to August 2004, he was the Program Executive for Executive Conversation, Inc., where he was responsible for executive training programs. From September 1997 to March 2002, he was President of TXU Energy Services, Enterprise Division, in Dallas, Texas, where he was responsible for a new venture created to address customers' changing energy needs. Mr. Breeden had joined TXU Corporation in May 1995 as Senior Vice President of TXU Electric & Gas, where he was responsible for marketing and sales.

Mr. Manning joined TVA in August 2008 as Executive Vice President, Power System Operations. From April 2006 to August 2008, Mr. Manning served as Vice President of Field Operations for Duke Energy Corporation, an energy company, where he was responsible for the operation of all transmission and distribution system activity in Duke Energy Corporation's Carolinas Region. Mr. Manning joined Duke Energy Corporation in 1978 and held a variety of leadership positions there, including Vice President, Central Region for Duke Energy Power Delivery (from January 2004 to April 2006), Vice President of Engineering Standards and Process Management for Duke Energy Electric Transmission (from May 2003 to January 2004), and Vice President of Engineering for Duke Energy Gas Transmission (now Spectra Corporation) (from September 2000 to June 2003).

Mr. Swafford joined TVA in May 2006 and was named Executive Vice President, Fossil Power Group, in June 2007. From May 2006 until May 2007, he was Senior Vice President, Nuclear Support of TVA. From December 1995 to April 2006, Mr. Swafford held various positions at Exelon Corporation, an energy company based in Illinois, and its subsidiaries. From 2002 to 2006, he served as Senior Vice President, Exelon Energy Delivery, and was responsible for transmission and distribution of electricity. From 2002 to 2003, he was Vice President, Exelon Power, and was responsible for its fleet of gas, coal-fired, and hydroelectric generating facilities. From 2000 to 2002, he was Vice President, Dresden Nuclear Station.

Mr. Wardlaw was named Executive Vice President of Power Supply and Fuels in July 2008. Prior to this appointment, Mr. Wardlaw served as Senior Vice President Commercial Operations and Fuels from January 2007 to June 2008, and Vice President, Bulk Power Trading from September 2006 to December 2006. From December 2000 to September 2006, he served as Vice President of Transmission and Reliability where he was responsible for real time control of TVA's generation fleet and transmission system. Mr. Wardlaw began his career with TVA in January 1982 as an electrical engineer, and has also worked in customer service, marketing, and field services.

Mr. Bhatnagar is the Senior Vice President of Nuclear Generation Development and Construction, a position he has held since April 2007. He joined TVA in August 1999 as Site Support Manager at Browns Ferry and was subsequently appointed Browns Ferry Plant Manager in July 2000, Browns Ferry Site Vice President in July 2001, and Senior Vice President, Nuclear Operations, in June 2004.

Mr. Hairston was named Senior Vice President, Corporate Responsibility and Diversity, in April 2007, and was additionally named TVA's Chief Ethics and Compliance Officer in July 2007. He previously served as Senior Vice President, Communications, a position he assumed in March 2006. From October 2002 to March 2006, he held the position of Senior Vice President, Employee Relations and Diversity. Mr. Hairston served as Senior Vice President, Labor Relations, from October 2000 to October 2002, and had held that position previously from June 1994 to June 1998. From August 1998 to October 2000, he was Senior Vice President, Strategic Initiatives. Mr. Hairston also served as Senior Manager, Strategic Planning and Support, from May 1993 to June 1994.

Ms. Herrin is the Senior Vice President, River Operations, a position she has held since February 1999. Ms. Herrin is responsible for establishing river operations policies, procedures, and standards for TVA and serves as TVA's Dam Safety Officer. She began her career at TVA in 1978 as a Civil Engineer. She has served on the TVA Retirement System Board since 2005.

Mr. Hoskins, Senior Vice President and Treasurer, joined TVA in 1978 and worked in several areas of TVA business including accounting, audit, and revenue before joining the Treasurer's office in 1987. He was named Vice President and Treasurer in 1994 and Senior Vice President and Treasurer in 2000. He has served on the TVA Retirement System Board of Directors since 2003. Mr. Hoskins also served as Interim Chief Financial Officer of TVA from November 2006 to September 2007.

Mr. Jernigan was named Senior Vice President, Nuclear Operations, in September 2008. From November 2004 until August 2008, he served as Site Vice President of Surry Nuclear Power Station and from November 2003 to November 2004, he served as Director of Operations and Maintenance at North Anna Nuclear Power Station for Dominion Resources, Inc. ("Dominion"), an energy company. Before joining Dominion, Mr. Jernigan worked for Florida Power & Light Company, serving as Site Vice President at St. Lucie Nuclear Station from June 2001 to April 2004 and as General Manager at Turkey Point Nuclear Station from 1994 to 2001.

Ms. Ray was named the Senior Vice President of the Office of Environment and Research in August 2008. In this role she serves as the agency's Environmental Executive responsible for development of the agency's environmental policy and strategy. She served as the Vice President of Environmental Stewardship and Policy from August 2007 to July 2008 where she was responsible for management of 293,000 acres of public land. Prior to this, Ms. Ray served as the Vice President of Enterprise Performance and Analysis, and was the Director of TVA's Public Power Institute where she focused on new energy technologies. Ms. Ray began her career with TVA in 1983 with the nuclear power organization, and worked in several other TVA functions including fossil generation, customer groups, and strategic planning.

Ms. Reynolds joined TVA in April 2007 as Senior Vice President of Communications, Government and Valley Relations. Ms. Reynolds served as the 31 st secretary of the U.S. Senate (from January 2003 to January 2007), where she managed the legislative, financial, and administrative operations of the Senate. She also served as a consultant to the subsequent secretary of the U.S. Senate from January 2007 to April 2007. She previously served as chief of staff for Senator Frist (from January 2001 to January 2003), where she had overall responsibility for the management and coordination of staffing, legislative activity, communications, constituent relations, and scheduling.

Mr. McCormick joined TVA as Vice President, Fossil Operations, in December 2007 and was later named Senior Vice President in October 2008. Prior to that, Mr. McCormick served in various roles at Exelon Corporation, an energy company, including General Manager of Eddystone Generation Station, General Manager of Conowingo and Muddy Run Hydro Facilities, and Director of Operations from September 2004 to February 2007 responsible for supervising power plant general managers of more than 10,000 megawatts of fossil and hydro generation. Mr. McCormick began his career with Exelon in 1982.

Mr. Thomas was named Vice President and Controller and Chief Accounting Officer in January 2008. Prior to being named Controller, he was the General Manager, Operations Business Services, where he was responsible for financial and performance support to TVA's operating organizations. Prior to joining TVA, Mr. Thomas was Chief Financial Officer for Benson Security Systems. He was also the Controller of Progress Fuels Corporation and Controller of Progress Ventures, Inc., both subsidiaries of Progress Energy, where he was responsible for accounting operations, financial reporting, forecasting, and risk management.

Disclosure and Financial Code of Ethics

TVA has a Disclosure and Financial Ethics Code ("Financial Ethics Code") that applies to all executive officers and directors of TVA as well as to all employees who certify information contained in quarterly reports, annual reports, or information statements or who have responsibility for internal control self-assessments. The Financial Ethics Code includes provisions covering conflicts of interest, ethical conduct, compliance with applicable laws, rules, and regulations, responsibility for full, fair, accurate, timely, and understandable disclosures, and accountability for adherence to the Financial Ethics Code. TVA will provide a current copy of the Financial Ethics Code to any person, without charge, upon request. Requests may be made by calling 888-882-4975 or by sending an e-mail to: investor@tva.com. Any waivers of or changes to provisions of the Financial Ethics Code will be promptly disclosed to the public, subject to limitations imposed by law, on TVA's website at: www.tva.gov. Information contained on TVA's website shall not be deemed incorporated into, or to be a part of, this Annual Report.

Committees of the TVA Board

TVA does not have a Nominating Committee. Each member of the TVA Board is appointed by the President of the United States with the advice and consent of the U.S. Senate. The TVA Act provides that to be eligible to be appointed as a member of the TVA Board, an individual must (1) be a citizen of the United States, (2) have management expertise relative to a large for-profit or nonprofit corporate, government, or academic structure, (3) not be an employee of TVA, (4) make full disclosure to Congress of any investment or other financial interest that the individual holds in the energy industry, and (5) affirm support for the objectives and missions of TVA, including being a national leader in technological innovation, low-cost power, and environmental stewardship. No more than two of the TVA Board members may be legal residents outside of TVA's service area.

The TVA Board has an Audit, Governance, and Ethics Committee established in accordance with the TVA Act. TVA's Audit, Governance, and Ethics Committee consists of Thomas C. Gilliland (chair), Robert M. Duncan, and Howard A. Thrailkill. None of the members of the Audit, Governance, and Ethics Committee has been determined to be an "audit committee financial expert" under applicable SEC rules, as none of the appointed TVA Board members was required by the TVA Act to meet the criteria of an "audit committee financial expert" under applicable SEC rules.

TVA is exempted by section 37 of the Exchange Act from complying with section 10A(m)(3) of the Exchange Act, which requires each member of a listed issuer's audit committee to be an independent member of the board of directors of the issuer. The TVA Act contains certain provisions that are similar to the considerations for independence under section 10A(m)(3) of the Exchange Act, including that to be eligible for appointment to the TVA Board, an individual shall not be an employee of TVA and shall make full disclosure to Congress of any investment or other financial interest that the individual holds in the energy industry. These provisions became applicable to TVA Board members on March 31, 2006.

Under section 10A(m)(2) of the Exchange Act, which applies to TVA, the audit committee is directly responsible for the appointment, compensation, and oversight of the external auditor; however, the TVA Act assigns the responsibility for engaging the services of the external auditor to the TVA Board.

The TVA Board has also established the following committees in addition to the Audit, Ethics, and Governance Committee:

- Finance, Strategy, Rates, and Administration Committee
- Operations, Environment and Safety Committee
- Community Relations and Energy Efficiency Committee

ITEM 11. EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

This Compensation Discussion and Analysis provides information about TVA's compensation philosophy and strategy, as well as the policies and decisions that guided TVA in 2008 in establishing the level and nature of the compensation provided to the President and Chief Executive Officer ("CEO"), the Chief Financial Officer and Executive Vice President, Financial Services ("CFO"), and the three most highly compensated executive officers other than the CEO and CFO. References to the "Named Executive Officers" or "NEOs" throughout this section refer to the executive officers listed in the Summary Compensation Table.

Executive Summary

The TVA Board has established a compensation plan for all TVA employees (the "Compensation Plan") based on the requirements of the TVA Act. The Compensation Plan is designed to support TVA's mission and Strategic Plan and to fulfill the following purposes:

- *Provide a competitive level of compensation that enables TVA to attract, retain, and motivate highly competent employees.* Total compensation for each position in TVA is determined by market pricing based on a level needed to attract, retain, and motivate employees critical to TVA's success in achieving its mission. Accordingly, total compensation levels are targeted at the median (50 th percentile) of the relevant labor market for most positions. However, for positions affected by market scarcity, recruitment and retention issues, and other business reasons, total compensation levels are targeted above the median (typically between the 50 th and 75 th percentile).

- *Encourage and reward executives for their performance and contributions to the successful achievement of financial and operational goals.* A key component of the Compensation Plan is "pay for performance," which rewards executives for improvement in TVA's overall performance, as well as that of individual business units and individual employees. The TVA Board believes that the portion of total direct compensation placed at-risk should increase as an employee's position and level of responsibility within TVA increases. Accordingly, a significant percentage of total direct compensation for the Named Executive Officers (40 percent to 65 percent) is performance-based compensation.

- *Provide executives with the focus to achieve short-term and long-term business goals that are important to TVA, TVA's customers, and the people TVA serves.* TVA seeks to hire and retain executives who are focused on both the short-term and long-term success of TVA. The Compensation Plan is designed to achieve this goal by providing a mix of salary and at-risk annual and long-term incentive compensation.

- *Improve overall company performance through productivity enhancement.* An executive cannot help meet TVA's goals and improve performance without the work of others. For this reason, the performance goals set at the TVA level and business unit level are the same for both executives and all non-executive employees. In this way, all TVA employees receive compensation in a manner that aligns their work with the same goals and encourages and rewards them for the successful achievement of TVA's goals.

Under the Compensation Plan, the compensation programs for the Named Executive Officers consist of the components identified in the following table:

Compensation Program Components for Named Executive Officers

Compensation Component	Objective	Key Features
Annual Salary	Fixed and paid biweekly to executives	Total annual cash compensation (salary plus annual and long-term incentive compensation plus long-term deferred compensation) is targeted at the median (50 th percentile) for similar positions at other companies in TVA's peer group, or above the median (50 th to 75 th percentile) for positions affected by market scarcity, recruitment and retention issues, and other business reasons Reviewed annually to consider changes in peer group benchmark salaries, changes in percentage of performance-based compensation, and/or exceptional individual merit performances in past years
Annual Incentive Compensation	At-risk and based on the attainment of certain pre-established performance goals for the year	Annual incentive opportunities increase with position and responsibility and are based on the opportunities other companies in TVA's peer group provide to those in similar positions Annual incentive payouts are based on the results of performance goals at the TVA level, business unit level, and the individual level Reviewed annually to consider changes in peer group benchmark short-term incentives, changes in percentage of performance-based compensation, and/or exceptional individual merit performances in past years
Long-Term Incentive Compensation	At-risk and based on the attainment of certain pre-established performance goals for a performance cycle, typically three years	Long-term incentive payouts are based on the results of performance goals for a specific performance cycle Reviewed annually to consider changes in peer group benchmark long-term incentives, changes in percentage of performance-based compensation, and/or exceptional individual merit performances in past years
Long-Term Deferred Compensation	Awarded in the form of annual credits that vest after a specified period of time, typically three to five years	Awarded to provide a benefit similar to restricted stock and to provide retention incentives to executives Executives generally must remain at TVA for the entire length of the agreement in order to receive compensation credits Annual credit amounts targeted such that long-term deferred compensation comprises 20 percent of total long-term compensation (in conjunction with long-term incentive compensation described above)
Pension Plans	Both qualified and supplemental, which provide compensation beginning with retirement or termination of employment	Broad-based plans available to full-time employees of TVA that are qualified under IRS rules and that are similar to the qualified plans provided by other companies in TVA's peer group Certain executives in critical positions also participate in a non-qualified pension plan that provides supplemental pension benefits

Authority for the Executive Compensation Program

The TVA Act is the authority for establishing the compensation of all TVA employees, including the Named Executive Officers, and places responsibility for doing so with the TVA Board. Under section 2 of the TVA Act, the TVA Board is directed to establish a compensation plan for all TVA employees which:

- Specifies all compensation (including salary or any other pay, bonuses, benefits, incentives, and any other form of remuneration) for the CEO and TVA employees;
- Is based on an annual survey of the prevailing compensation for similar positions in private industry, including engineering and electric utility companies, publicly owned electric utilities, and federal, state, and local governments; and
- Provides that education, experience, level of responsibility, geographic differences, and retention and recruitment needs will be taken into account in determining compensation of employees.

The TVA Act also provides that:

- The TVA Board will annually approve all compensation (including salary or any other pay, bonuses, benefits, incentives, and any other form of remuneration) of all managers and technical personnel who report directly to the CEO (including any adjustment to compensation);
- On the recommendation of the CEO, the TVA Board will approve the salaries of employees whose salaries would be in excess of Level IV of the Executive Schedule ($149,000 in 2008); and
- The CEO will determine the salary and benefits of employees whose annual salary is not greater than Level IV of the Executive Schedule ($149,000 in 2008).

The philosophy of the Compensation Plan approved by the TVA Board for all TVA employees, including the Named Executive Officers, is based on the TVA Act. The philosophy recognizes that many employees, including executives, are called on to accomplish specialized aspects of TVA's mission safely, reliably, and efficiently, and must have the requisite education, experience, and professional qualifications. These requirements make it necessary for TVA to offer compensation to its specialized employees that makes it possible for TVA to attract highly qualified candidates for positions similar to those in relevant industries and motivates them to stay with TVA.

Board Committee Oversight

For 2008, the Human Resources Committee of the TVA Board was responsible for oversight of executive compensation and was charged with various duties under the Compensation Plan. In May 2008, the TVA Board reduced the number of Board committees and the duties and responsibilities of the Human Resources Committee under the Compensation Plan were assumed by the Finance, Strategy, Rates, and Administration ("FSRA") Committee of the TVA Board. In this Compensation Discussion and Analysis, the Human Resources Committee will be referenced with regard to matters involving the establishment of compensation for 2008; however, the FSRA Committee is responsible for the review of this Compensation Discussion and Analysis, for the review of performance goal achievement for 2008, and for oversight of executive compensation pursuant to the Compensation Plan after May 2008.

Use of Market Data and Benchmarking

TVA seeks to set total compensation for executives at a competitive level with respect to the relevant labor market. Market information for total compensation, as well as each element of compensation, for the Named Executive Officers in 2008 was obtained from:

- Published and customized compensation surveys reflecting the relevant labor markets identified for designated positions, and
- Publicly disclosed information from the proxy statements and annual reports on Form 10-K of energy services companies with revenues of $3 billion and greater.

After the competitive market compensation was compiled for the positions, the Human Resources department, with the assistance of its compensation consultant, Towers Perrin, analyzed the data, and provided its analysis to the Human Resources Committee. The Human Resources Committee, with the assistance of its independent compensation consultant, Watson Wyatt, used this information to:

- Test compensation level and incentive opportunity competitiveness,
- Serve as a point of reference for establishing pay packages for recruiting executives, and
- Determine appropriate adjustments to compensation levels and incentive opportunities to maintain the desired degree of market competitiveness.

TVA's relevant labor market for most executives, including the Named Executive Officers, was comprised of both private and publicly owned companies in the energy services industry of similar revenue and scope to TVA. For the survey-based analysis, TVA looked at the following energy services companies with annual revenues of $3 billion and greater from the 2007 Towers Perrin Energy Services Executive Compensation Database:

Allegheny Energy, Inc.
Alliant Energy Corp.
Ameren Corp.*
American Electric Power Co., Inc.*
Calpine Corp.
CenterPoint Energy, Inc.
CMS Energy Corp.*
Consolidated Edison, Inc.*
Constellation Energy Group, Inc.*
Dominion Resources, Inc.*
DTE Energy Co.*
Duke Energy Corp.*
Edison International*
El Paso Corp.
Entergy Corp.*
Exelon Corp.*
FirstEnergy Corp.*
FPL Group, Inc.*
Integrys Energy Group, Inc. *
MDU Resources, Inc
Mirant Corp.
Northeast Utilities System *
NRG Energy, Inc.
NSTAR Electric Co.
OGE Energy Corp.
Pacific Gas & Electric Co.*
PacifiCorp
Pepco Holdings, Inc.*
Pinnacle West Capital Corp.
PPL Corp.*
Progress Energy, Inc.*
Public Service Enterprise Group, Inc.*
Reliant Energy, Inc.*
SCANA Corp.
Sempra Energy *
The Southern Company *
SUEZ Energy North America
TXU Corp.
Wisconsin Energy Corp.
Xcel Energy, Inc.*

For the analysis of proxy statements and annual reports on Form 10-K, TVA looked at a subset of the peer group above, identified with asterisks, as well as two additional companies in the energy services industry (AES Corp. and NiSource Inc.), as recommended by Watson Wyatt.

Executive Compensation Program Components

Total compensation (salaries, annual and long-term incentive compensation, and long-term deferred compensation) for Mr. Kilgore, Ms. Greene, and Mr. McCollum for 2008 was reviewed by the Human Resources Committee, and the recommended compensation packages were submitted by the Human Resources Committee to the TVA Board for approval. Total compensation for Mr. Campbell and Mr. Bhatnagar for 2008 was reviewed and approved by Mr. Kilgore as CEO.

Salary. The salaries received by the Named Executive Officers were based on their levels of responsibility, their individual merit performances in past years, and the competitive levels of compensation for executives in similar positions in the energy services industry.

For 2008, the TVA Board approved a salary of $500,000 for Ms. Greene, unchanged from 2007, and a salary of $721,000 for Mr. McCollum, a 3 percent increase over 2007. For 2008, Mr. Kilgore as CEO approved a salary of $477,000 for Mr. Campbell, a 6 percent increase over 2007, and a salary of $434,520 for Mr. Bhatnagar, a 2 percent increase over 2007. The salaries approved for Ms. Greene and Mr. McCollum for 2008 kept both of them near the 50 th percentile of the benchmark salaries for similar positions in TVA's peer group. The salaries approved for Mr. Campbell and Mr. Bhatnagar for 2008 kept both of them near the 75 th percentile of the benchmark salaries for similar positions in TVA's peer group. The salaries for Mr. Campbell and Mr. Bhatnagar were targeted at a higher percentile because their positions as Chief Nuclear Officer and Senior Vice President, Nuclear Generation Development and Construction, are subject to high demand and scarcity and recruitment and retention issues within the nuclear industry. Information about the approval of Mr. Kilgore's salary for 2008 is provided below under the heading "Considerations Specific to Mr. Kilgore."

Annual Incentive Compensation. All executives, including the Named Executive Officers, participate in the Executive Annual Incentive Plan ("EAIP"). The EAIP is designed to encourage and reward executives for their contributions to successfully achieving short-term financial and operational goals of TVA and applicable business units, as well as individual goals. Under the EAIP, an executive's annual incentive payment is calculated as follows:

EAIP Payout	=	Salary	X	Annual Incentive Opportunity	X	Percent of Opportunity Achieved

Annual incentive opportunities increase with position and responsibility. The annual incentive opportunity was established for each of the Named Executive Officers based on the opportunities other companies provide to those in comparable positions in the energy services industry. For 2008, the TVA Board approved a 65 percent annual incentive opportunity for Ms. Greene and a 70 percent annual incentive opportunity for Mr. McCollum, both unchanged from 2007. For 2008, Mr. Kilgore as CEO approved a 75 percent annual incentive opportunity for Mr. Campbell and a 60 percent annual incentive opportunity for Mr. Bhatnagar, both unchanged from 2007. The annual incentive opportunities were approved for Ms. Greene and Mr. McCollum for 2008 at a level such that 100% target payout (together with salary, 100% target payout of long-term incentive opportunities, and long-term compensation credits) would place their total compensation near but below the 50 th percentile of the benchmark total compensation for similar positions in TVA's peer group. The annual incentive opportunities were approved for Mr. Campbell and Mr. Bhatnagar for 2008 at a level such that 100 percent target payout (together with salary, 100 percent target payout of long-term incentive opportunities, and long-term compensation credits) would place their total compensation near but below the 75 th percentile of the benchmark total compensation for similar positions in TVA's peer group. The total compensation for Mr. Campbell and Mr. Bhatnagar was targeted at a higher percentile because their positions as Chief Nuclear Officer and Senior Vice President, Nuclear Generation Development and Construction, are subject to high demand and scarcity and recruitment and retention issues within the nuclear industry. Information about the approval of Mr. Kilgore's EAIP incentive opportunity for 2008 is provided below under the heading "Considerations Specific to Mr. Kilgore."

The percent of opportunity achieved, as used in the formula above, was determined in 2008 by a weighted average of the results of a combination of performance goals at the TVA level, the business unit level, and the individual level. Performance goals at the TVA level and their weights were identified in TVA's Winning Performance Balanced Scorecard (the "TVA Scorecard"). Three of the performance goals identified in the TVA Scorecard (connection point interruptions, non-fuel operation and maintenance expense, and equivalent availability factor) were used in determining annual incentive payouts for the Named Executive Officers and all other participants in the EAIP, as well as all other non-executive TVA employees who participate in TVA's Winning Performance Team Incentive Plan. These three performance measures, their weights, and the goals approved by the TVA Board for the 2008 TVA Scorecard, as well as the results for 2008, are set forth below:

2008 TVA Scorecard

			Goals		
Performance Metric	**Weight**	**Results Achieved**	**Threshold (75%)**	**Target (100%)**	**Maximum (125%)**
Customers					
Connection Point Interruptions (Interruptions per Connection Point)	30%	0.81	0.90	0.85	0.80
Financial					
Non-Fuel O&M [1] ($/MWh Sales)	40%	13.31	13.45	13.20	12.95
Assets/Operations					
Equivalent Availability Factor (%) [2]	30%	87.3	89.0	89.5	90.0

1 Operation and Maintenance

2 The equivalent availability factor for 2008 included all of TVA's primary generation components. For 2009, the calculation of equivalent availability factor has been adjusted to include only nuclear, coal, and combined cycle generation assets. The availability for combustion turbines and hydroelectric generation has been excluded beginning in 2009. This adjustment will focus TVA's performance on the equivalent availability of base load facilities which are needed nearly all times of the year. Combustion turbine and hydroelectric generation performance will be measured during critical periods of the year, and separate metrics will be utilized to monitor this performance. If the 2009 calculation methodology had been in place for 2008, the equivalent availability factor would have been 84.

Performance levels between threshold and target achievement levels, and between target and maximum achievement levels, were calculated using straight line interpolation. The TVA Scorecard represented 30 percent of the potential payout for the Named Executive Officers.

Another 30 percent of the potential payout was tied to business unit performance. Mr. Campbell's business unit performance was measured by the results of the Nuclear Power Group, Central Office and Staff scorecard. The performance measures for the scorecard are: Nuclear Power Group ("NPG") Site Unit Capability; NPG Forced Loss Rate; Central Office Safe Workplace; NPG Collective Radiation Exposure; NPG Site Production Expense; NPG INPO Performance Indicator; and NPG Unplanned Automatic Scrams.

Mr. Bhatnagar's business unit performance was measured by the results of the Nuclear Generation Development & Construction scorecard. The performance measures for this scorecard are: Nuclear Generation Development and Construction ("NGD&C") No Significant Plant Events; NGD&C Safe Workplace; NGD&C Capital Budget; and NGD&C Major Milestones Met.

As executives who oversee all business aspects of the company, the business unit performance of Mr. Kilgore, Ms. Greene, and Mr. McCollum was measured by a composite average of the results of all of TVA's 27 business unit scorecards.

A further 30 percent of the potential payout was tied to the achievement of personal goals established for each of the Named Executive Officers. Personal goals for Mr. Kilgore were not finalized and documented, and therefore no payment has been made. Ms. Greene's personal goals, as approved by Mr. Kilgore as CEO, included pricing programs to promote peak production, improving long-range financial forecasting, and financial statement and reporting controls. Mr. McCollum's personal goals, as approved by Mr. Kilgore as CEO, included meeting non-fuel operation and maintenance expense targets, succession planning, and improvement of generation fleet. Mr. Campbell's personal goals, as approved by Mr. Kilgore as CEO, included CHI improvement, meeting non-fuel operation and maintenance expense targets, and injury prevention. Mr. Bhatnagar's personal goals, as approved by Mr. Kilgore as CEO, included meeting licensing milestones for Watts Bar Unit 2 and Bellefonte, succession planning, and meeting non-fuel operation and maintenance expense targets.

The remaining 10 percent of the potential payout for Mr. Kilgore was based on the subjective assessment by the TVA Board of Mr. Kilgore's overall performance and contribution to TVA during 2008, the remaining 10 percent of the potential payout for Ms. Greene and Mr. McCollum was based on the subjective assessment by Mr. Kilgore of each of their overall individual performances and contributions to TVA during 2008, and the remaining 10 percent of the potential payout for Mr. Campbell and Mr. Bhatnagar was based on the subjective assessment by Mr. McCollum of each of their overall individual performances and contributions to their respective business units during 2008.

The following table shows for each of the Named Executive Officers for 2008 the performance goals and weighting, the percent of opportunity achieved, the target payout, and the actual payout:

Performance Goals, Percent of Opportunity Achieved, and Target and Actual Payout

NEO	Salary	Annual Incentive Opportunity	Target EAIP Payout	Performance Goals	Weight	Percent of Opportunity Achieved	EAIP Payout
Tom D. Kilgore	**$ 650,000**	**125%**	**$ 812,500**			**46.13%**	**$ 374,806**
				TVA Scorecard	30%	21.48%	
				Composite average of all TVA business unit scorecards	30%	16.65%	
				Personal Goals and Subjective Assessment	40%	8.00% [1]	
Kimberly S. Greene	**$ 500,000**	**65%**	**$ 325,000**			**77.63%**	**$ 252,298**
				TVA Scorecard	30%	21.48%	
				Composite average of all TVA business unit scorecards	30%	16.65%	
				Personal Goals and Subjective Assessment	40%	39.50%	
William R. McCollum, Jr.	**$ 721,000**	**70%**	**$ 504,700**			**74.63%**	**$ 376,658**
				TVA Scorecard	30%	21.48%	
				Composite average of all TVA business unit scorecards	30%	16.65%	
				Personal Goals and Subjective Assessment	40%	36.50%	
William R. Campbell	**$ 477,000**	**75%**	**$ 357,750**			**43.72%**	**$ 156,408**
				TVA Scorecard	30%	21.48%	
				Results of scorecard for Nuclear Power Group, Central Office and Staff	30%	3.49%	
				Personal Goals and Subjective Assessment	40%	18.75%	
Ashok S. Bhatnagar	**$ 434,520**	**60%**	**$ 260,712**			**99.09%**	**$ 258,340**
				TVA Scorecard	30%	21.48%	
				Results of scorecard for Nuclear Generation Development and Construction	30%	36.36%	
				Personal Goals and Subjective Assessment	40%	41.25%	

1 Because personal goals for Mr. Kilgore were not finalized and documented, Mr. Kilgore was not evaluated, and no award was made on 30 percent.

Overall EAIP awards may be adjusted based on the evaluation of individual achievements and performance results. In 2008, no adjustment was made to the amount of the calculated payout for any Named Executive Officer.

Awards to the Named Executive Officers under the EAIP for 2008 are reported in the “Non-Equity Incentive Plan Compensation” column in the Summary Compensation Table. Additional information regarding the basis of the payouts under the EAIP is presented in the

narrative that accompanies the Grants of Plan-Based Awards Table.

Long-Term Incentive Compensation. In addition to the EAIP, certain executives in critical positions, including the Named Executive Officers, participate in the Executive Long-Term Incentive Plan ("ELTIP"). Executives in critical positions are those who make decisions that significantly influence the development and execution of TVA's long-term strategic objectives. In 2008, the TVA Board approved certain revisions to the design of the ELTIP in order to strengthen the pay-for-performance orientation and overall effectiveness of the plan by:

- Using performance criteria that are directly aligned with TVA's Strategic Plan;
- Shifting from a "last year of cycle" performance approach to a "cumulative" performance approach to measure performance achieved for the three-year performance cycles (i.e., making the ELTIP function more as a long-term than an annual incentive);
- Targeting award opportunities at levels that approximate median levels of competitiveness with TVA's peer group and incorporating the Human Resource Committee's policy of having (i) approximately 80 percent of each executive's total long-term incentive opportunity be performance based (under the ELTIP) and approximately 20 percent of each executive's total long-term incentive opportunity be retention and security-oriented (under the Long-Term Deferred Compensation Plan ("LTDCP") as described below under the heading "Long-Term Deferred Compensation"), while allowing for a reasonable period of time to transition to the median levels of opportunity; and
- Expanding the award opportunity range from the range of 75 percent to 125 percent of salary to a broader range of 50 percent to 150 percent of salary to enable payment of awards that are commensurate with performance achievements.

As a part of implementing the revised ELTIP plan design, the TVA Board approved two initial overall measures of TVA performance to be applied to all participants in the ELTIP: connection point interruptions (the number of interruptions of power at connection points caused by TVA's transmission system) and retail rates (the quotient of distributor reported retail power revenue divided by distributor reported retail power sales). Since transition to the new structure was required, the TVA Board approved the performance measures of connection point interruptions and retail rates for the one-year cycle ended September 30, 2008, the two-year cycle ending September 30, 2009, and the three-year cycle ending September 30, 2010. The TVA performance criteria may be adapted for future performance cycles, and the number of criteria used may vary from cycle to cycle.

The goals associated with the two performance measures are generally based on a comparison of TVA's performance to the performance of surveyed transmission providers and regional utilities, and rolling three-year target comparisons for the surveyed group are utilized. The goals approved for the connection point interruptions performance measure for each of the one-, two-, and three-year performance cycles described above are as follows:

- The target goal (which will also serve as the threshold goal that must be met before there is any incentive payment under this measure) is TVA ranking at or above the 75 th percentile of the performance of the surveyed transmission providers (the "ELTIP CPI Comparison Group"), and
- The maximum goal is TVA ranking at or above the 90 th percentile of the ELTIP CPI Comparison Group's performance.

The goals approved for the retail rates performance measure for each of the one-, two-, and three-year performance cycles described above are as follows:

- The threshold goal is based on improvement over the last performance cycle,
- The target goal is TVA ranking at or above the 75 th percentile of the performance of a comparison group of regional utilities with annual revenues greater than $3 billion (the "ELTIP Retail Rates Comparison Group"), and
- The maximum goal is TVA ranking at or above the 90 th percentile of the ELTIP Retail Rates Comparison Group's performance.

For 2008, connection point interruptions performance data came from data provided by SGS Statistical Services based on an analysis of voluntary survey responses solicited from 30 electric utilities (not all of which provided data). Retail rate data (retail sales and retail revenue) for the ELTIP Retail Rates Comparison Group was obtained from the EIA-826 Monthly Electric Utility Database. The ELTIP Retail Rates Comparison Group was composed of 22 utilities, which are subsidiaries of holding companies with annual revenues greater than $3 billion, in the regional proximity of the TVA service territory.

Under the revised ELTIP plan design, an executive's incentive payment continues to be calculated as follows:

ELTIP Payout	=	Salary	X	ELTIP Incentive Opportunity	X	Percent of Opportunity Achieved

The objective of the revised ELTIP plan design is to establish incentive opportunities for each of the Named Executive Officers, based on a percentage of his or her base salary rate at the end of the performance period, to approximate 80 percent of each Named Executive Officer's total long-term compensation (in conjunction with long-term deferred compensation described below). Accordingly, for the performance period ended September 30, 2008, the TVA Board approved a 65 percent long-term incentive opportunity for Ms. Greene and a 70 percent long-term incentive opportunity for Mr. McCollum, both unchanged from 2007, and Mr. Kilgore as CEO approved an 80 percent long-term incentive opportunity for Mr. Campbell and a 45 percent long-term incentive opportunity for Mr. Bhatnagar, both unchanged from 2007. Information about the approval of Mr. Kilgore's ELTIP incentive opportunity for the performance period ended September 30, 2008, is provided below under the heading "Considerations Specific to Mr. Kilgore."

The following table shows the performance goals and weighting and percent of opportunity achieved for the ELTIP for the one-year cycle ended September 30, 2008:

ELTIP Performance Goals, Weighting, and Percent of Opportunity

	Goals				Percent Achieved				
Performance Measure	Threshold (50%)	Target (100%)	Maximum (150%)	**Performance Result**	Actual (%)	X	Weight (%)	=	Result (%)
Retail Rate	Improvement Over Last Performance Cycle	Top 25% of Comparison Companies	Top 10% of Comparison Companies	Below Threshold	0.00%	X	50%		0.00%
Connection Point Interruption	Top 25% of Comparison Companies	Top 25% of Comparison Companies	Top 10% of Comparison Companies	Between Target and Maximum	148.65%	X	50%		74.32%
				Overall Percent of Opportunity Achieved					74.32%

As a part of the revised ELTIP plan design, the TVA Board reserved discretion to review results and peer group comparison at the end of each performance cycle and to approve adjustments in payouts, if appropriate, given the circumstances. In 2008, no discretion was exercised to adjust the amount of the payout for the Named Executive Officers based on the performance criteria described above.

As a result, the Named Executive Officers were awarded the following ELTIP payouts for 2008 in comparison to the 2008 target payouts:

2008 ELTIP payouts

NEO	Salary	ELTIP Incentive Opportunity	Target ELTIP Payout	Percent of Opportunity Achieved	ELTIP Payout
Tom D. Kilgore	$ 650,000	150%	$ 975,000	74.32%	$ 724,620
Kimberly S. Greene	$ 500,000	65%	$ 325,000	74.32%	$ 241,540
William R. McCollum, Jr.	$ 721,000	70%	$ 504,700	74.32%	$ 375,093
William R. Campbell	$ 477,000	80%	$ 381,600	74.32%	$ 283,605
Ashok S. Bhatnagar	$ 434,520	45%	$ 195,534	74.32%	$ 145,321

Awards provided to the Named Executive Officers under the ELTIP for the performance period that ended on September 30, 2008, are reported in the "Non-Equity Incentive Plan Compensation" column in the Summary Compensation Table. Additional information regarding the basis of the payouts under the ELTIP is presented in the narrative that accompanies the Grants of Plan-Based Awards Table.

Long-Term Deferred Compensation. Unlike private sector companies in the energy services industry, TVA is a corporate agency and instrumentality of the United States and thus does not have equity securities to provide stock awards or options as a form of compensation for its employees. Although TVA cannot and does not seek to replicate the type of equity-based compensation available at companies in TVA's peer group, TVA does enter into agreements with certain executives, including the Named Executive Officers, that are administered under TVA's LTDCP, which provides a retention incentive similar to restricted stock. The LTDCP agreements are designed to provide retention incentives to executives to encourage them to remain with TVA and to provide, in combination with salary and EAIP and ELTIP incentive awards, a competitive level of total compensation. Under these agreements, credits (which may be vested or unvested) are made to an account in an executive's name (typically on an annual basis) for a predetermined period. If the executive remains employed at TVA until the end of this period (typically three to five years), the executive becomes vested in the balance of the account, including any return on investment on the credits in the account, and receives a distribution in accordance with a deferral election made at the time the LTDCP agreement was entered into. Annual credits provided to the Named Executive Officers under LTDCP agreements in 2008 are reported in the "All Other Compensation" column in the Summary Compensation Table. These credits are also reported in the "Registrant Contributions in Last FY" column in the Nonqualified Deferred Compensation Table since the credits were placed in deferred compensation accounts in the Named Executives Officers' names.

Descriptions of all the LTDCP agreements with the Named Executive Officers are found following the Grants of Plan-Based Awards Table.

Considerations Specific to Mr. Kilgore. Since selecting Mr. Kilgore as President and CEO in October 2006, the TVA Board had not adjusted Mr. Kilgore's compensation leading into 2008. Accordingly, at the beginning of 2008, the Human Resources Committee, in consultation with its independent executive compensation consultant, Watson Wyatt, evaluated Mr. Kilgore's current compensation relative to TVA's Compensation Plan and peer group to determine whether to recommend adjustments to Mr. Kilgore's compensation to the TVA Board for 2008.

In 2007, Mr. Kilgore received an annual salary of $650,000, an EAIP incentive opportunity of 70 percent of salary, and an ELTIP incentive opportunity of 60 percent of salary, plus a $300,000 credit under an LTDCP agreement. After considering information on chief executive officer compensation at the median of the relevant marketplace (TVA's peer group) provided by Watson Wyatt, the Human Resources Committee recommended that the TVA Board increase Mr. Kilgore's potential total compensation in 2008 by keeping his salary and LTDCP credit the same and increasing his EAIP and ELTIP incentive opportunities to 125 percent and 150 percent of salary, respectively. The Human Resources Committee's recommendation was lower than that recommended by Watson Wyatt, and the Human Resources Committee made its recommendation taking into account the special place and mission of TVA, Mr. Kilgore's preference that his base salary not be increased, and the belief that his total compensation should be placed at greater risk than any other TVA executive (65 percent of overall compensation) given the special challenges facing TVA in 2008 and his overall responsibility for the company as President and CEO. At its November 29, 2007, meeting, the TVA Board reviewed and approved the recommendation of the Human Resources Committee.

Below is a chart comparing the chief executive officer median compensation data provided by Watson Wyatt based on TVA's peer group with the compensation approved by the TVA Board for Mr. Kilgore for 2008:

CEO Peer Group Compensation Comparison

	Watson Wyatt Chief Executive Officer Median Market Data Range (TVA Peer Group)	TVA Board Approved Compensation for 2008
Base Salary	$1,000,000 - $1,020,000	$650,000
Annual Incentive %	128% - 138%	125%
Total Cash Compensation	$2,323,000 - $2,427,000	$1,462,500
Long-Term Incentive %	297% - 343%	150%
Total Direct Compensation	$5,357,000 - $5,922,000	$2,737,500

Pension Benefits. All of the Named Executive Officers are eligible to participate in the following qualified plans available to all annual TVA employees:

- Defined benefit plan
  - Cash Balance Benefit Structure ("CBBS") for employees first hired on or after January 1, 1996, with a pension based on an account that receives pay credits equal to six percent of compensation plus interest

- 401(k) plan

  - For CBBS members, TVA provides matching contributions of 75 cents on every dollar up to 4.5 percent of annual salary.

The availability of these qualified plans is consistent with similar qualified plans provided by other companies in TVA's peer group.

In addition, certain executives in critical positions, including each of the Named Executive Officers, as determined by TVA on an individual basis, are eligible to participate in a supplemental executive retirement plan ("SERP"). The SERP is a non-qualified pension plan that provides supplemental pension benefits tied to compensation levels that exceed limits imposed by IRS regulations applicable to TVA's qualified plans. The availability of this supplemental pension plan helps TVA to remain competitive in attracting and retaining top-level executives.

More information regarding these retirement and pension plans is found following the Pension Benefits Table.

Perquisites. In 2008, TVA provided certain executives, including Ms. Greene, Mr. McCollum, Mr. Campbell, and Mr. Bhatnagar, a flat-dollar biweekly vehicle allowance that may be applied toward the purchase or lease of a vehicle, operating fees, excess mileage, maintenance, repairs, and insurance. Vehicle allowances are granted on a "business need" basis to a very limited number of executives. The amount of the vehicle allowances granted to the Named Executive Officers is reported in the "All Other Compensation" column in the Summary Compensation Table.

In connection with their moves to Tennessee in 2007, Ms. Greene and Mr. McCollum received in 2008 certain relocation reimbursements and payments. These relocation reimbursements and payments are reported in the "All Other Compensation" column in the Summary Compensation Table.

TVA did not provide any other perquisites to the Named Executive Officers in 2008.

Health and Other Benefits. TVA offers a group of health and other benefits (medical, dental, vision, life and accidental death and disability insurance, and long-term disability insurance) that are available to a broad group of employees. The Named Executive Officers are eligible to participate in TVA's health benefit plans and other non-retirement benefit plans on the same terms and at the same contribution rates as other TVA employees.

Executive Compensation Tables and Narrative Disclosures

Summary Compensation and Grants of Plan-Based Awards

The following table sets forth information regarding compensation earned by each of the Named Executive Officers in 2008 (and 2007 and 2006 as applicable).

Summary Compensation Table

Name and Principal Position (a)	Year (b)	Salary ($) (c)	Bonus [1] ($) (d)	Stock Awards ($) (e)	Option Awards ($) (f)	Non-Equity Incentive Plan Compensation ($) (g)	Change in Pension Value and Nonqualified Deferred Compensation Earnings [2] ($) (h)	All Other Compensation ($) (i)	Total ($) (j)
Tom D. Kilgore President and Chief Executive Officer	2008	$655,000	–	–	–	$ 1,099,426[3]	$ 406,152[4]	$ 310,125 [5]	$ 2,470,703
	2007	$308,693	$341,293	–	–	$ 890,507[6]	$ 138,274[7]	$ 309,900	$ 1,988,667
	2006	$140,000	$511,984	–	–	$ 627,861[8]	$ 98,172[9]	$ 306,300	$ 1,684,317
Kimberly S. Greene Chief Financial Officer and Executive Vice President, Financial Services	2008	$503,847	–	–	–	$ 493,838[10]	$ 223,707[11]	$ 78,797 [12]	$ 1,300,189
	2007	$ 38,462	–	–	–	$ 36,159[13]	$ 242,752[14]	$ 370,900	$ 688,273
	2006	–	–	–	–	–	–	–	–
William R. McCollum, Jr. Chief Operating Officer	2008	$726,547	–	–	–	$ 751,751[15]	$ 126,440[16]	$ 223,237 [17]	$ 1,827,975
	2007	$293,461	–	–	–	$ 1,042,132[18]	$ 2,026,417[19]	$ 468,727	$ 3,830,737
	2006	–	–	–	–	–	–	–	–
William R. Campbell Chief Nuclear Officer and Executive Vice President, TVA Nuclear	2008	$480,669	–	–	–	$ 440,013[20]	$ 161,975[21]	$ 222,113 [22]	$ 1,304,770
	2007	–	–	–	–	–	–	–	–
	2006	–	–	–	–	–	–	–	–
Ashok S. Bhatnagar Senior Vice President, Nuclear Generation Development and Construction	2008	$437,863	–	–	–	$ 403,661[23]	$ 29,226[24]	$ 165,612 [25]	$ 1,036,362
	2007	$236,608	$189,384	–	–	$ 470,668[26]	$ 154,937[27]	$ 165,405	$ 1,217,002
	2006	$140,000	$276,070	–	–	$ 390,648[28]	$ 160,615[29]	$ 158,655	$ 1,125,988

Notes:

(1) Represents additional annual compensation paid in quarterly installments through May 31, 2007. Prior to March 31, 2006, the TVA Act provided that salaries for TVA employees, including the Named Executive Officers, could match but not exceed the salary of a TVA Board member. Although the TVA Act, as amended by the Consolidated Appropriations Act, removed this limitation, salaries were limited to $145,400 for a portion of 2007. Accordingly, additional annual compensation, which was paid in quarterly installments, was used in conjunction with salaries to provide a competitive level of base compensation.

(2) Represents the aggregate change in pension value under TVA's qualified defined benefit plan and TVA's SERP.

(3) Includes $374,806 awarded under the EAIP and $724,620 awarded under the ELTIP.

(4) Includes increases of $12,232 under TVA's qualified defined benefit plan and $393,920 under the SERP.

(5) Includes an unvested annual credit in the amount of $300,000 provided under a LTDCP agreement with Mr. Kilgore, and $10,125 in 401(k) employer matching contributions. Mr. Kilgore will become vested in the $300,000 credit in accordance with the terms of the LTDCP agreement. See information regarding the details of the LTDCP agreement under "Long-Term Deferred Compensation Plan Agreements."

(6) Includes $427,382 awarded under the EAIP and $463,125 awarded under the ELTIP.

(7) Includes increases of $11,088 under TVA's qualified defined benefit plan and $127,186 under the SERP.

(8) Includes $334,152 awarded under the EAIP and $293,709 awarded under the ELTIP.

(9) Includes increases of $8,882 under TVA's qualified defined benefit plan and $89,290 under the SERP.

(10) Includes $252,298 awarded under the EAIP and $241,540 awarded under the ELTIP.

(11) Includes increases of $9,529 under TVA's qualified defined benefit plan and $214,178 under the SERP.

(12) Includes $11,764 in vehicle allowance payments, $44,384 in relocation assistance payments, and $15,101 in tax reimbursements associated with relocation assistance payments.

(13) Includes $25,439 awarded under the EAIP and $10,720 awarded under the ELTIP. Ms. Greene joined TVA on September 1, 2007, and both the EAIP and ELTIP incentive awards were prorated based on the number of months she participated in the performance cycles.

(14) Includes increases of $5,598 under TVA's qualified defined benefit plan and $237,154 under the SERP.

(15) Includes $376,658 awarded under the EAIP and $375,093 awarded under the ELTIP.

(16) Includes increases of $10,821 under TVA's qualified defined benefit plan and $115,619 under the SERP.

(17) Includes an unvested annual credit in the amount of $200,000 provided under a LTDCP agreement with Mr. McCollum, $11,764 in vehicle allowance payments, $114 in relocation assistance payments, and $1,233 in tax reimbursements associated with relocation assistance payments, and $10,125 in 401(k) employer matching contributions. Mr. McCollum will become vested in the $200,000 credit in accordance with the terms of the LTDCP agreement. See information regarding the details of the LTDCP agreement under "Long-Term Deferred Compensation Plan Agreements."

(18) Includes $460,257 awarded under the EAIP and $581,875 awarded under the ELTIP.

(19) Includes increases of $5,385 under TVA's qualified defined benefit plan and $2,021,032 under the SERP. The $2,026,417 amount represents a correction of the $1,430,162 amount reported in TVA's 2007 Annual Report on Form 10-K, as amended, which included increases of $5,385 under TVA's qualified defined benefit plan and $1,424,777 under the SERP.

(20) Includes $156,408 awarded under the EAIP and $283,605 awarded under the ELTIP.

(21) Includes increases of $14,049 under TVA's qualified defined benefit plan and $147,926 under the SERP.

(22) Includes an unvested annual credit in the amount of $200,000 provided under a LTDCP agreement with Mr. Campbell, $11,764 in vehicle allowance payments, $224 in tax reimbursements associated with relocation assistance payments, and $10,125 in 401(k) employer matching contributions. Mr. Campbell will become vested in the $200,000 credit in accordance with the terms of the LTDCP agreement. See information regarding the details of the LTDCP agreement under "Long-Term Deferred Compensation Plan Agreements."

(23) Includes $258,340 awarded under the EAIP and $145,321 awarded under the ELTIP.

(24) Includes increases of $14,284 under TVA's qualified defined benefit plan and $14,942 under the SERP.

(25) Includes an unvested annual credit in the amount of $150,000 provided under a LTDCP agreement with Mr. Bhatnagar, and $11,764 in vehicle allowance payments. Mr. Bhatnagar will become vested in the $150,000 credit in accordance with the terms of the LTDCP agreement. See information regarding the details of the LTDCP agreement under "Long-Term Deferred Compensation Plan Agreements."

(26) Includes $199,572 awarded under the EAIP, $227,644 awarded under the ELTIP, and a credit in the amount of $43,452 made to Mr. Bhatnagar's deferred compensation account provided under a LTDCP agreement with Mr. Bhatnagar for achievement of major milestones in 2007 associated with the Browns Ferry Unit 1 Recovery Project. See information regarding the details of the LTDCP agreement under "Long-Term Deferred Compensation Plan Agreements."

(27) Includes increases of $16,030 under TVA's qualified defined benefit plan and $138,907 under the SERP.

(28) Includes $210,007 awarded under the EAIP, $140,641 awarded under the ELTIP, and a credit in the amount of $40,000 made to Mr. Bhatnagar's deferred compensation account provided under a LTDCP agreement with Mr. Bhatnagar for achievement of major milestones in 2006 associated with the Browns Ferry Unit 1 Recovery Project. See information regarding the details of the LTDCP agreement under "Long-Term Deferred Compensation Plan Agreements."

(29) Includes increases of $12,945 under TVA's qualified defined benefit plan and $147,670 under the SERP.

The following table provides information regarding non-equity incentive plan awards and the possible range of payouts associated with incentives the Named Executive Officers were eligible to receive for performance in the performance cycles ending in 2008.

Grants of Plan-Based Awards Table

		Estimated Possible Payouts Under Non-Equity Incentive Plan Awards [1]		
Name (a)	**Grant Date (b)**	**Threshold ($) (c)**	**Target ($) (d)**	**Maximum ($) (e)**
Tom D. Kilgore	EAIP [2]	$609,375	$812,500	$1,015,625
	ELTIP [3]	$487,500	$975,000	$1,462,500
Kimberly S. Greene	EAIP [2]	$243,750	$325,000	$406,250
	ELTIP [3]	$162,500	$325,000	$487,500
William R. McCollum, Jr.	EAIP [2]	$378,525	$504,700	$630,875
	ELTIP [3]	$252,350	$504,700	$757,050

William R. Campbell	EAIP [2]	$268,313	$357,750	$447,188
	ELTIP [3]	$190,800	$381,600	$572,400
Ashok S. Bhatnagar	EAIP [2]	$195,534	$260,712	$325,890
	ELTIP [3]	$97,767	$195,534	$293,301

Notes

(1) TVA does not have any equity securities and has no equity-based awards.

(2) Actual awards earned for performance in 2008 are reported for each of the Named Executive Officers under “Non-Equity Incentive Plan Compensation” in the Summary Compensation Table.

(3) Actual awards earned for the performance cycle ended on September 30, 2008, are reported for each of the Named Executive Officers under “Non-Equity Incentive Plan Compensation” in the Summary Compensation Table.

Executive Annual Incentive Plan Awards. Incentive opportunities under the EAIP for 2008 were as follows:

Executive Annual Incentive Plan

Name	EAIP Incentive Opportunity [1]
Tom D. Kilgore	125%
Kimberly S. Greene	65%
William R. McCollum, Jr.	70%
William R. Campbell	75%
Ashok S. Bhatnagar	60%

Note
(1) Represents a percentage of each participant's salary.

Awards earned under the EAIP for 2008 were calculated as the product of salary times the annual incentive opportunity times the percent of opportunity achieved for each Named Executive Officer. Based on this calculation, the EAIP payouts were $374,806 (57.66 percent of salary) for Mr. Kilgore; $252,298 (50.46 percent of salary) for Ms. Greene; $376,658 (52.24 percent of salary) for Mr. McCollum; $156,408 (32.79 percent of salary) for Mr. Campbell; and $258,340 (59.45 percent of salary) for Mr. Bhatnagar. All awards will be paid in cash during the first quarter of 2009 with a deferral option. Mr. McCollum elected to defer 100 percent of his EAIP award earned for 2008.

Executive Long-Term Incentive Plan Awards. Incentive opportunities for the one-year performance cycle ended on September 30, 2008, were as follows:

Executive Long-Term Incentive Plan

Name	ELTIP Incentive Opportunity [1]
Tom D. Kilgore	150%
Kimberly S. Greene	65%
William R. McCollum, Jr.	70%
William R. Campbell	80%
Ashok S. Bhatnagar	45%

Note
(1) Represents a percentage of each participant's salary.

Awards earned under the ELTIP for the one-year performance cycle ended on September 30, 2008, were calculated as the product of salary times the ELTIP incentive opportunity times the percent of opportunity achieved for each Named Executive Officer. Based on this calculation, and a 74.32 percent of opportunity achieved, the ELTIP payouts were $724,620 (111.48 percent of salary) for Mr. Kilgore; $241,540 (48.31 percent of salary) for Ms. Greene; $375,093 (52.02 percent of salary) for Mr. McCollum; $283,605 (59.46 percent of salary) for Mr. Campbell; and $145,321 (33.44 percent of salary) for Mr. Bhatnagar. All awards will be paid in cash during the first quarter of 2009 with a deferral option. Mr. McCollum elected to defer 100 percent of his ELTIP award earned for the performance cycle ended on September 30, 2008.

Long-Term Deferred Compensation Plan Agreements.

In March 2005, TVA entered into a LTDCP agreement with Mr. Kilgore. Under the terms of the agreement, Mr. Kilgore received deferred compensation credits of $300,000 on March 31, 2005, October 1, 2005, October 1, 2006, October 1, 2007, and October 1, 2008. Pursuant to the agreement, Mr. Kilgore was vested in the first credit of $300,000 at the time the credit was made in March 2005 and will be vested in any earnings on this amount. Mr. Kilgore will vest in the remaining balance of his account only if he remains employed by TVA until the expiration of the agreement on September 30, 2009, after which the account will be distributed to him in a lump sum following the termination

of his employment with TVA. In the event TVA terminates Mr. Kilgore's employment during the term of the LTDCP agreement through no act or delinquency of his own, any credits and earnings on those credits in Mr. Kilgore's account at the time of termination will become vested and distributed to him in a lump sum. If Mr. Kilgore voluntarily terminates his employment or TVA terminates Mr. Kilgore's employment for cause prior to the expiration of the agreement, all credits in Mr. Kilgore's account, except the initial $300,000 credit and any earnings on this amount, will be forfeited.

In September 2007, TVA entered into a LTDCP agreement with Ms. Greene. Under the terms of the agreement, Ms. Greene received a deferred compensation credit of $280,000 on September 4, 2007, and a deferred compensation credit of $100,000 on October 1, 2008. Ms. Greene will also receive deferred compensation credits in the amount of $100,000 each on October 1, 2009, and October 1, 2010, if she remains employed by TVA on these dates. Pursuant to the agreement, Ms. Greene was vested in the first credit of $280,000 at the time the credit was made and will be vested in any earnings on this amount. Ms. Greene will vest in the remaining balance of her account only if she remains employed by TVA until the expiration of the agreement on September 30, 2011. All vested credits in her account under this LTDCP agreement will be distributed to her in five annual installments following the termination of her employment with TVA. In the event TVA terminates Ms. Greene's employment during the term of the LTDCP agreement through no act or delinquency of her own, any credits and earnings on those credits in Ms. Greene's account at the time of termination will become vested and distributed to her in five annual installments. If Ms. Greene voluntarily terminates her employment or TVA terminates Ms. Greene's employment for cause prior to the expiration of the agreement, all credits in Ms. Greene's account, except the initial $280,000 credit and any earnings on this amount, will be forfeited.

In May 2007, TVA entered into a LTDCP agreement with Mr. McCollum. Under the terms of the agreement, Mr. McCollum received a deferred compensation credit of $350,000 on May 1, 2007, and deferred compensation credits of $200,000 on October 1, 2007, and October 1, 2008. Mr. McCollum will also receive deferred compensation credits in the amount of $200,000 each on October 1, 2009, and October 1, 2010, if he remains employed by TVA on these dates. Pursuant to the agreement, Mr. McCollum was vested in the first credit of $350,000 at the time the credit was made and will be vested in any earnings on this amount. Mr. McCollum will vest in the remaining balance of his account only if he remains employed by TVA until the expiration of the agreement on September 30, 2011. All vested credits in his account under this LTDCP agreement will be distributed to him in five annual installments following the termination of his employment with TVA. In the event TVA terminates Mr. McCollum's employment during the term of the LTDCP agreement through no act or delinquency of his own, any credits and earnings on those credits in Mr. McCollum's account at the time of termination will become vested and distributed to him in five annual installments. If Mr. McCollum voluntarily terminates his employment or TVA terminates Mr. McCollum's employment for cause prior to the expiration of the agreement, all credits in Mr. McCollum's account, except the initial $350,000 credit and any earnings on this amount, will be forfeited.

In March 2007, TVA entered into a LTDCP agreement with Mr. Campbell. Under the terms of the agreement, Mr. Campbell received a deferred compensation credit of $70,000 on May 14, 2007, and deferred compensation credits of $200,000 on October 1, 2007, and October 1, 2008. Mr. Campbell will also receive deferred compensation credits in the amount of $200,000 each on October 1, 2009, October 1, 2010, and October 1, 2011, if he remains employed by TVA on these dates. Pursuant to the agreement, Mr. Campbell was vested in the first credit of $70,000 at the time the credit was made and will be vested in any earnings on this amount. Mr. Campbell will vest in the remaining balance of his account only if he remains employed by TVA until the expiration of the agreement on September 30, 2012. All vested credits in his account under this LTDCP agreement will be distributed to him in five annual installments following the termination of his employment with TVA. In the event TVA terminates Mr. Campbell's employment during the term of the LTDCP agreement through no act or delinquency of his own, any credits and earnings on those credits in Mr. Campbell's account at the time of termination will become vested and distributed to him in five annual installments. If Mr. Campbell voluntarily terminates his employment or TVA terminates Mr. Campbell's employment for cause prior to the expiration of the agreement, all credits in Mr. Campbell's account, except the initial $70,000 credit and any earnings on this amount, will be forfeited.

In September 2004, TVA entered into a LTDCP agreement with Mr. Bhatnagar. Under the terms of the agreement, Mr. Bhatnagar received deferred compensation credits of $150,000 on October 1, 2004, October 1, 2005, October 1, 2006, October 1, 2007, and October 1, 2008. Mr. Bhatnagar will vest in his account only if he remains employed by TVA until the expiration of the agreement on September 30, 2009, after which the account will be distributed to him in a lump sum. In the event TVA terminates Mr. Bhatnagar's employment during the term of the LTDCP agreement through no act or delinquency of his own, any credits and earnings on those credits in Mr. Bhatnagar's account at the time of termination will become vested and distributed to him in a lump sum. If Mr. Bhatnagar voluntarily terminates his employment or TVA terminates Mr. Bhatnagar's employment for cause prior to the expiration of the agreement, all credits in Mr. Bhatnagar's account will be forfeited.

In addition to the LTDCP agreement with Mr. Bhatnagar described above, TVA has entered into a second LTDCP agreement with Mr. Bhatnagar that provides annual credits of up to $50,000 for a period of four years based on the accomplishment of major milestones associated with the Browns Ferry Unit 1 Recovery Project. The actual amount credited each year is based on the achievement of specific milestones established at the beginning of each year. Under this agreement, credits earned were vested and credited to a deferred compensation account in Mr. Bhatnagar's name at the end of each year. For 2007, the milestone objective established for Mr. Bhatnagar's agreement was the successful restart date of Browns Ferry Unit 1 with a 100 percent payout for restart by May 22, 2007, 75 percent payout for restart by June 15, 2007, and no payout for restart after June 15, 2007. The payout percentage for a successful restart date between May 22, 2007, and June 15, 2007 was determined by straight-line interpolation. For purposes of the agreement, Browns Ferry Unit 1 was considered successfully restarted on June 2, 2007. As a result, Mr. Bhatnagar was awarded a credit of $43,452 for 2007, which, under the terms of the agreement, has been placed in a deferred compensation account in his name to be distributed in a lump sum upon termination of employment.

Retirement and Pension Plans

The following table provides the actuarial present value of the Named Executive Officer's accumulated benefits, including the number of years of credited service, under TVA's retirement and pension plans as of September 30, 2008, determined using a methodology and interest rate and mortality rate assumptions that are consistent with those used in the financial statements contained in this Annual Report as set forth in Note 14.

Pension Benefits Table

Name (a)	Plan Name (b)	Number of Years of Credited Service [1] (#) (c)	Present Value of Accumulated Benefit ($) (d)	Payments During Last Year ($) (e)
Tom D. Kilgore	(1) Qualified Plan – CBBS (2) Non-Qualified – SERP Tier 1	3.58 8.00 [2]	$36,809 $1,978,804	$0 $0
Kimberly S. Greene	(1) Qualified Plan – CBBS (2) Non-Qualified – SERP Tier 1	1.08 16.08 [3]	$15,127 $451,332	$0 $0
William R. McCollum, Jr.	(1) Qualified Plan – CBBS (2) Non-Qualified – SERP Tier 1	1.42 11.42 [4]	$16,206 $2,136,651	$0 $0
William R. Campbell	(1) Qualified Plan – CBBS (2) Non-Qualified – SERP Tier 1	1.33 6.33 [5]	$15,599 $870,414	$0 $0
Ashok S. Bhatnagar	(1) Qualified Plan – CBBS (2) Non-Qualified – SERP Tier 1	9.08 9.08	$112,561 $569,930	$0 $0

Notes:

(1) Limited to 24 years when determining supplemental benefits available under SERP Tier 1, described below.

(2) Mr. Kilgore has been granted three additional years of credited service for pre-TVA employment following five years of actual TVA service. In the event his employment is terminated during the first five years (other than for cause), the five-year vesting requirement will be waived and he will receive credit for eight years of service. In addition, the offset for prior employer pension benefits will be waived, and the offset for benefits provided under TVA's defined benefit plan will be calculated based on the actual pension benefit he will receive as a participant in the CBBS. Without waiving the vesting requirement and the additional years of credited service, the present value of Mr. Kilgore's accumulated benefit would be $0.

(3) Ms. Greene has been granted 15 additional years of credited service for pre-TVA employment and the offset for prior employer pension benefits has been waived. The offset for benefits provided under TVA's defined benefit plan will be calculated based on the benefit she will be eligible to receive as a participant in the CBBS taking into account the additional years of credited service being used for SERP benefit calculation purposes. In the event that Ms. Greene voluntarily terminates her employment with TVA or is terminated for cause prior to satisfying the minimum five-year vesting requirement, no benefits will be provided to her under the SERP. In the event of termination for any other reason, prior to five years of employment, the five-year vesting requirement will be waived and the benefit Ms. Greene will be eligible to receive will be payable no earlier than age 55. As of September 30, 2008, the present value of this benefit is $451,332. Without the additional years of credited service, the present value of Ms. Greene's accumulated benefit would be $0.

(4) Mr. McCollum has been granted 10 additional years of credited service for pre-TVA employment and the offset for prior employer pension

benefits has been waived. The additional years of credited service will be used for SERP benefit calculation purposes only and will not count toward the minimum five-year vesting requirement. In the event Mr. McCollum voluntarily terminates his employment with TVA or is terminated for cause prior to satisfying the minimum five-year vesting requirement, no benefits will be provided under the SERP. In the event of termination for any other reason, prior to five years of employment, the five-year vesting requirement will be waived as long as the termination is considered acceptable to TVA, and Mr. McCollum would be eligible to receive benefits payable in five annual installments following termination. The present value of this benefit as of September 30, 2008, is $2,136,651. Without the additional years of credited service, the present value of Mr. McCollum's accumulated benefit would be $0.

(5) Mr. Campbell has been granted five additional years of credited service for pre-TVA employment and the offsets for prior employer pension benefits and social security benefits have been waived. The additional years of credited service will be used for SERP benefit calculation purposes only and will not count toward the minimum five-year vesting requirement. In addition, the offset for benefits provided under TVA's defined benefit plan will be calculated based on the actual pension benefit he will receive as a participant in the CBBS. In the event Mr. Campbell voluntarily terminates his employment with TVA or is terminated for cause prior to satisfying the minimum five-year vesting requirement, no benefits will be provided under the SERP. In the event of termination (other than for cause) following the required five years of vesting service, his termination will be considered an approved termination under TVA's SERP and a benefit equal to that calculated for an "Approved Termination" will be payable upon termination as long as the termination is considered acceptable to TVA. The present value of this benefit as of September 30, 2008, is $870,414. Without the additional years of credited service, the present value of Mr. Campbell's accumulated benefit would be $0.

Qualified Defined Benefit Plan. TVA sponsors a qualified defined benefit plan with two structures for employees, including the Named Executive Officers, which is administered by the TVA Retirement System. The structures are the Original Benefit Structure ("OBS") and the CBBS. Participation in the OBS is limited to employees who were covered under the plan prior to January 1, 1996. All employees first hired by TVA on or after January 1, 1996, participate in the CBBS. As with any other qualified retirement plan, there are limits on employee and employer contributions and compensation that can be counted for benefit calculations set by the TVA Retirement System rules and IRS regulations.

All of the Named Executive Officers are members of the CBBS. Under the CBBS, each member has a cash balance account that receives pay credits equal to six percent of his/her compensation each pay period (every two weeks). For executives who are members of the CBBS, compensation is defined as annual salary only for benefit calculation purposes and is shown under the column titled "Salary" in the Summary Compensation Table, although compensation could not exceed $225,000 in 2008 pursuant to the IRS annual compensation limit applicable to qualified plans. The account is credited with interest each month, and interest is compounded on an annual basis. The annual interest rate used for interest credits is determined each January 1. The interest rate is 3 percent greater than the percentage increase in the 12-month average of the Consumer Price Index for the period ending on the previous October 31. The minimum interest rate is 6 percent and the maximum interest rate is 10 percent unless the TVARS Board, with TVA's approval, selects a higher interest rate. When a member elects to begin receiving retirement benefits, the cash balance account is converted to a monthly pension payment by dividing the ending value of the cash balance account by a conversion factor set forth in the plan based on the member's actual age in years and months.

Members with at least five years of CBBS service are eligible to receive an immediate benefit. CBBS service is the length of time spent as a member of the TVA Retirement System and does not include credit for unused sick leave, forfeited annual leave, or pre-TVA employment military service. The CBBS does not provide early retirement benefits to any Named Executive Officer or any other member in the CBBS.

Supplemental Executive Retirement Plan. The SERP is a non-qualified defined benefit pension plan similar to those typically found in other companies in TVA's peer group and is provided to a limited number of executives, including the Named Executive Officers. TVA's SERP was created to recruit and retain key executives. The plan is designed to provide a competitive level of retirement benefits in excess of the limitations on contributions and benefits imposed by TVA's qualified defined benefit plan and IRS code section 415 limits on qualified retirement plans.

The SERP provides two distinct levels of participation, Tier 1 and Tier 2. Each employee is assigned to one of the two tiers at the time he or she is approved to participate in the SERP. The level of participation ("Tier") defines the level of retirement benefits provided under the SERP at the time of retirement.

Under the SERP, normal retirement eligibility is age 62 with five years of vesting service. No vested and accrued benefits are payable prior to age 55, and benefits are reduced for retirements prior to age 62. The level of reduction in benefits for retirements prior to age 62 depends on whether a participant's termination is "approved" or "unapproved." In the event of an approved termination of TVA employment, any vested and accrued benefits are reduced by 5/12 percent for each month that the date of benefit commencement precedes the participant's 62nd birthday up to a maximum reduction of 35 percent. In the event of an unapproved termination of TVA employment, the participant's accrued benefits are first subject to a reduced percentage of vesting if the participant's years of service are between five and ten. At five years of vesting service, the vested percentage of retirement benefits is 50 percent and increases thereafter by 10 percent for each full additional year of service, reaching 100 percent vesting for ten or more years of vesting service. Thereafter, any vested and accrued benefits are reduced by 10/12 percent for each month that the date of benefit commencement precedes the participant's 62nd birthday up to a maximum reduction of 70 percent.

For purposes of the SERP, an "approved" termination means termination of employment with TVA due to (i) retirement on or after the participant's 62nd birthday, (ii) retirement on or after attainment of actual age 55, if such retirement has the approval of the TVA Board or its delegatee, (iii) death in service as an employee, (iv) disability (as such term is defined under TVA's long-term disability plan), or (v) any other circumstances approved by the TVA Board or its delegatee. For purposes of the SERP, an "unapproved" termination means a termination of employment with TVA when such termination does not constitute an "approved" termination as defined in the preceding sentence.

SERP Tier 1 . All of the Named Executive Officers are participants in Tier 1. The Tier 1 structure is designed to replace 60 percent of the amount of a participant's compensation at the time the participant reaches age 62 and has accrued 24 years of service at TVA.

Tier 1 benefits are based on a participant's highest average compensation during three consecutive SERP years and a pension multiple of 2.5 percent for each year of credited service up to a maximum of 24 years. Compensation is defined as salary, additional annual compensation, and EAIP for benefit calculation purposes. Tier 1 benefits are offset by Social Security benefits, benefits provided under TVA's defined benefit plan, and prior employer pension benefits when applicable. All of the Named Executive Officers are participants in Tier 1.

SERP Tier 2 . None of the Named Executive Officers participates in Tier 2.

The TVA Sponsored 401(k) Plan. Members of the TVA Retirement System, including the Named Executive Officers, may elect to participate in the TVA Retirement System's 401(k) plan on a before- and/or after-tax basis. For CBBS members, TVA provides a matching contribution of 75 cents on every dollar contributed on a before- and/or after-tax basis up to 4.5 percent of the participant's annual salary.

Nonqualified Deferred Compensation

The following table provides information regarding deferred contributions, earnings, and balances for each of the Named Executive Officers. The amounts reported under this table do not represent compensation in addition to the compensation that was earned in 2008 and already reported in the Summary Compensation Table but rather the amounts of compensation earned by the Named Executive Officers in 2008 or prior years that was or has been deferred.

Nonqualified Deferred Compensation Table

Name (a)	Executive Contributions in Last FY ($) (b)	Registrant Contributions in Last FY ($) (c)	Aggregate Earnings in Last FY [1] ($) (d)	Aggregate Withdrawals/ Distributions ($) (e)	Aggregate Balance at Last FYE [2] ($) (f)
Tom D. Kilgore	$ 0	$ 300,000[3]	$ (9,578)	$ 0	$ 3,031,630[4]
Kimberly S. Greene	$ 0	$ 0	$ 14,093	$ 0	$ 295,069
William R. McCollum, Jr.	$ 751,751[5]	$ 200,000[6]	$ (145,695)	$ 0	$ 1,193,092[7]
William R. Campbell	$ 0	$ 200,000[8]	$ 13,580	$ 0	$ 284,893[9]
Ashok S. Bhatnagar	$ 0	$ 150,000[10]	$ (433,599)	$ 0	$ 2,145,527[11]

Notes

(1) Includes vested and unvested earnings. None of these amounts are included in the Summary Compensation Table.

(2) Includes vested and unvested amounts.

(3) Represents an unvested annual credit in the amount of $300,000 provided under a LTDCP agreement with Mr. Kilgore (reported in the "All Other Compensation" column in the Summary Compensation Table).

(4) Represents the balance of Mr. Kilgore's account, including unvested credits and earnings totaling $990,564, as of September 30, 2008. The amount in the "Aggregate Balance at Last FYE" column includes $783,661 (EAIP and ELTIP deferrals) reported in the Summary Compensation Table for 2007.

(5) Mr. McCollum elected to defer 100 percent of the $376,658 to be awarded under the EAIP for 2008 and 100 percent of the $375,093 to be awarded under the ELTIP for the performance period that ended on September 30, 2008. These amounts are reported in the "Non-Equity Incentive Plan Compensation" column in the Summary Compensation Table.

(6) Represents an unvested annual credit in the amount of $200,000 provided under a LTDCP agreement with Mr. McCollum (reported in the "All Other Compensation" column in the Summary Compensation Table).

(7) Represents the balance of Mr. McCollum's account, including unvested credits and earnings totaling $179,036, as of September 30, 2008. The amount in the "Aggregate Balance at Last FYE" column includes $781,599 (EAIP and ELTIP deferrals) reported in the Summary Compensation Table for 2007. The amount reported in "Executive Contributions in Last FY" column will be credited to his account in the first quarter of 2009 and is not included in the balance.

(8) Represents an unvested annual credit in the amount of $200,000 provided under a LTDCP agreement with Mr. Campbell (reported in the "All Other Compensation" column in the Summary Compensation Table).

(9) Represents the balance of Mr. Campbell's account, including unvested credits and earnings totaling $210,003, as of September 30, 2008.

(10) Represents an unvested annual credit in the amount of $150,000 provided under a LTDCP agreement with Mr. Bhatnagar (reported in the "All Other Compensation" column in the Summary Compensation Table).

(11) Represents the balance of Mr. Bhatnagar's account, including unvested credits and earnings totaling $627,348, as of September 30, 2008.

TVA allows participants in the EAIP, ELTIP, and LTDCP to elect to defer all or a portion of the compensation earned under those plans that is eligible for deferral under applicable IRS regulations. All deferrals are credited to each participant in a deferred compensation account, and the deferral amounts are then funded into a rabbi trust. Each participant may elect one or more of several notional investment options made available by TVA or allow some or all funds to accrue interest at the rate established at the beginning of each fiscal year. Participants may elect to change from either one notional investment option or the TVA interest bearing option to another at any time. Upon termination, funds are distributed pursuant to elections made in accordance with applicable IRS regulations.

No executives, including the Named Executive Officers, were permitted to defer any portion of their annual salary in 2008. Participants in the EAIP and ELTIP, including the Named Executive Officers, are permitted to elect annually to defer all or a portion of their awards (25, 50, 75 or 100 percent) received under the plans.

Severance Agreements

In January 2005, TVA entered into an agreement with Mr. Kilgore that provides a lump-sum payment equal to one year's annual compensation if (1) his duties, responsibilities, or compensation is substantially reduced, and he terminates his employment with TVA, or (2) his employment is terminated for any reason other than "for cause." For purposes of this agreement, "annual compensation" is defined as annual salary plus additional annual compensation plus the amount of the annual and long-term incentive awards he would have been eligible to receive based on 100 percent achievement of target performance goals. As of September 30, 2008, this lump-sum payment would have been equal to $2,437,500. In addition, if his employment had been terminated on September 30, 2008, other than for cause or as a result of a voluntary resignation, Mr. Kilgore would have received $990,564 under his LTDCP agreement payable in a lump sum following termination, and SERP benefits payable in five annual installments, which as of September 30, 2008, had a present value of $1,978,804. Upon termination of employment for any reason, Mr. Kilgore would be eligible to receive any amounts in his 401(k) plan account, subject to plan rules, and any amounts that he earned in past years but elected to defer.

In August 2007, TVA entered into an agreement with Ms. Greene that provides a lump-sum payment in an amount equal to two years' annual compensation in the event that TVA's current Chief Executive Officer no longer occupies that position and Ms. Greene is asked to leave TVA employment for any reason other than for cause or she terminates her employment because she is asked to take a position with TVA other than her then current position as Chief Financial Officer and Executive Vice President, Financial Services. For purposes of this agreement, "annual compensation" is defined as annual salary plus the amount of the annual incentive award based on 100 percent achievement of target performance goals. As of September 30, 2008, this lump-sum payment would have been equal to $1,650,000. In addition, if her employment had been terminated on September 30, 2008, other than for cause or as a result of a voluntary resignation, Ms. Greene would have been eligible to receive SERP benefits payable in five annual installments beginning no earlier than age 55. As of September 30, 2008, the present value of these SERP benefits was $451,332. Upon termination of employment for any reason, Ms. Greene would be eligible to receive any amounts in her 401(k) plan account that she contributed and any earnings on these amounts, subject to plan rules, and any amounts that she earned in past years but elected to defer.

Neither Mr. McCollum, Mr. Campbell, nor Mr. Bhatnagar has a severance agreement with TVA. However, had Mr. McCollum's employment been terminated on September 30, 2008, other than for cause or as a result of a voluntary resignation, Mr. McCollum would have received $179,036 under his LTDCP agreement payable in five annual installments following termination, and SERP benefits payable in five annual installments, which as of September 30, 2008, had a present value of $2,136,651, assuming the termination was deemed an approved termination under the SERP. In addition, upon termination of employment for any reason, Mr. McCollum would be eligible to receive any amounts in his 401(k) plan account that he contributed and any earnings on these amounts, subject to plan rules, and any amounts that he earned in past years but elected to defer. Had Mr. Campbell's employment been terminated on September 30, 2008, other than for cause or as a result of a voluntary resignation, Mr. Campbell would have received $210,003 under his LTDCP agreement payable in five annual installments following termination, and SERP benefits payable in five annual installments, which as of September 30, 2008, had a present value of $870,414, assuming the termination was deemed an approved termination under the SERP. In addition, upon termination of employment for any reason, Mr. Campbell would be eligible to receive any amounts in his 401(k) plan account that he contributed and any earnings on these amounts, subject to plan rules, and any amounts that he earned in past years but elected to defer. Had Mr. Bhatnagar's employment been terminated on September 30, 2008, other than for cause or as a result of a voluntary resignation, Mr. Bhatnagar would have received $627,348 under his LTDCP agreement payable in a lump sum following termination, and SERP benefits payable in five annual installments beginning no earlier than age 55, which as of September 30, 2008, had a present value of $569,561, assuming the termination was deemed an approved termination under the SERP. In addition, upon termination of employment for any reason, Mr. Bhatnagar would be eligible to receive $112,561 under TVA's qualified defined benefit plan payable in the form of an actuarial equivalent lifetime annuity, any amounts in his 401(k) plan account, subject to plan rules, and any amounts that he earned in past years but elected to defer.

Other Agreements

Except as described above, there are no other agreements between TVA and any of the Named Executive Officers.

Director Compensation

The TVA Act provides for nine directors on the TVA Board. The TVA Board is currently composed of seven directors with two vacant positions to be filled upon nomination by the President of the United States and confirmation by the Senate. Under the TVA Act, each of TVA's directors receives certain stipends that are increased annually by the same percentage increase applicable to adjustments under 5 U.S.C. § 5318, which provides for adjustments in the annual rates of pay of employees on the Executive Schedule of the United States Government. As of September 30, 2008, the base stipend amounted to $46,900 per year unless (1) the director is the chair of a TVA Board committee, in which case the stipend is $48,000 per year, or (2) the director is the chairman of the TVA Board, in which case the stipend is $53,200 per year. Directors are also reimbursed under federal law for travel, lodging, and related expenses that they incur in attending meetings and for other official TVA business in the same manner as other persons employed intermittently in federal government service.

The annual stipends provided by the TVA Act for each director and to the chairman of the TVA Board as of September 30, 2008, were as follows:

TVA Board Annual Stipends

Name	Annual Stipend ($)
Dennis C. Bottorff	$ 48,000
Donald R. DePriest	$ 48,000
Robert M. Duncan	$ 46,900
Thomas C. Gilliland	$ 48,000
Bishop William H. Graves	$ 46,900
William B. Sansom	$ 52,200
Howard A. Thrailkill	$ 48,000

The following table set outs the compensation received by TVA's directors during 2008.

Director Compensation

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)	Option Awards ($) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings [1] ($) (f)	All Other Compensation ($) (g)	Total ($) (h)
Dennis C. Bottorff	$ 48,631	–	–	–	–	$ 869	$ 49,500
Donald R. DePriest	$ 48,631	–	–	–	–	$ 2,301	$ 50,932
Robert M. Duncan	$ 48,631	–	–	–	–	$ 869	$ 49,500
Thomas Chandler Gilliland [2]	$ 24,554	–	–	–	–	$ 435	$ 24,989
Bishop William H. Graves [3]	$ 24,433	–	–	–	–	$ 574	$ 25,007
Skila S. Harris [4]	$ 30,908	–	–	–	–	$ 1,735	$ 32,643
William B. Sansom	$ 52,909	–	–	–	–	$ 945	$ 53,854
Howard A. Thrailkill	$ 48,631	–	–	–	–	$ 2,445	$ 51,076
Susan Richardson Williams [5]	$ 11,677	–	–	–	–	$ 669	$ 12,346

Notes

(1) TVA directors do not participate in the TVA Retirement System, TVA's SERP, or any non-qualified deferred compensation plan available to TVA employees. However, as appointed officers of the United States government, the directors are members of the Federal Employees Retirement System ("FERS"). FERS is administered by the federal Office of Personnel Management ("OPM"), and information regarding the value of FERS pension benefits is not available to TVA.

(2) Mr. Gilliland did not become a director until March 28, 2008.

(3) Bishop Graves served on the TVA Board from October 10, 2006 to December 31, 2007, and was reappointed to the TVA Board on June 24, 2008.

(4) Ms. Harris ended her service as a director on May 19, 2008.

(5) Ms. Williams served on the TVA Board from March 31, 2006 to December 31, 2007. Although Ms. Williams has been nominated for a second term, she has not been confirmed by the Senate.

Directors are eligible to participate in TVA's health benefit plans and other non-retirement benefit plans on the same terms and at the same contribution rates as other TVA employees. The directors are not eligible to participate in any incentive programs available to TVA employees. The directors do not participate in the TVA Retirement System and do not participate in TVA's SERP. However, as appointed officers of the United States government, the directors are members of the Federal Employees Retirement System ("FERS"). FERS is a tiered retirement plan that includes three components: (1) Social Security benefits, (2) the Basic Benefit Plan, and (3) the Thrift Savings Plan. Each director pays full Social Security taxes and makes a small contribution (0.8 percent of salary or stipend) to the Basic Benefit Plan.

The FERS Basic Benefit Plan is a qualified defined benefit plan that provides a retirement benefit based on a final average pay formula that includes age, highest average salary during any three consecutive years of service, and years of creditable service. A director must have at least five years of creditable service in order to be eligible to receive retirement benefits. Directors are eligible for immediate, unreduced retirement benefits once (1) they reach age 62 and have five years of creditable service, (2) they reach age 60 and have 20 years of creditable service, or (3) they attain the minimum retirement age and accumulate the specified years of service. Generally, benefits are calculated by multiplying 1.0 percent of the highest average salary during any three consecutive years of service by the number of years of creditable service. Directors who retire at age 62 or later with at least 20 years of service receive an enhanced benefit (a factor of 1.1 percent is used rather than 1.0 percent).

Directors may also retire with an immediate benefit under FERS if they reach their minimum retirement age and have accumulated at least 10 years of creditable service. For directors who reach the minimum retirement age and have at least 10 years of creditable service, the annuity will be reduced by five percent for each year the director is under age 62.

Each director is also eligible to participate in the Thrift Savings Plan. The Thrift Savings Plan is a tax-deferred retirement savings and investment plan that offers the same type of savings and tax benefits offered under 401(k) plans. Once a director becomes eligible, after a mandatory waiting period, TVA contributes an amount equal to one percent of the director's stipend into a Thrift Savings Plan account for the director. These contributions are made automatically every two weeks regardless of whether the director makes a contribution of his or her own money. Directors are eligible to contribute up to the Internal Revenue Service ("IRS") elective deferral limit. Directors receive a matching contribution according to the following schedule: 100 percent of each dollar for the first three percent of the director's stipend, 50 percent of each dollar for the next two percent of the director's stipend, and zero percent for contributions above five percent of the director's stipend.

Compensation Committee Interlocks and Insider Participation

The FSRA Committee consists of the following three directors: Dennis C. Bottorff, Chair, Donald R. DePriest, and William B. Sansom. Pursuant to the Compensation Plan, the FSRA Committee will review the compensation of the CEO and his direct reports, monitor the process for approving compensation for TVA employees compensated in excess of the federal government's Executive Schedule Level IV ($149,000 as of September 30, 2008), monitor TVA executive compensation programs, and periodically review the compensation and benefits programs for all TVA employees.

Under the TVA Act, the TVA Board has the authority to approve the compensation of the CEO and his direct reports as well as the salaries of employees whose salaries exceed Executive Schedule Level IV. While the FSRA Committee can recommend that the TVA Board approve the compensation of the CEO and his direct reports and the salaries of employees whose salaries exceed Executive Schedule Level IV, the FSRA Committee has no approval authority.

No executive officer of TVA serves on the board of an entity which in turn has an executive officer of the entity serving as a director of TVA.

Compensation Committee Report

The FSRA Committee has reviewed and discussed the Compensation Discussion and Analysis with management, and based on the review and discussions, the FSRA Committee recommended to the TVA Board that the Compensation Discussion and Analysis be included in this Annual Report.

THE FINANCE, STRATEGY, RATES, AND ADMINISTRATION COMMITTEE

Dennis C. Bottorff, Chair
Donald R. DePriest
William B. Sansom

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Not applicable.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Director Independence

The composition of the TVA Board is governed by the TVA Act. The TVA Act contains certain provisions that are similar to the considerations for independence under section 10A(m)(3) of the Exchange Act, including that to be eligible for appointment to the TVA Board, an individual shall not be an employee of TVA and shall make full disclosure to Congress of any investment or other financial interest that the individual holds in the energy industry. These provisions became applicable to TVA Board members on March 31, 2006.

Related Party Transactions

Conflict of Interest Provisions

All TVA employees, including directors and executive officers, are subject to the conflict of interest laws and regulations applicable to employees of the federal government. Accordingly, the general federal conflict of interest statute (18 U.S.C. § 208) and the Standards of Ethical Conduct for Employees of the Executive Branch (5 C.F.R. part 2635) ("Standards of Ethical Conduct") form the basis of TVA's policies and procedures for the review, approval, or ratification of related party transactions. The general federal conflict of interest statute, subject to certain exceptions, prohibits each government employee, including TVA's directors and executive officers, from participating personally and substantially (by advice, decision, or otherwise) as a government employee in any contract, controversy, proceeding, request for determination, or other official particular matter in which, to his or her knowledge, he or she (or his or her spouse, minor child, general partner, organization with which he or she serves as officer, director, employee, trustee, or general partner, or any person or organization with which he or she is negotiating, or has an arrangement, for future employment) has a financial interest. Exceptions to the statutory prohibition relevant to TVA employees are (1) financial interests which have been deemed by the Office of Government Ethics, in published regulations, to be too remote or inconsequential to affect the integrity of the employee's services, or (2) interests which are determined in writing, after full disclosure and on a case by case basis, to be not so substantial as to be deemed likely to affect the integrity of the employee's services for TVA. In accordance with the statute, individual waiver determinations are made by the official responsible for the employee's appointment. In the case of TVA directors, the determination may be made by the Chairman of the TVA Board, and in the case of the Chairman of the TVA Board, the determination may be made by the Counsel to the President of the United States.

More broadly, Subpart E of the Standards of Ethical Conduct provides that where an employee (1) knows that a particular matter involving specific parties is likely to have a direct and predictable effect on the financial interests of a member of his or her household, or that a person with whom the employee has a "covered relationship" (which includes, but is not limited to, persons with whom the employee has a close family relationship and organizations in which the employee is an active participant) is or represents a party to the matter, and (2) determines that the circumstances would cause a reasonable person with knowledge of relevant facts to question his or her impartiality in the matter, the employee should not participate in the matter absent agency authorization. This authorization may be given by the employee's supervising officer, as agency designee, in consultation with the TVA Designated Agency Ethics Official, upon the determination that TVA's interest in the employee's participation in the matter outweighs the concern that a reasonable person may question the integrity of TVA's programs and operations.

The previously described restrictions are reflected in TVA's Employment Practice 1, *Business Ethics* , which requires employees, including TVA's directors and executive officers, to comply with the guidelines outlined in the Standards of Ethical Conduct and which restates the standard of the conflict of interest statute.

Additionally, on November 30, 2006, the TVA Board approved a written conflict of interest policy that applies to all TVA employees, including TVA's directors and executive officers. The conflict of interest policy reaffirms the requirement that all TVA employees must comply with applicable federal conflict of interest laws, regulations, and policies. It also establishes an additional policy that is applicable to TVA's directors and Chief Executive Officer, which provides as follows:

> In addition to the law and policy applicable to all TVA employees, TVA Directors and the Chief Executive Officer shall comply with the following additional policy restricting the holding of certain financial interests:

1. For purposes of this policy, "financial interest" means an interest of a person, or of a person's spouse or minor child, arising by virtue of investment or credit relationship, ownership, employment, consultancy, or fiduciary relationship such as director, trustee, or partner. However, financial interest does not include an interest in TVA or any interest:

   - comprised solely of a right to payment of retirement benefits resulting from former employment or fiduciary relationship,
   - arising solely by virtue of cooperative membership or similar interest as a consumer in a distributor of TVA power, or
   - arising by virtue of ownership of publicly traded securities in any single entity with a value of $25,000 or less, or within a diversified mutual fund investment in any amount.

2. Directors and the Chief Executive Officer shall not hold a financial interest in any distributor of TVA power.

3. Directors and the Chief Executive Officer shall not hold a financial interest in any entity engaged in the wholesale or retail generation, transmission, or sale of electricity.

4. Directors and the Chief Executive Officer shall not hold a financial interest in any entity that may reasonably be perceived as likely to be adversely affected by the success of TVA as a producer or transmitter of electric power.

5. Any action taken or interest held that creates, or may reasonably be perceived as creating, a conflict of interest restricted by this additional policy applicable to TVA Directors and the Chief Executive Officer should immediately be disclosed to the Chairman of Board of Directors and the Chairman of the Audit Governance, and Ethics Committee. The Audit, Governance, and Ethics Committee shall be responsible for initially reviewing all such disclosures and making recommendations to the entire Board on what action, if any, should be taken. The entire Board, without the vote of any Director(s) involved, shall determine the appropriate action to be taken.

6. Any waiver of this additional policy applicable to TVA Directors and the Chief Executive Officer may be made only by the Board, and will be disclosed promptly to the public, subject to the limitations on disclosure imposed by law.

TVA relies on the policies, practices, laws, and regulations discussed above to regulate conflicts of interest involving employees, including directors and executive officers. TVA has no other written or unwritten policy for the approval or ratification of any transactions in which TVA was or is to be a participant and in which any director or executive officer of TVA (or any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of any director or executive officer of TVA) had or will have a direct or indirect material interest.

U.S. Treasury Interim Obligations

TVA has access to a financing arrangement with the U.S. Treasury under which the U.S. Treasury is authorized to accept interim obligations with maturities of one year or less in an aggregate amount outstanding not to exceed $150 million. TVA may draw any portion of the authorized $150 million. Interest is accrued daily at a rate determined by the United States Secretary of the Treasury each month based on the average rate on outstanding marketable obligations of the United States with maturities of one year or less. During 2008, the daily average outstanding balance was approximately $74 million. See Note 11 — *Short-Term Debt.*

Power Facility Appropriation Investment

In addition, TVA makes payments to the U.S. Treasury as a repayment of and a return on the Power Facility Appropriation Investment. Under the TVA Act, TVA is required to repay $1 billion of the Power Facility Appropriation Investment, and $110 million of this amount remained unpaid as of September 30, 2008. Once TVA repays this $110 million, there will still be an outstanding balance on the Power Facility Appropriation Investment, and TVA is obligated under the TVA Act to pay the U.S. Treasury a return on this remaining balance indefinitely. See Notes 9 and 16.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table shows the fees billed (after applicable adjustments) for the audit and other services provided by Ernst and Young LLP, for the year ended September 30, 2008, and PricewaterhouseCoopers LLP, for the year ended September 30, 2007.

Principal Accountant Fees and Services
(in actual dollars)

Year	Principal Accountant	Audit Fees [1]	Audit-Related Fees [2]	Other Fees [3]	Total
2008	Ernst and Young LLP	$ 1,603,016	$ 517,090	$ –	$ 2,120,106
2007	PricewaterhouseCoopers LLP	1,723,508	77,881	1,960	1,803,349

(1) Audit fees consist of fees for professional services rendered for the audit of TVA's annual financial statements, fees for review of the interim financial statements included in TVA's quarterly reports, and fees for Bond offering comfort letters.

(2) Audit-related fees include professional services rendered in connection with Sarbanes-Oxley Act of 2002 Section 404 readiness assistance.

(3) Other fees include transition services related to the change in auditors.

The TVA Board has an Audit, Governance, and Ethics Committee. Under the TVA Act, the Audit, Governance, and Ethics Committee, in consultation with the Inspector General, recommends to the TVA Board the selection of an external auditor. TVA's Audit, Governance, and Ethics Committee in consultation with the Inspector General recommended that the TVA Board select Ernst and Young LLP as TVA's external auditor for the 2008 and 2009 audits and other related services, and the TVA Board approved these recommendations.

At the Audit, Governance, and Ethics Committee's August 6, 2007, meeting, the Audit, Governance, and Ethics Committee approved a policy on audit and permissible non-audit services (the "Policy"). The Policy provides that all auditing services and permissible non-audit services shall be pre-approved by the Audit, Governance, and Ethics Committee unless:

- The aggregate amount of all such non-audit services provided to TVA does not exceed five percent of the total amount TVA pays the external auditor during the fiscal year in which the non-audit services are provided;
- Such services were not recognized by TVA at the time of the engagement to be non-audit services or non-audit related services; and
- Such services are promptly brought to the attention of the Audit, Governance, and Ethics Committee and approved at the next scheduled Audit, Governance, and Ethics Committee meeting or by one or more members of the Audit, Governance, and Ethics Committee to whom the authority to grant such approvals has been delegated.

The Policy also lists the following services as ones the external auditor is not permitted to perform. The prohibited non-audit services are:

- Bookkeeping or other services related to the accounting records or financial statements of TVA;
- Financial information system design and implementation;
- Appraisal or valuation services, fairness opinions, and contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management functions or human resources;
- Broker or dealer, investment adviser, or investment banking services;
- Legal services and expert services unrelated to the audit; and
- Any other services that the Public Company Accounting Oversight Board determines, by regulation, is impermissible.

The Policy also delegates to the Chairman of the Audit, Governance, and Ethics Committee the authority to pre-approve a permissible service so long as the amount of the service does not exceed $100,000 and the Chairman reports for informational purposes the services pre-approved at the Audit, Governance, and Ethics Committee's next meeting.

The Audit, Governance, and Ethics Committee pre-approved all of the audit and audit-related services for 2008.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents have been filed as part of this Annual Report:

(1) Financial Statements. The following documents are provided in Item 8 herein.

Statements of Income
Balance Sheets
Statements of Cash Flow
Statements of Changes in Proprietary Capital
Notes to Financial Statements
Report of Independent Registered Public Accounting Firm (Ernst and Young LLP)

(2) Financial Statement Schedules.

Schedules not included are omitted because they are not required or because the required information is provided in the financial statements, including the notes thereto.

Schedule II — Valuation and Qualifying Accounts
(in millions)

Description	Balance at beginning of year	Additions charged to expense	Deductions	Balance at end of year
For the year ended September 30, 2008				
Allowance for doubtful accounts				
Receivables	$ 2	$ 1	$ (1)	$ 2
Loans	15	4	(6)	13
Inventories	43	7	(3)	47
Total allowances deducted from assets	$ 60	$ 12	$ (10)	$ 62
For the year ended September 30, 2007				
Allowance for doubtful accounts				
Receivables	$ 10	$ –	$ (8)	$ 2
Loans	15	–	–	15
Inventories	38	7	(2)	43
Total allowances deducted from assets	$ 63	$ 7	$ (10)	$ 60
For the year ended September 30, 2006				
Allowance for doubtful accounts				
Receivables	$ 7	$ 3	$ –	$ 10
Loans	15	1	(1)	15
Inventories	36	13	(11)	38
Total allowances deducted from assets	$ 58	$ 17	$ (12)	$ 63

(3) List of Exhibits

Exhibit No.	Description
3.1	Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (Incorporated by reference to Exhibit 3.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended December 31, 2007, File No. 000-52313)
3.2	Bylaws of Tennessee Valley Authority Adopted by the TVA Board of Directors on May 18, 2006, as Amended on April 3, 2008, and May 19, 2008 (Incorporated by reference to Exhibit 3.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, File No. 000-52313)
4.1	Basic Tennessee Valley Authority Power Bond Resolution Adopted by the TVA Board of Directors on October 6, 1960, as Amended on September 28, 1976, October 17, 1989, and March 25, 1992 (Incorporated by reference to Exhibit 4.1 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.1	Fall Maturity Credit Agreement Dated as of May 17, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.1 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.2	Spring Maturity Credit Agreement Dated as of May 17, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.2 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.3	Amendment Dated as of November 2, 2006, to the Fall Maturity Credit Agreement Dated as of May 17, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended December 31, 2006, File No. 000-52313)
10.4	Amendment Dated as of May 11, 2007, to the Spring Maturity Credit Agreement Dated as of May 17, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007, File No. 000-52313)
10.5	Second Amendment Dated as of November 2, 2007, to the Fall Maturity Credit Agreement Dated as of May 17, 2006, and Amended as of November 2, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.5 to TVA's Annual Report on Form 10-K for the year ended September 30, 2007, File No. 000-52313)
10.6*	Second Amendment Dated as of May 9, 2008, to the Spring Maturity Credit Agreement Dated as of May 17, 2006, and Amended as of May 11, 2007, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, File No. 000-52313)
10.7*	Third Amendment Dated as of November 10, 2008, to the Fall Maturity Credit Agreement Dated as of May 17, 2006, and Amended as of November 2, 2006, and November 2, 2007, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 99.1 to TVA's Current Report on Form 8-K filed on November 13, 2008, File No. 000-52313)
10.8	TVA Discount Notes Selling Group Agreement (Incorporated by reference to Exhibit 10.2 to TVA's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, File No. 000-52313)
10.9	Electronotes ® Selling Agent Agreement Dated as of June 1, 2006, Among TVA, LaSalle Financial Services, Inc., A.G. Edwards & Sons, Inc., Citigroup Global Markets Inc., Edward D. Jones & Co., L.P., First Tennessee Bank National Association, J.J.B. Hilliard, W.L. Lyons, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, and Wachovia Securities, LLC (Incorporated by reference to Exhibit 10.4 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.10	Assumption Agreement Between TVA and Incapital LLC Dated as of February 29, 2008, Relating to the electronotes ® Selling Agent Agreement Dated as of June 1, 2006, Among TVA, LaSalle Financial Services, Inc., A.G. Edwards & Sons, Inc., Citigroup Global Markets Inc., Edward D. Jones & Co., L.P., First Tennessee Bank National Association, J.J.B. Hilliard, W.L. Lyons, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, and Wachovia Securities, LLC (Incorporated by reference to Exhibit 10.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008, File No. 000-52313)
10.11	Commitment Agreement Among Memphis Light, Gas and Water Division, the City of Memphis, Tennessee, and

TVA Dated as of November 19, 2003 (Incorporated by reference to Exhibit 10.5 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)

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32.1	Section 1350 Certification Executed by the Chief Executive Officer
32.2	Section 1350 Certification Executed by the Chief Financial Officer

† Management contract or compensatory arrangement.

* Certain schedule(s) and/or exhibit(s) have been omitted. The Tennessee Valley Authority hereby undertakes to furnish supplementally copies of any of the omitted schedules and/or exhibits upon request by the Securities and Exchange Commission.

SIGNATURES

Pursuant to the requirements of Section 13, 15(d), or 37 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: December 16, 2008

TENNESSEE VALLEY AUTHORITY
(Registrant)

By: /s/ Tom D. Kilgore
Tom D. Kilgore
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Tom D. Kilgore Tom D. Kilgore	President and Chief Executive Officer (Principal Executive Officer)	December 16, 2008
/s/ Kimberly S. Greene Kimberly S. Greene	Chief Financial Officer and Executive Vice President, Financial Services (Principal Financial Officer)	December 16, 2008
/s/ John M. Thomas John M. Thomas	Vice President and Controller (Principal Accounting Officer)	December 16, 2008
/s/ William B. Sansom William B. Sansom	Chairman and Director	December 16, 2008
/s/ Dennis C. Bottorff Dennis C. Bottorff	Director	December 16, 2008
/s/ Donald R. DePriest Donald R. DePriest	Director	December 16, 2008
/s/ Robert M. Duncan Robert M. Duncan	Director	December 16, 2008
/s/ Thomas C. Gilliland Thomas C. Gilliland	Director	December 16, 2008
/s/ Bishop William H. Graves Bishop William H. Graves	Director	December 16, 2008
/s/ Howard A. Thrailkill Howard A. Thrailkill	Director	December 16, 2008

EXHIBIT INDEX

Exhibit No.	Description
3.1	Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (Incorporated by reference to Exhibit 3.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended December 31, 2007, File No. 000-52313)
3.2	Bylaws of Tennessee Valley Authority Adopted by the TVA Board of Directors on May 18, 2006, as Amended on April 3, 2008, and May 19, 2008 (Incorporated by reference to Exhibit 3.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, File No. 000-52313)
4.1	Basic Tennessee Valley Authority Power Bond Resolution Adopted by the TVA Board of Directors on October 6, 1960, as Amended on September 28, 1976, October 17, 1989, and March 25, 1992 (Incorporated by reference to Exhibit 4.1 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.1	Fall Maturity Credit Agreement Dated as of May 17, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.1 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.2	Spring Maturity Credit Agreement Dated as of May 17, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.2 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.3	Amendment Dated as of November 2, 2006, to the Fall Maturity Credit Agreement Dated as of May 17, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended December 31, 2006, File No. 000-52313)
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10.5	Second Amendment Dated as of November 2, 2007, to the Fall Maturity Credit Agreement Dated as of May 17, 2006, and Amended as of November 2, 2006, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 10.5 to TVA's Annual Report on Form 10-K for the year ended September 30, 2007, File No. 000-52313)
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10.7*	Third Amendment Dated as of November 10, 2008, to the Fall Maturity Credit Agreement Dated as of May 17, 2006, and Amended as of November 2, 2006, and November 2, 2007, Among TVA, Bank of America, N.A., as Administrative Agent, Bank of America, N.A., as a Lender, and the Other Lenders Party Thereto (Incorporated by reference to Exhibit 99.1 to TVA's Current Report on Form 8-K filed on November 13, 2008, File No. 000-52313)
10.8	TVA Discount Notes Selling Group Agreement (Incorporated by reference to Exhibit 10.2 to TVA's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, File No. 000-52313)
10.9	Electronotes ® Selling Agent Agreement Dated as of June 1, 2006, Among TVA, LaSalle Financial Services, Inc., A.G. Edwards & Sons, Inc., Citigroup Global Markets Inc., Edward D. Jones & Co., L.P., First Tennessee Bank National Association, J.J.B. Hilliard, W.L. Lyons, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, and Wachovia Securities, LLC (Incorporated by reference to Exhibit 10.4 to TVA's Annual Report on Form 10-K for the year ended September 30, 2006, File No. 000-52313)
10.10	Assumption Agreement Between TVA and Incapital LLC Dated as of February 29, 2008, Relating to the electronotes ® Selling Agent Agreement Dated as of June 1, 2006, Among TVA, LaSalle Financial Services, Inc., A.G. Edwards & Sons, Inc., Citigroup Global Markets Inc., Edward D. Jones & Co., L.P., First Tennessee Bank National Association, J.J.B. Hilliard, W.L. Lyons, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, and Wachovia Securities, LLC (Incorporated by reference to Exhibit 10.1 to TVA's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008, File No. 000-52313)
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* Certain schedule(s) and/or exhibit(s) have been omitted. The Tennessee Valley Authority hereby undertakes to furnish supplementally copies of any of the omitted schedules and/or exhibits upon request by the Securities and Exchange Commission.

Exhibit 10.16

This Supplement No. 1 to the Joint Ownership Agreement has been filed to provide investors with information regarding its terms. It is not intended to provide any other factual information about the Tennessee Valley Authority. The representations and warranties of the parties in this Supplement No. 1 to the Joint Ownership Agreement were made to, and solely for the benefit of, the other party to this Supplement No. 1 to the Joint Ownership Agreement. The assertions embodied in the representations and warranties may be qualified by information included in schedules, exhibits, or other materials exchanged by the parties that may modify or create exceptions to the representations and warranties. Accordingly, investors should not rely on the representations and warranties as characterizations of the actual state of facts at the time they were made or otherwise.

AGREEMENT
Between
TENNESSEE VALLEY AUTHORITY
And
SEVEN STATES POWER CORPORATION

THIS AGREEMENT, dated as of September 2, 2008 (Agreement), is entered into by and between SEVEN STATES POWER CORPORATION (Seven States), a not-for-profit mutual benefit corporation created and existing under the Laws of the State of Tennessee, and TENNESSEE VALLEY AUTHORITY (TVA), a corporate agency and instrumentality of the United States Government created and existing under and by virtue of the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (2006).

W I T N E S S E T H :

WHEREAS, TVA and Seven States have entered into a Joint Ownership Agreement dated April 30, 2008, numbered as TVA Contract No. 00069956 (JOA); and

WHEREAS, Section 3(c) of the JOA provides for discussions among TVA, Seven States, and the Lenders of methods to secure Seven States' obligations upon any exercise of the Buy-Back Option; and

WHEREAS, agreement has been reached on such security arrangements and, in accordance with the last sentence of said Section 3(c) of the JOA, TVA and Seven States wish to supplement and amend the JOA in the respects necessary and appropriate to provide for the agreed-upon security;

NOW, THEREFORE, for and in consideration of the premises, the mutual covenants and agreements set forth herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, TVA and Seven States agree as follows:

1. The Designated Entity designated by Seven States pursuant to Section 3(b) of the JOA:

(a) Shall be a single-purpose entity organized for the benefit of Seven States and controlled by Seven States' members for the limited purposes of (i) owning and leasing the Elected Percentage of the Purchased Assets, including any Modifications and Replacement Components (Seven States' Purchased Assets Share), and (ii) potentially transferring ownership to another entity in connection

with the implementation of the Long-Term Arrangements contemplated by the JOA;

(b) Until such time as Long-Term Arrangements are in place or until such time as there is a consummation of a Buy-Back Closing, shall not have the power or authority to:

(i) Borrow any funds or otherwise incur any debt beyond the Lenders' short-term loan agreement (Loan) to finance the purchase of Seven States' Purchased Assets Share from TVA and to provide a line of credit (not to exceed $25 million) to finance Capitalized Modifications and Capitalized Replacement Components;

(ii) Enter into any Loan in which (A) the Borrowing Cost Rate for said Loan exceeds five percent (5%) at the time of origination or (B) there are additional penalties, charges, or fees for early Loan repayments or for early payoff of the Loan, provided, however, that nothing in this Subsection 1(b)(ii)(B) shall apply to customary LIBOR break charges for an early payoff so long as the LIBOR period does not exceed thirty (30) days; or

(iii) engage in any business or transactions other than those contemplated by the JOA, as shall be stated in the Designated Entity's charter;

(c) Until such time as Long-Term Arrangements are in place or until such time as there is a consummation of a Buy-Back Closing, shall not have the power or authority to grant a lien or other security interest on any of its property, other than the TVA liens and security interests provided for below in this Agreement;

(d) Shall be organized under constituent documents, approved by TVA and the Lenders, that include bankruptcy remoteness provisions including the Designated Entity lacking corporate authority to seek bankruptcy relief;

(e) Shall at all times observe the applicable legal requirements for the recognition of the Designated Entity as a legal entity separate from each of its members and from Seven States;

(f) Until such time as Long-Term Arrangements are in place or until such time as there is a consummation of a Buy-Back Closing, shall be governed by a governing Board with five Directors, two appointed by Seven States or the members of Seven States, two appointed by TVA, and a fifth elected by a majority vote of the other four Directors;

(g) Shall remit a portion of its net cash flow monthly to Seven States for the duration of the Lease, said portion to be specified under a management agreement between Seven States and the Designated Entity to be equal to the portion of

Basic Rent described in Section 3.3(a) of the Lease; and

(h) Shall meet all the requirements for the Designated Entity provided for by the JOA.

2. In addition to the Buy-Back Arrangements provided for in Section 5 of the JOA, TVA and the Lenders shall enter into Separate Buy-Back Arrangements to provide for:

(a) Lenders to give TVA concurrent notice of any default on the Loan when Lenders send notice of such default to the Designated Entity;

(b) The same repurchase by TVA of all of the Designated Entity's right, title, and interest in and to the Purchased Assets as is provided for under Section 5 of the JOA, including Subsection (e) of said Section 5 as amended by Section 4 of this Agreement below;

(c) The Separate Buy-Back Arrangements between TVA and the Lenders to survive any rejection of the JOA in a bankruptcy of the Designated Entity.

As used below in this Agreement, "Buy-Back Arrangements" refers both to the arrangements provided for in Section 5 of the JOA as amended by Section 4 of this Agreement and to the Separate Buy-Back Arrangements to be entered into by TVA and the Lenders under this Section 2.

3. Section 3 of the JOA is supplemented and amended in the respects necessary to provide that if TVA conveys Seven States' Purchased Assets Share at any Seven States Closing pursuant to Section 3(b)(ii)(B) of the JOA, then:

(i) Seven States' Purchased Assets Share shall be subject to a TVA-reserved deed of trust or mortgage interest and other appropriate security interest; and

(ii) Any cash not remitted to Seven States in accordance with Section 1(g) above shall be subject to an appropriate security interest and shall be placed in an escrow account for the duration of the Lease, said escrow account to be used only (A) to pay for Capitalized Modifications and Capitalized Replacement Components or (B) to pay off the Loan or to complete a Buy-Back Closing as provided for under Section 5(e) of the JOA as amended by Section 4 of this Agreement.

The security interests described in both (i) and (ii) above (referred to collectively below as the "Lien") shall be for the purpose of securing the Designated Entity's obligations to convey to TVA full, clear title to Seven States' Purchased Assets Share pursuant to the exercise of any Buy-Back Arrangements. The Lien shall provide that, if, upon exercise of any Buy-Back Arrangements, the Designated Entity should fail to convey such full,

clear title as required under the JOA as amended by this agreement, TVA shall be entitled to foreclose on the Lien, and to collect thereby the damages to TVA (Actual Damages) that result from TVA not immediately receiving such full, clear title, including the cost of temporarily or otherwise replacing the generation resource represented by Seven States' Purchased Assets Share and any amounts paid by TVA to cure or to purchase the Loan. Further, it is expressly recognized and agreed that said Actual Damages shall be equal to the full fair market value of the Purchased Assets, including any Modifications and Replacement Components and inclusive of the portion of said Purchased Assets owned by TVA, which full fair market value shall be determined as of the date of such failure.

4. Section 5(e) of the JOA is deleted and replaced in its entirety by the following:

5(e) Upon exercise of a Buy-Back Option under 5(a), 5(b), or 5(d) above, or upon a Buy-Back Option being deemed to have been exercised under 5(c) above, the following steps shall be taken:

(i) TVA shall immediately purchase the Loan at par by paying to Lenders a sum equal to:

(A) All outstanding principal;

(B) All accrued and unpaid interest, including default interest only to the extent TVA was given prompt notice of the relevant default or defaults; and

(C) All accrued and unpaid fees and unreimbursed expenses but, if these fees and unreimbursed expenses result from any defaults, only to the extent TVA was given prompt notice of the relevant default or defaults; provided, however, that nothing in this Subsection 5(e)(i)(C) shall exclude customary LIBOR break charges for an early payoff so long as the LIBOR period does not exceed thirty (30) days.

(ii) Upon TVA purchasing the Loan at par under (i) above:

(A) The amount so paid by TVA to the Lenders shall be deducted from the Buy-Back Price that TVA is to pay at the Buy-Back Closing, and

(B) TVA's obligation to pay Rent under the Lease shall cease; provided further, however, that it is expressly recognized and agreed that the Lease shall otherwise continue in full force and effect until the consummation of the Buy-Back Closing.

(iii) Within a reasonable time, but not to exceed thirty (30) days after TVA's purchase of the Loan at par under (i) above, Seven States shall sell

and TVA shall buy all of Seven States' rights, title, and interest (including transfer, assignment, or other conveyance of any and all relevant contracts, warranties, permits, licenses, and other approvals of Governmental Authorities) in the Purchased Assets at the Buy-Back Price, as said Buy-Back Price is reduced under (ii)(a) above.

It is expressly recognized and agreed that step (i) above is a precondition to steps (ii) and (iii).

5. It is further expressly recognized and agreed that TVA, Seven States, and the Designated Entity shall cooperate with each other and with the Lenders in enforcing any exercise of the Buy-Back Arrangements and in consummating any Buy-Back Closing, including cooperating in any bankruptcy proceedings in order to facilitate TVA obtaining full, clear title to Seven States' Purchased Assets Share. It is further expressly recognized and agreed that said cooperation shall include supporting any motion to lift the stay in any bankruptcy proceedings or any other action that may be necessary to allow exercise of the Buy-Back Arrangements and the consummation of the Buy-Back Closing.

6. Seven States and the Designated Entity shall include in the documents relating to the Loan:

(a) Provisions acceptable to TVA requiring Lenders to designate a single Lender to act as the agent for each of the Lenders for purposes of any purchase of the Loan by TVA under Section 5(e) of the JOA as amended by Section 4 of this Agreement;

(b) Provisions acceptable to TVA requiring Lenders to cooperate with TVA in enforcing any exercise of the Buy-Back Arrangements and in consummating any Buy-Back Closing, by (i) promptly executing all documents necessary to confirm TVA's purchase of the Loan under Section 5(e) of the JOA as amended by Section 4 of this Agreement, (ii) not opposing the exercise of the Buy-Back Arrangements and the consummation of the Buy-Back Closing, and (iii) not opposing any motion to lift the stay or any other action in bankruptcy to allow exercise of the Buy-Back Arrangements and the consummation of the Buy-Back Closing; and

(c) Provisions expressly recognizing that TVA shall be a third-party beneficiary of the provisions required by this Section 6.

7. Capitalized terms used in this Agreement, including the recitals, and not otherwise defined herein, shall have the respective meanings set forth in the JOA.

IN WITNESS WHEREOF, Seven States and TVA have caused this Agreement to be executed by their duly authorized representatives as of September 2, 2008.

SEVEN STATES POWER CORPORATION

By: /s/ Jack Simmons _____
Title: President and CEO

TENNESSEE VALLEY AUTHORITY

By: /s/ Tom D. Kilgore _____
Title: President and CEO

Exhibit 10.17

This Supplement No. 2 to the Joint Ownership Agreement has been filed to provide investors with information regarding its terms. It is not intended to provide any other factual information about the Tennessee Valley Authority. The representations and warranties of the parties in this Supplement No. 2 to the Joint Ownership Agreement were made to, and solely for the benefit of, the other party to this Supplement No. 2 to the Joint Ownership Agreement. The assertions embodied in the representations and warranties may be qualified by information included in schedules, exhibits, or other materials exchanged by the parties that may modify or create exceptions to the representations and warranties. Accordingly, investors should not rely on the representations and warranties as characterizations of the actual state of facts at the time they were made or otherwise.

AGREEMENT
Between
TENNESSEE VALLEY AUTHORITY
And
SEVEN STATES POWER CORPORATION

THIS AGREEMENT, dated as of September 30, 2008 (Agreement), is entered into by and between SEVEN STATES POWER CORPORATION (Seven States), a not-for-profit mutual benefit corporation created and existing under the Laws of the State of Tennessee, and TENNESSEE VALLEY AUTHORITY (TVA), a corporate agency and instrumentality of the United States Government created and existing under and by virtue of the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (2006).

W I T N E S S E T H :

WHEREAS, TVA and Seven States have entered into a Joint Ownership Agreement dated April 30, 2008, numbered as TVA Contract No. 00069956 (as amended "JOA"); and

WHEREAS, by the document attached hereto and incorporated herein by reference (Exhibit), Seven States has given notice to TVA in accordance with section 3 of the JOA specifying an undivided ownership share (Elected Percentage) of 90 percent and a Designated Entity; and

WHEREAS, the parties wish to provide for the scheduling of the Seven States Closing at which said Designated Entity will take title to that Elected Percentage; and

WHEREAS, the parties wish to further amend and supplement the JOA in the respects necessary to provide for the possibility of a Seven States Closing on an Elected Percentage of at least 51 percent (First Seven States Closing) taking place before October 1, 2008, with a closing on the remainder (Second Seven States Closing) taking place no earlier than January 2, 2009, and no later than May 9, 2009, all as provided for below;

NOW, THEREFORE, for and in consideration of the premises, the mutual covenants and agreements set forth herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, TVA and Seven States agree as follows:

1. If Seven States is ready to move forward with closing on an Elected Percentage of at least 51 percent before October 1, 2008, the parties will endeavor to schedule a First Seven States Closing on such Elected Percentage before that date. It is expressly recognized that such a First Seven States Closing is presently contemplated for September 26, 2008.

2. If at said First Seven States Closing, the Designated Entity takes title to an Elected Percentage of at least 51 percent but less than 90 percent, the parties will endeavor to schedule a Second Seven States Closing no earlier than January 2, 2009, and no later than May 9, 2009, at which closing the Designated Entity could take title to the remainder, or any portion thereof, of the Elected Percentage of 90 percent; provided, however, that if a Buy-Back Option is exercised at any time before said Second Seven States Closing, no such second closing shall proceed.

3. If the Designated Entity does not take title to any Elected Percentage at a First Seven States Closing occurring before October 1, 2008, there shall be only one Seven States Closing and it will be not be scheduled until on or after January 2, 2009, and no later than May 9, 2009, at which closing the Designated Entity could take title to an Elected Percentage of no less than 51 percent and no greater than 90 percent.

4. Capitalized terms used in this Agreement, including the recitals, and not otherwise defined herein, shall have the respective meanings set forth in the JOA.

IN WITNESS WHEREOF, Seven States and TVA have caused this Agreement to be executed by their duly authorized representatives as of September 30, 2008.

SEVEN STATES POWER CORPORATION

By: /s/ Jack Simmons _____
Title: President/CEO

TENNESSEE VALLEY AUTHORITY

By: /s/ Tom D. Kilgore _____
Title: President and CEO

Exhibit 10.18

This Lease Agreement has been filed to provide investors with information regarding its terms. It is not intended to provide any other factual information about the Tennessee Valley Authority. The representations and warranties of the parties in this Lease Agreement were made to, and solely for the benefit of, the other party to this Lease Agreement. The assertions embodied in the representations and warranties may be qualified by information included in schedules, exhibits, or other materials exchanged by the parties that may modify or create exceptions to the representations and warranties. Accordingly, investors should not rely on the representations and warranties as characterizations of the actual state of facts at the time they were made or otherwise.

TVA Contract No. 00072495

LEASE AGREEMENT

Dated September 30, 2008

between

SEVEN STATES SOUTHAVEN, LLC

and

TENNESSEE VALLEY AUTHORITY

Southaven Power Plant
An 810 MW (nominal) Gas-Fired Combined Cycle Electric Generating Facility
Located In DeSoto County, Mississippi

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EXHIBIT A — Legal Description
EXHIBIT B — TVA’s People with Actual Knowledge

EXHIBIT C — Seven States’ People with Actual Knowledge

SCHEDULE 10.1 — Insurance Requirements

LEASE AGREEMENT

This LEASE AGREEMENT, dated September 30, 2008 (Lease), is entered into by and between SEVEN STATES SOUTHAVEN, LLC (Seven States), a limited liability company formed and existing under the Laws of the State of Delaware, as owner and lessor, and TENNESSEE VALLEY AUTHORITY (TVA), a corporate agency and instrumentality of the United States Government created and existing under and by virtue of the Tennessee Valley Authority Act of 1933, as amended, 16 U.S.C. §§ 831-831ee (2006), and acting as to real property as agent and in the name of the United States of America, as lessee.

W I T N E S S E T H:

WHEREAS, TVA generates and transmits electric power and energy to Distributors, who resell that power and energy to consumers in portions of seven states in and around the Tennessee River Valley watershed; and

WHEREAS, through the Tennessee Valley Public Power Association (TVPPA), substantially all of the Distributors formed Seven States Power Corporation (Seven States Parent) for various purposes, among which is obtaining ownership interests in generating facilities jointly with TVA; and

WHEREAS, TVA and Seven States Parent have entered into that certain Joint Ownership Agreement, dated as of April 30, 2008, as amended and supplemented (the Joint Ownership Agreement); and

WHEREAS, pursuant to the Joint Ownership Agreement, Seven States Parent has designated Seven States as the “Designated Entity” for purposes of the Section 1 of the Joint Ownership Agreement and has exercised its option to obtain a specified undivided ownership

share in the Purchased Assets from TVA, and TVA has agreed to sell such ownership share to Seven States at the Seven States Closing; and

WHEREAS, in connection with the Seven States Closing, the Parties desire to enter into this Lease whereby TVA will lease Seven States' ownership interest in the Purchased Assets so that TVA may utilize the Purchased Assets while Long-Term Arrangements described in the Joint Ownership Agreement are being developed; and

WHEREAS, pursuant to the Assignment and Assumption Agreement, on the Lease Commencement Date, Seven States desires to assign the Project Document Interest to TVA for the Lease Term and TVA desires to assume and accept the same, subject to the terms and conditions set forth herein;

NOW, THEREFORE, for and in consideration of the premises, the mutual covenants and agreements herein contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

ARTICLE 1. DEFINITIONS .

Capitalized terms used in this Lease, including the foregoing recitals, and not otherwise defined herein have the respective meanings set forth in this Article 1. The rules of interpretation and the other general provisions of Section 14.21 shall apply to the terms used in this Lease.

"Accumulated Amortization Costs" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Actual Knowledge" means:

(a) with respect to TVA, actual knowledge of

(i) each individual set forth on Exhibit B (or successors or replacements of each such individual), in each case with respect to the period specified therein, or

(ii) an Authorized Officer of TVA (or successors or replacements of each such individual) who, in the ordinary performance of such individual's duties or activities, has substantial responsibility for management or administration of

(1) the operation and maintenance of the Purchased Assets, or

(2) the preparation of TVA's compliance matters with respect thereto; and

(b) with respect to Seven States, actual knowledge of each individual set forth on Exhibit C (or successors or replacements of such individual), in each case with respect to the period specified therein, and

(c) with respect to any other Person, actual knowledge of an Authorized Officer of such Person who, in the ordinary performance of such individual's duties or activities, has substantial responsibility for management or administration of

(i) the operation and maintenance of the Purchased Assets, or

(ii) the preparation of such Person's tax returns or compliance matters with respect thereto.

(d) Any Person shall in any event be deemed to have actual knowledge of any matter as to which such Person has been given notice (i) pursuant to and in accordance with the provisions of the Lease to which such Person is a party or (ii) from any Governmental Authority.

"Administrative and General Expenses" has the meaning generally applied in the electric utility industry as implemented by the Federal Energy Regulatory Commission's Uniform

System of Accounts, 18 C.F.R. Part 101, including accounts 920 (salaries), 921 (office supplies and expenses), 923 (outside services employed), 924 (property insurance), 926 (employee pensions and benefits), 931 (rents), and 933 (transportation expenses).

"Affiliate" of any specified Person means any other Person that, directly or indirectly, controls, is controlled by, or is under common control with such Person. For purposes of this definition, "control" when used with respect to any particular Person means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract, or otherwise, and the terms "controlling," "controlled," and "under common control" have meanings correlative to the foregoing; *provided, however* , that any Person owning, directly or indirectly, ten percent (10%) or more of the securities having ordinary voting power for the election of directors or other members of the governing body of a corporation, or ten percent (10%) or more of the partnership or other ownership interests of any other Person, is deemed to control such corporation or other Person; and *provided further* that any Federal Governmental Authority shall not be deemed to be an Affiliate of the Tennessee Valley Authority.

"Appurtenant Rights" has the meaning specified in Section 2.1.

"Assignment and Assumption Agreement" means the Assignment and Assumption Agreement, dated as of the date of this Lease, by and between TVA and Seven States.

"Authorized Officer" means, with respect to any Person: its chairman of the board, its chief executive officer, its president, any of its executive vice presidents, any of its senior vice presidents, its chief financial officer, any of its vice presidents, its treasurer, or any other similar senior management employee (i) that has the power to take the action in question and has been authorized, directly or indirectly, by the governing body of such Person, (ii) working under the

direct supervision of such chairman of the board, chief executive officer, president, executive vice president, senior vice president, chief financial officer, vice president, or treasurer, or (iii) whose responsibilities include the administration of the transactions and agreements contemplated under this Lease.

"Bankruptcy Event" means that which occurs with respect to any Person if:

(a) that Person institutes a voluntary case seeking liquidation or reorganization under the Bankruptcy Law, or consents to the institution of an involuntary case thereunder against it; or

(b) such Person files a petition or consent or shall otherwise institute any similar proceeding under any other applicable Federal or state Law, or consents thereto; or

(c) such Person applies for, or consents or acquiesces to, the appointment of a receiver, administrator, administrative receiver, liquidator, sequestrator, trustee, or other officer with similar powers for itself or any substantial part of its assets; or

(d) such Person makes a general assignment for the benefit of its creditors; or

(e) such Person admits in writing its inability to pay its debts generally as they become due; or

(f) an involuntary case is commenced seeking liquidation or reorganization of such Person under the Bankruptcy Law or any similar proceedings are commenced against such Person under any other applicable Federal or state Law and

(1) the petition commencing the involuntary case is not timely disputed, or

(2) the petition commencing the involuntary case is not dismissed within sixty (60) days of its filing, or

(3) an interim trustee is appointed to take possession of all or a portion of the property, or to operate all or any part of the business of such Person and such appointment is not vacated within sixty (60) days of the involuntary case filing, or

(4) an order for relief has been issued or entered therein; or

(g) a decree or order of a court having jurisdiction over the Leased Premises for the appointment of a receiver, administrator, administrative receiver, liquidator, sequestrator, trustee, or other officer having similar powers, over such Person or all or a part of its property has been entered; or

(h) any other similar relief is granted against such Person under any applicable Bankruptcy Law.

"Bankruptcy Law" means Title 11, United States Code, and any other state or Federal insolvency, reorganization, moratorium, receivership, or similar Law for the relief of debtors, or any successor statute.

"Basic Rent" has the meaning specified in Section 3.3.

"Borrowing Cost Rate" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Business Day" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Buy-Back Closing" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Buy-Back Option" means the options described in Section 5 of the Joint Ownership Agreement.

"Buy-Back Period" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Buy-Back Price" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Capitalized Modification" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Capitalized Replacement Components" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Casualty" means any event of damage, destruction, or other casualty relating to the Purchased Assets or any part thereof.

"Casualty Insurance Proceeds" means any and all proceeds of any insurance, indemnity, warranty, or guaranty payable from time to time with respect to any Casualty, including the insurance required by Section 10.1.

"Certifying Party" has the meaning specified in Section 14.17.

"Change in Law" means:

(a) any material change in, or the adoption, effectiveness, or phase-in of any applicable Law; or

(b) any material change in the interpretation or application of any applicable Law; or

(c) any new request or directive (whether or not having the force of law) of any Governmental Authority;

any of which (a), (b), and (c) are made subsequent to the execution of this Lease.

“Claim” means any asserted liability (including liability with respect to negligence (whether passive or active), strict or absolute liability in tort or otherwise, warranty, latent or other defects (regardless of whether or not discoverable), statutory liability, property damage, bodily injury, or death), obligation, loss, settlement, damage, penalty, claim (including any claim related to an Environmental Liability of TVA that relates to the Purchased Assets), action, suit, judicial or administrative proceeding (whether civil or criminal), order, judgment, penalty, fine, or other legal or administrative sanction, cost, expense, or disbursement, including reasonable legal, investigation, and expert fees, expenses, and related charges of whatsoever kind and nature.

“Commercially Reasonable” has the meaning specified in Section 1 of the Joint Ownership Agreement.

“Component” means any appliance, part, instrument, appurtenance, accessory, furnishing, equipment, or other property of whatever nature that may from time to time be incorporated in the Purchased Assets, except to the extent constituting spare parts being held for future use.

“Condemnation” means a seizure, condemnation, confiscation, or other taking of, or requisition of title to or use of, the Purchased Assets, or any part thereof by any Governmental Authority (or other Person acting under color of Governmental Authority).

“Condemnation Proceeds” means any and all payments (in any form whatsoever) made or due and payable from time to time in connection with any Condemnation.

“Designated Entity” has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Defaulting Party" has the meaning specified in Section 12.2.

"Distributor" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Dollars" and the symbol "$" means lawful money of the United States of America.

"Elected Percentage" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Emissions Allowances" means any emission credits, emission allowances, or other appropriate entitlements issued pursuant to applicable Environmental Laws that have been allocated to the Purchased Assets by any Governmental Authority.

"Environmental Condition" means any event or condition, including the presence or Release of any Hazardous Material at, into, on, or under any land, water, air, or otherwise within or into the environment or within any structure, or the presence of wetlands or protected species or organism that does or reasonably could: (i) require assessment, investigation, monitoring, abatement, correction, clean-up, mitigation, removal, remediation, or any other response; (ii) give rise to an Environmental Liability or any obligation or liability of any nature (whether civil or criminal, arising under a theory of negligence, strict liability, or otherwise) under or relating to any Environmental Law; (iii) create or constitute a public or private nuisance or trespass; (iv) constitute a violation of or non-compliance with any Environmental Law; (v) result in or contribute to the actual or threatened loss of or damage to any property, natural resources, wildlife, or environmental media, or the death of or injury to any Person from an Environmental Liability; or (vi) result in limitations under Environmental Law on the development or use of the Property.

“Environmental Laws” means all Federal, state, and local statutes, Laws, ordinances, codes, rules, regulations, consent decrees, administrative orders, administrative directives, injunctions, deed restrictions, judgments, and any other legally enforceable requirements, in each case, of any Governmental Authority relating to, regulating, or imposing liability or mandatory standards of conduct concerning public health, safety, or the environment or natural resources, as each may from time to time be amended, supplemented, or supplanted as the context in any Project Document may require (including specifically the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§ 9601 *et seq* .; the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901 *et seq* .; the Federal Water Pollution Control Act, 33 U.S.C. §§ 1251 *et seq* .; the Clean Air Act, 42 U.S.C. §§ 7401 *et seq* .; the Hazardous Materials Transportation Act, 49 U.S.C. §§ 1471 *et seq.;* the Toxic Substances Control Act, 15 U.S.C. §§ 2601 through 2629; the Oil Pollution Act, 33 U.S.C. §§ 2701 *et seq* .; the Emergency Planning and Community Right-to-Know Act, 42 U.S.C. §§ 11001 *et seq* .; the Safe Drinking Water Act, 42 U.S.C. §§ 300 *et seq* .; and all other applicable statutes, rules, or regulations of the Federal government or the State of Mississippi that govern the management of hazardous materials or the environment and all amendments thereto, and regulations implementing any of the foregoing).

“Environmental Liability” means any administrative, regulatory, or judicial action, fee, cause of action, obligation, suit, liability (including but not limited to any contingent liability), loss, damage, proceeding, decree, judgment, penalty, fine, demand, demand letter, order, directive, claim (including any claim involving liability in tort: strict, absolute, or otherwise), lien, sanction, notice of noncompliance or violation, legal or consultant fee or expense, or cost of

investigation, remediation, or proceeding (Liabilities), relating in any way to any Environmental Law, or arising from the actual or alleged presence or Release of any Hazardous Material or the generation, use, handling, treatment, removal, storage, cleanup, remediation, transport, or disposal of Hazardous Material including, but not limited to, and regardless of the merit of such Liability, any and all Liabilities for: (i) investigation, delineation, assessment, abatement, correction, enforcement, mitigation, corrective action, cleanup, removal, response, remediation, or other activities related to the actual or alleged presence or Release of Hazardous Material; (ii) damages, contribution, indemnification, cost recovery, compensation, mitigation, or injunctive or declaratory relief related to violations of or noncompliance with Environmental Laws or the actual or alleged presence or Release of Hazardous Material or the generation, use, handling, treatment, removal, storage, cleanup, remediation, transport, or disposal of Hazardous Material; (iii) any alleged or actual injury or threat of injury to human health, safety, natural resources, property, or the environment (including protection of flora and fauna) in connection with a violation of or noncompliance with Environmental Law or the actual or alleged presence or Release of or exposure to or threat of exposure to Hazardous Material or the generation, use, handling, treatment, removal, storage, cleanup, remediation, transport, or disposal of Hazardous Material; or (iv) any failure or alleged failure to obtain or comply with any Governmental Approval required by any Environmental Law for the construction, operation, or maintenance of the Purchased Assets.

"Equipment" means all equipment, apparatus, furnishings, fittings, and personal property of every kind and nature whatsoever purchased, leased, or otherwise acquired by Seven States or TVA or both and now or subsequently attached to, contained in, or used or usable in any way in connection with any operation or letting of the Leased Premises together with any Replacement

Components and any Modifications, including all storm doors and windows, shelving, furniture, furnishings, heating, electrical, switch gear, uninterrupted power supply, mechanical equipment, lighting, switchboards, plumbing, ventilation, air conditioning and air-cooling apparatus, refrigerating equipment, incinerating equipment, escalators, generators, elevators, loading and unloading equipment and systems, stoves, ranges, laundry equipment, cleaning systems, telephones, communications systems, televisions, computers, sprinkler systems and other fire prevention and extinguishing apparatus and materials, security systems, motors, engines, machinery, pipes, pumps, tanks, conduits, appliances, and fittings of every kind and description.

"Estoppel Certificate" means a statement, addressed to the Requesting Party or as the Requesting Party shall direct, containing statements to the following effect (identifying in reasonable detail any exceptions that may exist at the time), as requested by the Requesting Party: (a) this Lease has not been amended, constitutes the entire agreement between the Parties relating to the Leased Premises, and is in full force and effect; (b) neither Party is, to the best of the Certifying Party's knowledge, in default under this Lease and to the best of the Certifying Party's knowledge no facts or circumstances exist that, with the passage of time or the giving of notice or both, would constitute an Event of Default under this Lease by either Party; (c) TVA has paid all Rent to date; (d) the Lease Commencement Date and any other then-ascertainable dates relevant to this Lease but not expressly set forth in the text of this Lease, and the basis for such date; (e) the Certifying Party is not, to the best of its knowledge, entitled to any defenses, offsets, claims, counterclaims, or rights of recoupment against its obligations under this Lease; (f) the current Base Rent; (g) the Certifying Party's address for notices; and (h) such other matters as either Party shall reasonably request.

“Event of Abandonment” means at any time on or after the Lease Commencement Date, TVA shall announce that it is abandoning the Purchased Assets or the Purchased Assets shall be abandoned or operation of the Purchased Assets shall be suspended for any reason for a period of fifteen (15) consecutive days and Seven States has given written notice to TVA of such suspension of operation after such fifteen (15) -day period has expired, and an additional fifteen (15) days have passed after such notice from Seven States and no resumption of operation has occurred; *provided* , *however* , that none of (i) scheduled maintenance of the Purchased Assets, (ii) repairs to the Purchased Assets, whether scheduled or not scheduled, (iii) a forced outage (including as a result of Force Majeure) or scheduled outage of the Purchased Assets, or (iv) non-operation of the Purchased Assets as the result of economics or failure to dispatch by TVA for any other business reason, shall constitute abandonment or suspension of operations of the Purchased Assets, and, in the case of suspension of operation of the Purchased Assets as a result of a forced outage (including as a result of Force Majeure), or in the case of unscheduled repairs to the Purchased Assets, so long as TVA is diligently attempting to end such suspension of operation.

“Event of Default” has the meaning set forth in Section 12.1.

“Fair Market Value” means with respect to any Property or services as of any date, the cash rent or cash price obtainable in an arm’s length lease or sale contract, respectively, between an informed and willing lessee or purchaser under no compulsion to lease or purchase and an informed and willing lessor or seller under no compulsion to lease or sell the Property or services in question, and shall, in the case of the Purchased Assets, be determined (except as otherwise provided herein) on the basis, as applicable, that (i) the conditions contained in Articles 6

through 8 have been complied with in all material respects, (ii) the Purchased Assets are free and clear of all Liens (other than Seven States' Liens), and (iii) in the case of the Fair Market Value for purposes of lease rental, taking into account the terms of the Lease. If, with respect to lease rental, the Fair Market Value of the Purchased Assets is to be determined during the continuance of an Event of Default or in connection with the exercise of remedies by Seven States pursuant to Article 12 of the Lease, such value shall be determined by an appraiser appointed solely by Seven States on an "as-is," "where-is," and "with all faults" basis and shall take into account all Liens (other than Seven States' Liens).

"Force Majeure" has the meaning set forth in Section 12.5.

"GAAP" means generally accepted accounting principles in the United States as in effect from time to time.

"Generating Facility" means the Southaven Power Plant, an 810 megawatt (nominal) gas-fired combined cycle electric generating facility located on the Site, and all Equipment, buildings, structures, fixtures, and other improvements acquired by TVA from Seller.

"Good Utility Practice" means any of the practices, methods, and acts engaged in or approved, as the same may change from time to time, by a significant portion of the electric utility industry during the relevant time period, or practices, methods, and acts that, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety, and expedition. Good Utility Practice is not intended to be limited to any particular set of optimum practices, methods, or acts to the exclusion of all others, but rather is intended to encompass a broad spectrum of acceptable practices, methods, and acts.

"Governmental Approvals" means any and all permits, acceptances, authorizations, certificates, registrations, consents, approvals, waivers, exceptions, variances, orders, judgments, binding written interpretations, decrees, licenses, exemptions, publications, filings, notices to and declarations of or with, or required by, any Governmental Authority, or required by any applicable Law, and shall include any and all such environmental and operating permits, licenses, and other approvals that are required for the construction, use, occupancy, zoning, operation, and maintenance of the Purchased Assets.

"Governmental Authority" means any nation or government, any state, provincial, or other political subdivision thereof (whether Federal, state, or local), any court, and any administrative agency or other regulatory body, instrumentality, authority, or entity (other than TVA) exercising executive, legislative, judicial, regulatory, or administrative functions of or pertaining to government.

"Ground Interest" means the Site and the Appurtenant Rights.

"Hazardous Material" means:

(i) any "hazardous substance," as defined by any Environmental Law;

(ii) any "solid waste" or "hazardous waste," as defined by any Environmental Law;

(iii) any petroleum product or petroleum (including crude oil or any fraction thereof);

(iv) any coal waste or coal combustion waste; or

(v) any pollutant or contaminant or hazardous, dangerous, or toxic chemical, material, or other substance (including polychlorinated biphenyls, urea formaldehyde insulation, asbestos, asbestos-containing material, mold, mercury, or radioactive materials) the use

or Release of which is regulated, prohibited, or restricted pursuant to any Environmental Laws or that could otherwise result in any Environmental Liability.

"Impositions" means all Taxes (other than any excluded taxes), water and sewer rents, rates and charges, excises, levies, license and permit fees, fines, penalties, and other Governmental Authority charges and any interest or costs with respect thereto, charges for any easement or agreement maintained for the benefit of the Purchased Assets, and charges for public and private utilities (including gas, electricity, light, heat, air conditioning, power, and telephone and other communication services), general and special, ordinary and extraordinary, foreseen and unforeseen, of any kind and nature whatsoever which at any time prior to or during the Lease Term and applicable to the Lease Term or any part thereof may be assessed, levied, confirmed, imposed upon, or become due and payable out of or with respect to, or charged with respect to, or become a lien on the Purchased Assets.

"Initial Rent" has the meaning specified in Section 3.2, below.

"Insurance Requirements" means, as the case may be, the terms and conditions of any insurance policy required by Section 10.1 to be maintained by TVA or to be maintained or arranged, on behalf of Seven States, by TVA, and all requirements of the issuer of any such policy, as set forth on Schedule 10.1.

"Joint Ownership Agreement" means that certain agreement bearing that name between Seven States and TVA dated as of April 30, 2008 as amended and supplemented.

"Law" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Lease" means this lease agreement.

"Lease Commencement Date" means the date of the Seven States Closing.

"Lease Term" has the meaning specified in Section 3.1, below.

"Leased Premises" means Seven States' ownership interest and rights in the Purchased Assets.

"Leasehold Interest" means all the estate, right, title, and interest of TVA in and to the Leased Premises.

"Lender" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Liability" has the meaning specified within the definition of "Environmental Liability."

"Lien" means any mortgage, deed of trust, pledge, hypothecation, assignment, deposit arrangement, easement, encumbrance, lien (statutory or other), charge, lease, or other security interest, or any preference, priority, or other security agreement or preferential arrangement of any kind or nature whatsoever (including any conditional sale or other title retention agreement and any lease having substantially the same economic effect as any of the foregoing).

"Long-Term Arrangements" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Major Condemnation" means a Condemnation of all, or substantially all, of the Purchased Assets or that prevents TVA from operating or maintaining all, or substantially all, of the Purchased Assets following exhaustion of all permitted appeals or an election by TVA not to pursue such appeals *; provided* , *however* , that no such contest shall extend beyond the date that is one (1) year after the loss of such title.

"Material Adverse Effect" means a material adverse change in or material adverse effect on (i) the business, operations, Property, condition (financial or otherwise), economic prospects, or results of operations (including net cash flows) of the applicable Party, the operation of the Purchased Assets, or the then-current or residual Fair Market Value, utility, or useful life of the

Purchased Assets, (ii) the ability of the Parties to perform or comply with its obligations hereunder, or (iii) the validity or enforceability of the Lease or the rights, interests, and remedies of the Parties.

"Minor Condemnation" means a Condemnation that is not a Major Condemnation.

"Modification" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Monthly Amortization Costs" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Monthly Borrowing Costs" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Non-Defaulting Party" has the meaning specified in Section 12.2.

"Officer's Certificate" means with respect to any Person, a certificate signed by any Authorized Officer of such Person.

"Optional Modification" has the meaning specified in Section 8.2.

"Overdue Rate" means the interest rate equal to the rate provided under the Prompt Payment Act, 31 U.S.C. §§ 3901-07, which is adjusted by the United States Secretary of the Treasury semiannually.

"Party" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Permitted Liens" means: (i) the interests of Seven States under the Lease; (ii) Liens for (A) Taxes not yet due and payable or (B) Taxes being contested in good faith, if the Party responsible for such taxes has established (and is maintaining in accordance with GAAP) adequate reserves for such taxes; (iii) suppliers', vendors', workmen's, repairmen's, employees', mechanics', materialmen's, or other like Liens arising in the ordinary course of business for

amounts the payment of which is either (A) not yet delinquent or (B) being contested in good faith, if (1) the Party responsible for such taxes has established (and is maintaining in accordance with GAAP) adequate reserves for the discharge of such Lien and (2) such proceedings do not involve a material risk of the sale, forfeiture, or loss of the Purchased Assets (or any material part of any thereof) or are bonded for the amount required under applicable Law to release any such Lien; (iv) pre-judgment Liens for claims that are being diligently contested in good faith and liens arising out of judgments or awards with respect to which an appeal or proceeding for review is being prosecuted in good faith and to which a stay of execution has been obtained pending such appeal or review and so long as such proceedings do not involve a material risk of the sale, forfeiture, or loss of the Purchased Assets (or any material part of any thereof) or are bonded for the amount required under applicable Law to release any such Lien; (v) pledges or deposits to secure statutory obligations; (vi) good faith deposits in connection with bids, tenders, or contracts, including rent security deposits; and (vii) any first mortgage that may now or hereafter be placed upon the Leased Premises or portion thereof by Seven States, as well as any junior mortgage to the extent such junior mortgage is approved by the applicable first mortgagee.

"Person" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Project Document Interest" means all right, title, and interest of Seven States in and to all Project Documents.

"Project Documents" means the following documents assigned by Seller to TVA and assumed by TVA at the closing of the TVA Purchase Agreement, collectively and as amended, restated, or otherwise modified from time to time:

1. Facility Letter Agreement, by and between Texas Gas Transmission Corporation and Seller, dated as of October 23, 2000

2. Amendment to Facility Letter Agreement, by and between Texas Gas Transmission Corporation and Cogentrix Energy, LLC, dated as of January 31, 2001

3. License and Indemnity Agreement, by and between Texas Gas Transmission Corporation and Seller, dated as of March 27, 2002

4. Gas Metering Agreement, between Texas Gas Transmission Corporation and Seller, dated as of June 1, 2000

5. Interconnection Agreement OOPAP-263655, between TVA and Seller, dated as of October 10, 2000

6. Amended and Restated Interconnection and Operating Agreement, by and between Seller and Entergy Mississippi, Inc., dated as of October 20, 2000

7. Long Term Service Agreement, by and between Seller and General Electric International, Inc., dated as of October 1, 2001, effective October 21, 2002

8. Parts Sharing Agreement, by and between Cogentrix Parts Company, Inc. and Various Project Affiliates, dated as of October 1, 2001

9. Amended and Restated Sewer Agreement, between the City of Southaven and Seller, dated as of August 23, 2000

10. Municipal Development Agreement, by and between the City of Southaven, Mississippi, and Cogentrix Energy, LLC, dated as of June 7, 1999

11. General Warranty Deed, by and between H&M Properties (Grantor) and Seller (Grantee), dated as of December 12, 2000

12. General Warranty Deed, by and between P&W Properties, LLC (Grantor) and Seller (Grantee), dated as of December 12, 2000

13. General Warranty Deed, by and between Seller (Grantor) and P&W Properties, LLC (Grantee), dated as of December 12, 2000

14. General Warranty Deed, by and between P&W Partners (Grantor) and Cogentrix Southaven Properties, LLC (Grantee), dated as of December 12, 2000

15. General Warranty Deed, by and between City of Southaven, Mississippi (Grantor), and Cogentrix Southaven Properties, LLC (Grantee), dated as of December 12, 2000

16. Corrected Quit Claim Deed, by and between P&W Properties, LLC (Grantor) and Seller (Grantee), dated as of September 26, 2002

17. Special Warranty Deed, by and between Southaven Properties, LLC (Grantor), and Tennessee Valley Authority (Grantee), dated as of May 9, 2008, as to certain Mississippi property

18. Special Warranty Deed, by and between Southaven Properties, LLC (Grantor), and Tennessee Valley Authority (Grantee), dated as of May 9, 2008, as to certain Tennessee property

19. Special Warranty Deed, by and between Cogentrix Southaven Properties, LLC (Grantor), and Tennessee Valley Authority (Grantee), dated as of May 9, 2008, as to certain Mississippi property

20. Special Warranty Deed, by and between Cogentrix Southaven Properties, LLC (Grantor), and Tennessee Valley Authority (Grantee), dated as of May 9, 2008, as to certain Tennessee property

and any replacement or substitute agreement for any of the foregoing.

"Property" means any right or interest in or to property or asset of any kind whatsoever, whether real, personal, or mixed and whether tangible or intangible, including the capital stock of any Person.

"Purchase Price" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Purchased Assets" has the meaning specified in the TVA Purchase Agreement.

"Qualified Appraiser" means a nationally recognized third-party appraiser that shall (a) be qualified to appraise independent electric generating businesses, (b) have been engaged in the appraisal or business valuation and consulting business for a period of not less than five (5) years, and (c) not be associated with Seven States, TVA, or any of their respective Affiliates.

"Release" means the actual or threatened release, deposit, disposal, or leakage of any Hazardous Material at, into, upon, from, or under any land, water, or air, or otherwise into the environment or within any structure, including by means of burial, disposal, discharge, emission,

injection, spillage, leakage, seepage, leaching, dumping, pumping, pouring, escaping, emptying, and placement.

"Rent" means Initial Rent, Basic Rent, and Supplemental Rent, collectively.

"Rent Payment Date" means the last Business Day of each calendar month.

"Replacement Component" has the meaning specified in Section 7.2(a).

"Requesting Party" has the meaning specified in Section 14.17.

"Required Modification" has the meaning specified in Section 8.1.

"Restoration" means, upon a Casualty or Condemnation, the safeguarding, clearing, repair, restoration, alteration, replacement, rebuilding, and reconstruction of the damaged or remaining improvements to a state substantially similar to the Purchased Assets prior to any such Casualty or Condemnation, subject to applicable Law.

"Seller" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Seven States" means Seven States Southaven, LLC, a Delaware limited liability company.

"Seven States Closing" has the meaning specified in Section 1 of the Joint Ownership Agreement.

"Seven States' Liens" means any Lien other than a Permitted Lien on the Purchased Assets or any part thereof arising from and after consummation of the transaction contemplated hereunder on the Lease Commencement Date as a result of (i) Claims against or any act or omission of Seven States or any of its respective Affiliates that are not related to or that are in violation of the Lease or that are in breach of any covenant or agreement of Seven States specified herein or (ii) Taxes and excluded taxes imposed upon Seven States or any of its

respective Affiliates that are not indemnified against by TVA pursuant to the Lease or are not related to or that are in violation of the Lease or the transactions contemplated hereby.

"Seven States Parent" means Seven States Power Corporation, a not-for-profit mutual benefit corporation created and existing under the laws of the State of Tennessee.

"Seven States Parties" has the meaning specified in Section 13.2.

"Site" means the parcels of real property described in Exhibit A .

"Statement" has the meaning specified in Section 3.7.

"Supplemental Rent" means any and all amounts, liabilities, indemnities, and monetary obligations (other than Initial Rent and Basic Rent) that this Lease requires TVA to pay (whether or not specifically identified as Supplemental Rent) to Seven States or any other Person.

"Tax" means all fees (including license, documentation, and registration fees), taxes (including receipts, gross receipts, transaction, rental, turn-over, excise, sales, use, stamp, value-added, *ad valorem* , and property taxes (personal and real, tangible and intangible), and payments made in lieu of such taxes, but excluding income, profits, or similar taxes), license, levies, exports, duties, recording charges or fees, assessments, withholdings, and other charges and impositions of any nature, plus all related interest, penalties, fines, and additions to tax, now or hereafter imposed by any Federal, state, local, or foreign government or other taxing authority, relating to the Leased Premises.

"Temporary Condemnation" means a Condemnation of the right to use or occupy the Purchased Assets or any part of the Purchased Assets for a limited period of time.

"Transfer" has the meaning specified in Section 14.1(a).

"Transferee" means any Person to whom a Transferring Party or its assignee effects a Transfer.

"Transferring Party" means a Party who effects a Transfer to a Transferee.

"TVA" means the Tennessee Valley Authority, a corporate agency and instrumentality of the United States Government created and existing under and by virtue of the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (2006). With respect to interests in real property, TVA shall be deemed to be acting as agent for and in the name of the United States of America.

"TVA Parties" has the meaning specified in Section 13.1.

"United States" or "U.S." means the United States of America.

ARTICLE 2. LEASE OF THE LEASED PREMISES .

2.1 Lease . On the Lease Commencement Date, subject to all of the terms and conditions of this Lease, the Joint Ownership Agreement, and the Assignment and Assumption Agreement, Seven States shall demise, license, and lease to TVA and as of the Lease Commencement Date demises, licenses, and leases to TVA Seven States' ownership interest and rights in the Purchased Assets, which includes:

(a) the Site; and

(b) all agreements, easements, servitudes, rights of way or use, rights of ingress or egress, privileges, appurtenances, tenements, hereditaments, prescriptions, advantages, and other rights and benefits at any time belonging or pertaining to the Site, the use of any streets, ways, alleys, vaults, or strips of land adjoining, abutting, adjacent, or contiguous to the Site, and all Governmental Approvals (to the extent permitted by applicable Law and the terms of such Governmental Approvals) and rights, whether or not of record, appurtenant to the Site (Appurtenant Rights); and

(c) the Generating Facility.

TVA shall lease, license from, hire, and take, and as of the Lease Commencement Date leases, licenses from, hires, and takes, the Leased Premises from Seven States, for the Lease Term. Seven States and TVA acknowledge and agree that legal fee title to the Leased Premises remains vested in Seven States at all times.

2.2 Representations and Warranties .

2.2(a) For the purpose of inducing Seven States to enter into this Lease, TVA represents and warrants to Seven States that:

2.2(a)(i) Neither the execution and delivery of this Lease by TVA nor the performance of the obligations contemplated hereby shall result in any breach or violation of or default under any judgment, decree, order, mortgage, lease, agreement, indenture, or other instrument to which TVA is a party;

2.2(a)(ii) TVA has full power and authority to execute this Lease and to perform all of the obligations of TVA as provided for in this Lease, and this Lease is binding and enforceable against TVA; and

2.2(a)(iii) TVA is a corporate agency and instrumentality of the United States Government created and existing under and by virtue of the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (2006). Each individual signing this Lease on behalf of TVA is fully authorized and empowered to sign this Lease on TVA's behalf. The Lease is duly authorized, executed, and delivered by TVA; such execution or delivery has been duly

authorized by all necessary official action of TVA; and constitutes the legal, valid, and binding obligation of TVA, enforceable in accordance with its terms.

2.2(b) For the purpose of inducing TVA to enter into this Lease, Seven States represents and warrants to TVA that:

2.2(b)(i) neither the execution and delivery of this Lease by Seven States nor the performance of the obligations contemplated hereby shall result in any breach or violation of or default under any judgment, decree, order, mortgage, lease, agreement, indenture, or other instrument to which Seven States is a party or under the charter or by-laws of Seven States;

2.2(b)(ii) there is no material case, suit, action, cause of action, claim, inquiry, investigation or proceeding, whether pending or threatened, against Seven States or the Leased Premises;

2.2(b)(iii) any consents or approvals necessary for the valid authorization, delivery, and implementation of this Lease and the consummation of the transactions contemplated thereunder have been made or obtained and are in full force and effect;

2.2(b)(iv) Seven States is the sole owner of fee title to the Leased Premises, subject only to Permitted Liens and other matters of record;

2.2(b)(v) Seven States has full power and authority to execute this Lease and to perform all of the obligations of Seven States as provided for in this Lease, and this Lease is binding and enforceable against Seven States; and

2.2(b)(vi) Seven States is a limited liability company formed and validly existing in good standing under the Law of the State of Delaware with all due

power and authority to transact business and own and lease property in the State of Tennessee and the State of Mississippi. The individual signing this Lease on behalf of Seven States is fully authorized and empowered to sign this Lease on Seven States' behalf. The Lease is each duly authorized, executed, and delivered by Seven States; such execution or delivery has been duly authorized by all necessary corporate action of Seven States; and constitutes the legal, valid, and binding obligation of Seven States, enforceable in accordance with its terms.

2.3 Compliance . TVA and Seven States shall during the Lease Term observe and comply with all applicable Law affecting the Leased Premises, including procuring and complying with necessary Governmental Approvals. Each Party shall promptly provide to the other Party a copy of any notice or correspondence relating to the Leased Premises, any Impositions (including any bill or statement), or any notice of nonrenewal or threatened nonrenewal of any Governmental Approvals from any Governmental Authority, utility company, insurance carrier, insurance rating bureau, or other agency or authority relating to the Leased Premises or this Lease.

ARTICLE 3. LEASE TERM, OPTION, AND RENT .

3.1 Lease Term . The term of this Lease (Lease Term) shall commence on the Lease Commencement Date and shall expire on the earliest to occur of: (a) completion of the Buy-Back Closing, without regard to the provision under which the Buy-Back Option was exercised; or (b) the execution and delivery by Seven States and TVA of Long-Term Arrangements.

3.2 Initial Rent . TVA hereby agrees to pay to Seven States as Initial Rent a one-time payment, due on the Lease Commencement Date, in the amount of $804,000.

3.3 Basic Rent . TVA hereby agrees to pay to Seven States as Basic Rent each month an amount equal to the sum of:

(a) $100,000 for the month's Administrative and General Expenses, *provided, however* , that each month said amount for Administrative and General Expenses shall be:

(i) increased by the amount equal to any amount by which Seven States' actual Administrative and General Expenses were greater than $100,000 for the preceding month, or

(i) decreased by the amount equal to any amount by which Seven States' actual Administrative and General Expenses were less than $100,000 for the preceding month;

plus

(b) an additional dollar amount calculated each month as follows:

Monthly Amortization Costs + Monthly Borrowing Costs.

TVA shall pay the Basic Rent in arrears on each Rent Payment Date during the Lease Term as provided in Section 3.5. All Basic Rent shall be payable to Seven States in the manner set forth in Section 3.5.

3.4 Supplemental Rent . TVA agrees to pay to Seven States or to any other Person entitled thereto as expressly provided herein, any and all Supplemental Rent, promptly as the same shall become due and owing, or where no due date is specified, promptly after demand by the Person entitled thereto. TVA shall also pay as Supplemental Rent, to the extent permitted by applicable Law, an amount equal to interest at the Overdue Rate on any part of any payment of

Basic Rent not paid when due for any period for which the same shall be overdue and on any Supplemental Rent not paid when due (whether promptly after demand or otherwise) for the period from such due date until the same shall be paid. All Supplemental Rent to be paid pursuant to this Section 3.4 shall be payable in the manner set forth in Section 3.5.

3.5 Manner of Payments; Late Payments .

3.5(a) All Rent shall be paid in arrears by TVA in Dollars in immediately available funds to the recipient on the date due. TVA shall pay all Rent payable to Seven States to an account that Seven States designates in writing.

3.5(b) If any installment of Rent is paid more than five (5) Business Days after the Rent Payment Date, it shall bear interest from the due date at the Overdue Rate, which interest shall be immediately due and payable as further Supplemental Rent.

3.6 Impositions . During the Lease Term, TVA shall pay and discharge as Supplemental Rent all Impositions. TVA shall also pay all interest and penalties assessed by any Governmental Authority on account of late payment of any Imposition, except (a) late payment caused by Seven States' failure to remit an Imposition (paid to Seven States by TVA) in accordance with TVA's reasonable instructions (provided that such involve only ministerial functions) or (b) if applicable, Seven States' failure to forward promptly to TVA a copy of a tax bill or other bill relating to any Imposition received by Seven States.

3.7 Payment of Taxes Received by Seven States . Seven States shall advise TVA, by a written statement, of any Taxes (Statement) at least thirty (30) days prior to the date when the same shall be payable by TVA. The Taxes or installment thereof shall be due and payable to Seven States not less than ten (10) days prior to the last date on which Seven States may make such payment to the appropriate taxing authority without the imposition of any fine, penalty, or

interest, provided that the Statement has been received by TVA at least thirty (30) days prior to such ten (10) -day period. If Seven States shall not have received a bill for any Taxes at the time Seven States desires to deliver the Statement, the Statement may be based upon Seven States' good faith estimate of such Tax. If a Statement is furnished to TVA after the date on which an installment of any Tax was due hereunder, TVA shall, within fifteen (15) days thereafter, pay to Seven States an amount equal to the amount of any underpayment of such Tax and, in the event of any overpayment, Seven States shall credit against subsequent payments of Base Rent and Supplemental Rent under this Lease, the amount of TVA's overpayment. If there shall be any increase or decrease in Taxes for any period, whether during or after such period, Seven States may furnish a revised Statement for such period, and such Tax shall be adjusted and paid or credited substantially in the same manner as provided in the preceding sentence.

3.8 Apportionment of Impositions . Any Imposition relating to the Leased Premises (whether or not such Imposition shall be assessed, levied, confirmed, imposed upon, or in respect of, or become a lien upon, the Leased Premises, or become payable, during the Lease Term) relating to a fiscal period of the applicable taxing authority, a part of which is included within the Lease Term and a part of which is included in the period of time before the commencement or after the expiration of the Lease Term, shall be apportioned between Seven States and TVA as of the commencement or expiration, as applicable, of the Lease Term so that TVA shall pay that portion of such Imposition which that part of such fiscal period included in the period of the Lease Term bears to the fiscal period of the applicable taxing authority.

3.9 Tax Contest . Seven States has the right to seek reductions in the valuation of the Leased Premises assessed for Tax purposes and to prosecute any action or proceeding in connection therewith by appropriate proceedings in accordance with applicable Laws. Seven

States agrees that during the Lease Term TVA may participate in any negotiations, renegotiations, and proceedings concerning payments made to the appropriate state or local governments for Taxes. If Seven States has not elected to seek any such reduction for any particular tax year, TVA may request that Seven States seek such reduction, and in such event Seven States shall, at TVA's expense, seek such reduction accordingly.

3.10. No Offset . Neither Party shall offset any amount owed to the other Party under this Lease against any amount owed by the other Party under any other agreement.

ARTICLE 4. DISCLAIMER OF WARRANTIES; RIGHT OF QUIET ENJOYMENT .

4.1 Disclaimer of Warranties .

4.1(a) TVA acknowledges that it is familiar with the Leased Premises as of the date of this Lease. Seven States expressly disclaims any warranties as to the condition of the Leased Premises, including implied warranties of merchantability or fitness for any particular use or purpose.

4.1(b) During the Lease Term, so long as no Event of Default has occurred and is continuing, Seven States hereby appoints irrevocably and constitutes TVA its agent and attorney-in-fact, coupled with an interest, to assert and enforce, from time to time, in the name and for the account of Seven States and TVA, as their interests may appear, whatever claims and rights Seven States may have with respect to the Purchased Assets or any Component against any manufacturer, vendor, warrantor, or contractor, or under any express or implied warranties relating to the Purchased Assets or any Component thereof. TVA agrees to assert and enforce the foregoing warranty claims, and Seven States agrees to execute and deliver such further documents and take such further action

(including the assignment of warranty claims) as may be reasonably requested by TVA in order to obtain such warranty service as may be furnished for the Purchased Assets or any Component by any warrantors.

4.2 Quiet Enjoyment . Seven States covenants and agrees that, notwithstanding any other provision of the Assignment and Assumption Agreement or any of the Project Documents, so long as TVA is paying Rent and performing its covenants and agreements set forth in this Lease , TVA shall peaceably and quietly have, hold, and enjoy the Leased Premises for the term hereof without hindrance or molestation from Seven States subject to the terms and provisions of this Lease, and neither Seven States nor any Person acting by, through, or under Seven States shall interfere with or interrupt TVA's peaceful and quiet enjoyment of the use, operation, and possession of the Leased Premises under this Lease and the benefits accruing to TVA hereunder. Upon a breach of this covenant of quiet enjoyment, which breach continues for a period of more than fifteen (15) days, TVA shall have the right to exercise its Buy-Back Option.

4.3 Use of Ground Interest . The Ground Interest shall be used by TVA for the operation, maintenance, repair, replacement, improvement, and use of the Purchased Assets under this Lease, and for any and all activities directly or indirectly associated therewith, whether functionally or incidentally related thereto.

ARTICLE 5. NO RETURN OF LEASED PREMISES; EXERCISE OF BUY-BACK OPTION .

It is recognized that if the parties do not agree on Long-Term Arrangements, under the provisions of Section 5 (Buy-Back) of the Joint Ownership Agreement, ownership of the Leased Premises will be conveyed to TVA at the end of the Lease. Accordingly there is no provision in the Lease for return of the Leased Premises. Further, Seven States, TVA, and the Lenders may

each cause this Lease to be terminated through exercise of the Buy-Back Option at any time such exercise is permitted by it under the Joint Ownership Agreement or under the separate Buy-Back Arrangements between TVA and the Lenders, regardless of whether at the time of such exercise an Event of Default exists under the Lease, or a Casualty or Condemnation has occurred.

ARTICLE 6. LIENS .

TVA hereby covenants that it will not create, incur, assume, or suffer to exist any Lien (other than Permitted Liens) on or with respect to Seven States' interest in the Purchased Assets on Seven States' interest in or under the Lease, and TVA shall promptly notify Seven States of the imposition of any Lien (other than Permitted Liens) of which TVA has Actual Knowledge and shall promptly, at its sole cost and expense, take such action as may be necessary to discharge or release fully any Lien (other than Permitted Liens). TVA may contest the amount or validity of imposition of any Lien by appropriate proceedings diligently conducted in good faith.

ARTICLE 7. OPERATION AND MAINTENANCE; REPLACEMENT OF COMPONENTS; ENVIRONMENTAL MATTERS .

7.1 Operation and Maintenance .

7.1(a) TVA shall: (i) operate, maintain, provide fuel for, and generate power at the Leased Premises in a manner materially consistent with Good Utility Practice and established TVA maintenance and repair programs for facilities similar to the Generating Facility owned, leased, or operated by TVA, so as to keep the Leased Premises in good working order and in such condition that the Leased Premises will have the capacity and

functional ability to perform, in normal commercial operation, the functions and at the levels of performance (subject to curtailments due to system power demands, dispatch decisions, maintenance requirements, or Force Majeure) provided in the Project Documents; (ii) operate and maintain the Leased Premises so as to be in material compliance with contractors' and manufacturers' warranty requirements in effect; (iii) operate and maintain the Leased Premises in material compliance with the Assignment and Assumption Agreement, the Project Documents, and all other material, relevant agreements to which TVA is a party or that pertain to or otherwise affect the Leased Premises, and perform in a timely manner all material obligations under the Project Documents assigned or delegated to it; (iv) maintain the Leased Premises in at least as good an operating condition as the Leased Premises is in on the Lease Commencement Date, ordinary wear and tear and degradation from normal operations excepted; (v) operate and maintain the Leased Premises in compliance with all applicable Law and the requirements of any applicable insurance policy; and (vi) maintain the Leased Premises including all appurtenances in substantially the same condition and repair as the same are delivered on the date hereof, ordinary wear and tear and degradation from normal operations excepted.

7.1(b) At the Site TVA shall maintain operating logs in a manner consistent with TVA's ordinary operating practices showing the production of the Generating Facility, and such other periodic reports or logs as are consistent with TVA's ordinary operating practices. At the Site TVA shall keep maintenance and repair reports for the Generating Facility in a manner consistent with TVA's ordinary operating practices and in reasonably sufficient detail to indicate the nature and date of major work done. At the

Site TVA shall maintain current operating manuals (including training, maintenance, and technology manuals) and a complete set of plans of the Generating Facility in sufficient detail to enable an engineer not otherwise familiar with the Generating Facility to locate and identify the various items of property comprising the Generating Facility, in each case in accordance with the standards set forth above; *provided, however* , that any or all of such logs and reports (but not such manuals and plans) may be destroyed periodically in accordance with TVA's normal document retention practice applicable to the Generating Facility and comparable facilities in the TVA system. Notwithstanding the above, TVA may keep any such reports and documentation at a location other than the Site provided that all such reports and documentation shall be made available for inspection at the Site promptly upon reasonable notice from Seven States.

7.2 Replacement of Components .

7.2(a) In the ordinary course of maintenance, service, repair, or testing of the Purchased Assets or any Component, TVA, at no cost to Seven States, may remove or cause to be removed from the Purchased Assets any Component; *provided, however* , that TVA (1) shall cause such Component to be replaced by a replacement Component of like utility that shall be free and clear of all Liens (except Permitted Liens) and shall be in as good operating condition consistent with Good Utility Practice as that of the Component replaced, assuming such replaced Component was maintained in accordance with the terms of this Lease, and (2) shall cause such replacement to be performed in a manner that (i) does not diminish the current Fair Market Value, residual value, utility, or remaining useful life of the Purchased Assets by more than a *de minimis* amount (individually or in the aggregate), and (ii) is reasonably expected to have no material

adverse effect on the Purchased Assets or the operation thereof (each such replacement Component being herein referred to as a Replacement Component). Each Component at any time removed from the Purchased Assets shall remain subject to this Lease, wherever located, until such time as such Component shall be replaced by a Replacement Component that has been incorporated in the Purchased Assets and that meets the requirements for Replacement Components specified above.

7.2(b) If during the Lease Term TVA undertakes a project by which TVA installs on the Leased Premises Replacement Components having a cost of one hundred thousand dollars ($100,000) or more (Capitalized Replacement Components), then TVA shall calculate Seven States' ownership share of the cost of such Capitalized Replacement Components by multiplying the Elected Percentage by such cost and submit an invoice therefor to Seven States, which shall pay promptly that amount to TVA, no later than thirty (30) days after receipt of the invoice. Once Seven States has paid said invoice, the Basic Rent under this Lease shall be adjusted to reflect this Elected Percentage of the cost of the Capitalized Replacement Components as described in Section 3.3.2, above.

7.3 Environmental Matters . TVA shall comply with all applicable Environmental Laws pertaining to TVA's use and operation of the Leased Premises and shall not cause or permit to occur on, under, or at the Leased Premises during the Lease Term: (a) any violation of any applicable Environmental Laws; or (b) the use, generation, Release, manufacture, refining, production, processing, storage, or disposal of any Hazardous Material, or the transportation to or from the Leased Premises of any Hazardous Material, except (i) as is incidental to and customary for the operation or maintenance of the Leased Premises for the uses permitted under this Lease and (ii) in compliance with all applicable Environmental Laws. TVA shall make all

submissions to, provide all information required by, and otherwise fully comply with the requirements of any Governmental Authority arising under applicable Environmental Laws pertaining to TVA's use and operation of the Leased Premises to include ownership and maintenance of any permits and licenses that may be necessary, required, or appropriate under the applicable Environmental Laws. If any Governmental Authority requires any clean-up plan or clean-up measures, under applicable Environmental Laws, on account of a Release or other Environmental Condition, TVA shall promptly provide Seven States with reasonable written notice thereof and prepare and submit the required plans (with copies to Seven States) and all related bonds and other financial assurances and shall promptly and diligently carry out all such clean-up plans. TVA shall, promptly upon completion, deliver to Seven States, true, correct, and complete copies of any and all environmental audits or related reports that TVA causes to be produced. TVA shall promptly provide Seven States with written notice regarding any Release or Environmental Condition on the Leased Premises, or any other notices, correspondence, or information (whether written or unwritten) regarding any investigations, any Claim, any threat of any Claim, or any notice by any Person relating to any Environmental Laws or any Environmental Condition. TVA acknowledges that all Emission Allowances issued pursuant to applicable Environmental Laws are and will remain the property of Seven States to the extent of its interest therein; but may be used by TVA to the extent required in the operation of the Purchased Assets. Any such Emission Allowances not so used may be sold or transferred by Seven States as it may elect. If such Emission Allowances shall at any time be insufficient to permit the operation of the Purchased Assets, TVA shall obtain Emission Allowances to the extent reasonably required.

7.4 Non-Interference; Purchased Assets Security .

7.4(a) TVA shall be designated with the SERC Reliability Corporation as the "Generator Operator" and "Generator Owner" and, as applicable, as the "Transmission Owner" and "Transmission Operator" and shall file such reports with the SERC Reliability Corporation as may be applicable in connection with such designations. TVA shall be solely responsible for the Purchased Assets' dispatch, power sales, and power deliveries. Seven States shall not attempt to sell, or effect the sale of, or control or set any price or terms of sale or transmission or delivery of any power from the Purchased Assets, notwithstanding any Event of Default by TVA.

7.4(b) During the Lease Term, other than as may be expressly provided in this Lease, all requests for access to the Purchased Assets shall be subject to TVA's review and shall be subject to TVA's security requirements, to be granted in its sole discretion.

7.5 Transmission and Interconnection . TVA certifies that during the Lease Term Seven States has no duties or obligations to TVA with respect to transmission of power from the Purchased Assets or with respect to interconnection of the Purchased Assets except as expressly provided in Section 7.4 above.

ARTICLE 8. MODIFICATIONS .

8.1 Required Modifications . TVA shall make or cause to be made any Modifications to the Purchased Assets as required by applicable Law or any Governmental Authority of competent jurisdiction (each, a Required Modification); *provided, however* , that TVA may in good faith and by appropriate proceedings, diligently contest the validity or application of any applicable Law in any reasonable manner. TVA shall promptly provide notice to Seven States of any such requirement for a Required Modification, upon obtaining Actual Knowledge thereof. TVA shall keep Seven States reasonably informed of TVA's plans with respect to the implementation of any Required Modification, and shall provide Seven States with any additional information that Seven States reasonably requests in connection with any such Required Modification.

8.2 Optional Modifications . TVA at any time may make or cause to be made any Modification to the Purchased Assets (that is not a Required Modification) as TVA considers in its discretion to be necessary or desirable in the proper conduct of its business (any such non-Required Modification being referred to as an Optional Modification); *provided, however* , that TVA shall make or cause to be made such Optional Modification only in accordance with applicable Law and Governmental Approvals. TVA shall promptly provide notice to Seven States, and keep Seven States reasonably informed, of TVA's plans with respect to the implementation of any Optional Modification, and shall provide Seven States with any additional information that Seven States reasonably requests in connection with any such Optional Modification.

8.3 Title to Modifications . Title to all Modifications shall automatically vest in both Seven States and TVA in proportion to their percentage ownership interests in the Purchased Assets upon being affixed to or incorporated into the Purchased Assets and such Modifications shall immediately (i) become subject to this Lease, (ii) be deemed part of the Purchased Assets for all purposes of this Lease and the Assignment and Assumption Agreement, and (iii) be deemed to be included in any reference to "Purchased Assets" under this Lease. TVA shall take such steps as Seven States may reasonably require from time to time, confirm that such title has vested in Seven States, and that such title is subject to this Lease.

8.4 Cost Responsibility for Capitalized Modifications . TVA and Seven States shall bear the cost of each Required Modification and each Optional Modification that costs one hundred thousand dollars ($100,000) or more (Capitalized Modification), in proportion to their percentage ownership interests in the Purchased Assets. TVA shall calculate Seven States' ownership share of the cost of such Capitalized Modifications by multiplying the Elected Percentage by such cost and submit an invoice therefor to Seven States, which shall pay promptly that amount to TVA, no later than thirty (30) days after receipt of the invoice. Once Seven States has paid said invoice, the Basic Rent under this Lease shall be adjusted to reflect this Elected Percentage of the cost of the Capitalized Modification as described in Section 3.3, above.

ARTICLE 9. EVENTS OF LOSS .

9.1 TVA Obligation to Restore . If a Casualty occurs, then not later than ninety (90) days after such Casualty TVA shall notify Seven States of such Casualty in writing of TVA's election, in TVA's discretion, either (a) to repair and restore the Leased Premises at TVA's expense, or (b) TVA may exercise its Buy-Back Option. Should TVA elect to repair and restore the Leased Premises, TVA shall complete Restoration within the following period after adjustment of the loss and initial disbursement of insurance proceeds (or, if no insurance proceeds are available, then after the date three months after the date of the Casualty): (a) if the Casualty destroys less than thirty percent (30%) of the Purchased Assets, then six (6) months; (b) if the Casualty destroys thirty percent (30%) or more of the Purchased Assets but less than substantially all of the Purchased Assets, then twelve (12) months; and (c) if the Casualty destroys substantially all

of the Purchased Assets, then eighteen (18) months. If TVA shall elect to restore but (i) shall fail or neglect to restore with reasonable diligence the Leased Premises or any portion thereof so damaged or destroyed, or (ii) having so commenced such Restoration, shall fail to complete the same with reasonable diligence in accordance with the terms of this Lease, then Seven States may complete the same at TVA's cost and expense. If TVA shall fail to make an election as provided in the first sentence of this Section 10.1, a Casualty shall be deemed to have occurred at the end of the ninety (90)-day period referred to in the first sentence of this Section 9.1, above, and TVA shall be deemed to have made the election to exercise its Buy-Back Option. In any event, all Rent hereunder shall continue unabated until this Lease terminates.

9.2 Application of Proceeds . Any payments with respect to the Purchased Assets received at any time by Seven States, TVA, or any other Person from any Governmental Authority or from Casualty Insurance Proceeds as a result of the occurrence during the Lease Term of a Casualty shall be deposited in an account jointly designated by Seven States and TVA.

9.3 Major Condemnation . If a Major Condemnation occurs after the Lease Commencement Date, then TVA shall be obligated to exercise its Buy-Back Option within a reasonable time but not to exceed thirty (30) days after such occurrence and to conduct the Buy-Back Closing, if practicable, before the effective date of the condemnation. Rent shall be apportioned as of the earlier of the effective date of the Major Condemnation or the date of the Buy-Back Closing. Any Condemnation Proceeds shall be paid to an account designated jointly by Seven States and TVA, and allocated between Seven States and TVA as follows:

9.3(a) Seven States' Share . Seven States shall be entitled to receive a percentage of the total Condemnation Proceeds equaling its Elected Percentage of the Purchased

Assets, with such share reduced by the Fair Market Value of TVA's Leasehold Interest as of the effective date of the Condemnation.

9.3(b) TVA's Share . TVA shall be entitled to receive a percentage of the total Condemnation Proceeds equaling its Elected Percentage of the Purchased Assets, as well as the Fair Market Value of TVA's Leasehold Interest as of the effective date of the Condemnation.

9.3(c) Costs and Expenses . Each Party shall bear its own legal costs incurred as a result of any Major Condemnation and any Minor Condemnation.

9.4 Minor Condemnation . If a Minor Condemnation occurs after the Lease Commencement Date, there shall be no abatement of rent, and the entire award shall be paid to an account designated jointly by Seven States and TVA and shall be applied first to Restoration of any remaining improvements not taken, then to TVA to reimburse it for the pro-rated portion of any rent TVA paid to Seven States for any portion of the Purchased Assets rendered unusable from the date of condemnation to the date full use of the Purchased Assets is restored. TVA shall perform such Restoration in accordance with the procedures set forth in this Article 9 so as to return the Leased Premises to its value and functionality prior to the Minor Condemnation to the extent Commercially Reasonable after giving effect to the consequences of the Minor Condemnation. Any remaining Condemnation Proceeds shall be distributed to Seven States and TVA in the same manner as are Condemnation Proceeds arising from a Major Condemnation, as described in Section 9.3, above. In the event of a Minor Condemnation, TVA has the right to exercise its Buy-Back Option within twenty (20) days of the occurrence of such Minor Condemnation, in which event the Lease shall terminate as of the consummation of the Buy-Back Closing, and Rent shall be apportioned as of such closing date.

9.5 Temporary Condemnation . If a Temporary Condemnation occurs after the Lease Commencement Date, then TVA shall give Seven States prompt notice thereof. The Lease Term shall not be reduced or affected in any way by such Temporary Condemnation, and TVA shall continue to pay all Rent. TVA shall be entitled to all Condemnation Proceeds attributable to any portion of the Temporary Condemnation occurring during the Lease Term.

9.6 TVA's Waiver . In any and all proceedings relating to a Condemnation, TVA waives the right to make a separate claim for the Leasehold Interest or for any costs related to the value of the Purchased Assets or any Component. TVA shall be entitled solely to the amounts, if any, payable to it pursuant to the provisions of this Article 9. In each such proceeding, Seven States and TVA agree to execute any and all documents that may be reasonably required to facilitate collection of the Condemnation Proceeds in such proceeding and distribution of such Condemnation Proceeds in the manner provided for in this Lease; *provided, however,* that TVA may raise and litigate in the condemnation proceeding any defense, including asserting that TVA's property as a matter of Law is not subject to condemnation.

9.7 Right of Compensation . In case of any action by any Governmental Authority not resulting in an actual transfer of interest in the Leased Premises but creating a right to compensation with respect to the Leased Premises, this Lease shall continue in full force and effect without reduction or abatement of Rent, and the award shall be equitably apportioned between Seven States and TVA.

9.8 Effect of Default . Notwithstanding anything to the contrary contained herein, if any Event of Default of which TVA has received notice exists, then any payments to which TVA would otherwise be entitled under this Article 9 shall first be applied to cure such Event of

Default. Notwithstanding the foregoing, if such Event of Default is not reasonably susceptible of cure by the payment of money alone, then TVA shall be entitled to receive any payments to which it is entitled under this Article 9 without first curing such Event of Default, provided that: (a) TVA has duly commenced the cure of such Event of Default, and (b) TVA is diligently prosecuting to completion the remedy of such Event of Default.

9.9 Appearance . Each Party has the right, at its own expense, to appear in any proceedings related to a Condemnation and participate in any and all hearings, trials, and appeals therein.

9.10 Prompt Notice . If Seven States or TVA shall receive notice of any proposed or pending Condemnation, such Party shall promptly notify the other Party of the receipt and contents thereof.

ARTICLE 10. INSURANCE .

During the Lease Term, TVA shall maintain (or cause to be maintained) the insurance required to be maintained pursuant to the Insurance Requirements set forth on Schedule 10.1 hereof and shall comply with such Insurance Requirements.

ARTICLE 11. INSPECTION .

During the Lease Term, Seven States and its agents and representatives, including any environmental consultant retained by Seven States and any agents and representatives of current or prospective lenders and underwriters, have the right, during normal business hours, upon reasonable notice to TVA and at no risk to TVA, to visit, observe, and inspect the Leased Premises and the records with respect to the operations and maintenance thereof (including

operating costs) in TVA's custody or to which TVA has access so long as TVA has the opportunity to be present; *provided, however* , that (a) TVA shall not be required to permit Seven States to review or inspect TVA's proprietary business records and documentation relating to TVA's budget projections, finances, projected load profiles, or pricing of the electricity produced at the Purchased Assets or any matters solely related to energy trading or the forward dispatch of the Purchased Assets, and (b) any such inspection shall be conducted so as not to disturb or interfere unreasonably with TVA's quiet enjoyment of the Purchased Assets, including the operation or maintenance of the Purchased Assets and the conduct by TVA of its business, and shall be in accordance with TVA's safety and insurance programs.

ARTICLE 12. EVENTS OF DEFAULT; REMEDIES .

12.1 Events of Default . Each of the following events shall constitute an Event of Default hereunder and, where specified in this Section 12.1, under the Assignment and Assumption Agreement (whether such event shall be voluntary or involuntary or come about or be effected by operation of law or pursuant to or in compliance with any judgment, decree, or order by any court or any order, rule, or regulation of any Governmental Authority):

12.1(a) TVA shall fail to make any payment of Basic Rent after the same has become due and payable, and such failure shall have continued for a period of ten (10) Business Days after receipt by TVA of written notice of such failure from Seven States;

12.1(b) TVA shall fail to make any payment of Supplemental Rent after the same has become due and such failure shall have continued for a period of thirty (30) Business Days after receipt by TVA of written notice of such failure from Seven States or any other Person to whom such payment is owed;

12.1(c) Either TVA or Seven States shall fail to perform or observe in any material respect (without giving duplicative effect to any materiality qualifier set forth in the text of any covenant, agreement, obligation, or representation) any covenant, obligation, or agreement to be performed or observed by it under this Lease or the Assignment and Assumption Agreement (other than any covenant, obligation, or agreement referred to in clause (a) or (b) of this Section 12.1) and such failure shall continue unremedied for thirty (30) days after receipt by the Defaulting Party of written notice thereof from the Non-Defaulting Party; *provided, however* , that in the case of TVA as Defaulting Party under this Section 12.1(c), if (A) such failure is reasonably susceptible of being remedied, but not within such thirty (30) -day period, and (B) TVA presents to Seven States a plan TVA reasonably believes will cure such failure, and TVA is diligently proceeding to cure such failure in accordance with such plan, then the period for cure shall be extended for the period as necessary for TVA to cure such failure, but in no event shall the aggregate cure period under this Section 12.1(d) exceed one hundred and eighty (180) days after receipt by TVA of written notice thereof from Seven States;

12.1(d) Any representation or warranty made by TVA or Seven States in this Lease or in any Officer's Certificate delivered pursuant thereto is materially false or misleading as of the date made (except to the extent that such representations and warranties relate solely to an earlier date, in which case as of such date) and shall continue to be material and the circumstances giving rise to such representation or warranty are unremedied for a period of thirty (30) days after receipt by the Defaulting Party of written notice thereof from the Non-Defaulting Party; *provided, however* , that if

such condition cannot be remedied within such thirty (30) -day period, then the period within which to remedy such condition shall be extended up to an additional one hundred and eighty (180) days, so long as the Defaulting Party diligently pursues such remedy and such condition is reasonably capable of being remedied within such additional one hundred and eighty (180) -day period;

12.1(e) Seven States (i) shall become subject to a Bankruptcy Event or (ii) shall breach its duty to TVA of quiet enjoyment under Section 4.2;

12.1(f) The termination, suspension, or revocation of, or material adverse modification or omission or failure to obtain, or cause a third party to obtain, under any Project Document, any Governmental Approval required for the construction, use, maintenance, and operation of the Leased Premises or the Purchased Assets, which termination, suspension, revocation, modification, omission, or failure to obtain, or cause to be obtained, could reasonably be expected to result in a Material Adverse Effect, and such termination, suspension, revocation, modification, omission, or failure shall continue unremedied for a period of thirty (30) days after the earlier to occur of TVA obtaining Actual Knowledge thereof or receipt by TVA of written notice thereof from Seven States; *provided, however* , that if (A) such termination, suspension, revocation, modification, omission, or failure cannot be cured within such period, or (B) such termination, suspension, revocation, modification, omission, or failure is reasonably susceptible of cure within one hundred and eighty (180) days after the earlier of TVA obtaining Actual Knowledge or TVA's receipt of written notice of such termination, suspension, revocation, modification, omission, or failure from Seven States, or (C) TVA is proceeding with diligence and in good faith to cure such termination, suspension,

revocation, modification, omission, or failure, or (D) the existence of such termination, suspension, revocation, modification, omission, or failure has not had and could not, after considering the nature of the cure, be reasonably expected to result in a Material Adverse Effect, then such cure period shall be extended to such date, not to exceed one hundred and eighty (180) days after such termination, suspension, revocation, modification, omission, or failure, as necessary for TVA diligently to cure such termination, suspension, revocation, modification, omission, or failure;

12.1(g) With respect to the Lease or the Assignment and Assumption Agreement, (A) such Lease or Assignment and Assumption Agreement (1) ceases to be a valid and binding obligation of the parties thereto or (2) is declared unenforceable by a Governmental Authority or (B) such Lease or Assignment and Assumption Agreement is terminated or ceases to be in full force and effect (prior to its normal or permitted expiration or termination pursuant to Section 3.1), except if caused by a default by Seven States thereunder;

12.1(h) An Event of Abandonment shall occur;

12.1(i) With respect to any of the Project Documents:

12.1(i)(i) Any Person shall be in breach of, or in default under, a Project Document (without regard to any cure periods therein), and such breach or default shall not be remediable or, if remediable, shall continue unremedied for the lesser of (A) a period of thirty (30) days from the time TVA obtains Actual Knowledge of such breach or default or (B) such period of time under such Project Document that such Person has available to it in which to remedy the breach or default; *provided* , *however* , that if (1) such breach or default cannot be cured within such

thirty (30)-day period (or lesser period, as the case may be), and (2) such breach or default is susceptible of cure within one hundred and eighty (180) days, and (3) the breaching Person or TVA is proceeding with diligence and in good faith to cure such breach or default, then such thirty (30)-day cure period (or lesser period, as the case may be) shall be extended to such date, not to exceed a total of one hundred and eighty (180) days after such breach or default, as shall be necessary for such breaching Person diligently to cure such breach; *provided, further* , that no Event of Default shall occur as a result of any such action if TVA obtains a replacement party for the affected party within the thirty (30)-day cure period (or lesser period, as the case may be) referred to in this Section 12.1(i)(i) (or within the one hundred and eighty (180)-day cure period, if an extension pursuant to this Section 12.1(i)(i) is given) and such action does not have, prior to so obtaining such replacement party, a Material Adverse Effect; or

12.1(i)(ii) Any material provision in any Project Document shall for any reason cease to be valid and binding on any party thereto except upon fulfillment of such party's obligations thereunder, or shall be declared null and void, and such deficiency is in TVA's reasonable power to remediate; *provided* , *however* , that no Event of Default shall occur as a result of such breach or default if (A) such provision is restored or replaced by a replacement provision in form and substance reasonably acceptable to Seven States within a period of one hundred and eighty (180) days thereafter or (B) TVA obtains a replacement party for the affected party within one hundred and eighty (180) days thereafter and, in either

case, such breach or default has not had, and does not have prior to so obtaining such replacement provision or replacement party, a Material Adverse Effect; or

12.1(i)(iii) Either Party shall cause or permit any Project Document to be amended or altered without the prior written consent of the other Party, which consent shall not be unreasonably withheld or delayed in each instance;

12.1(j) Either Party shall materially fail to comply with applicable Law in connection with this Lease specifically or the Purchased Assets generally.

12.2 Remedies for Event of Default . Upon the occurrence of any Event of Default and at any time thereafter so long as the same shall be continuing, either Party who is not in default (Non-Defaulting Party) may declare this Lease to be in default by written notice to the other, defaulting Party (Defaulting Party). At any time after this Lease is declared or deemed declared to be in default pursuant to the preceding sentence, so long as the outstanding Event of Default shall not have been remedied or cured as may be specifically provided with respect to any such Event of Default under Section 12.1, above, or so long as the occurrence of the Event of Default is no longer within any applicable grace or notice periods provided in Section 12.1, above, the Parties may do one or more of the following, as may be appropriate, to the extent permitted by and subject to compliance with any mandatory requirements of applicable Law then in effect:

12.2(a) The Non-Defaulting Party may, from time to time and at any time, proceed by appropriate court action or actions, either at law or in equity, to enforce performance by the Defaulting Party of the applicable covenants and terms of this Lease or to recover damages for breach thereof.

12.2(b) The Non-Defaulting Party may give the Defaulting Party written notice terminating this Lease, whereupon (1) the Non-Defaulting Party shall be deemed eligible

to exercise the Buy-Back Option and (2) (i) if TVA is the Non-Defaulting Party, TVA shall be deemed to have exercised its Buy-Back Option and (ii) if Seven States is the Non-Defaulting Party, Seven States may elect to exercise the Buy-Back Option; *provided, however,* that this Lease shall not terminate until completion of the closing in which TVA purchases the Leased Premises. All rights of the Parties under this Lease, except for those rights that expressly survive such termination, shall cease. Such notice, however, shall not in any way adversely affect TVA's existing ownership interest in the Purchased Assets.

12.3 Right to Cure . If the Defaulting Party at any time fails to make any payment or perform any other act on its part to be made or performed pursuant to this Lease, then the Non-Defaulting Party, after ten (10) Business Days' notice to the Defaulting Party, or in an emergency with such notice as is reasonably practicable under the circumstances, and without waiving or releasing the Defaulting Party from any obligation or from any Event of Default and without waiving the Non-Defaulting Party's right to take such action as may be permissible under this Lease as a result of such Event of Default, may make such payment or perform such act on the Defaulting Party's behalf pursuant to this Lease. The Defaulting Party shall reimburse the Non-Defaulting Party, within ten (10) days after written notice from the Non-Defaulting Party, an amount equal to all Commercially Reasonable sums, costs, and expenses paid or incurred by the Non-Defaulting Party in connection with the exercise of the Non-Defaulting Party's cure rights under this paragraph.

12.4 Waiver of Outside Cure Periods . Notwithstanding anything to the contrary contained in this Article 12, in the event that TVA is a Defaulting Party, to the extent that (a) TVA continues to timely pay all Rent and its other monetary obligations as provided under this

Lease, (b) TVA's long-term debt obligations are rated A3 or higher by Moody's Investor Service, Inc. and A- or higher by Standard & Poor's Ratings Group, and (c) TVA is diligently acting to cure any non-monetary Event of Default or an Event of Default that (1) does not involve (A) any material risk of foreclosure, sale, forfeiture or loss of any part of the Leased Premises or of impairment of Seven States' use, operation, or maintenance of the Leased Premises in any material respect or (B) a risk of criminal sanctions or criminal liability being incurred by, or a material risk of any Material Adverse Effect on Seven States, or (2) could not reasonably be expected to have any Material Adverse Effect on the business and interests of Seven States, including any material risk of subjecting any such Person to regulation as a public utility under applicable Law, then any provision where TVA is limited to an outside cure deadline of one hundred and eighty (180) days shall not apply.

12.5 Force Majeure .

12.5(a) Any delays in or failure of performance (except for the obligation to pay money) by a Party or its contractors shall not constitute an Event of Default hereunder if and to the extent such delays or failures of performance are caused by occurrences beyond the reasonable control of that Party or its contractors, and that Party shall not be liable for any loss or damage due to or arising out of any such delays or failure of performance. Such occurrences include acts of God or the public enemy, fires, epidemics, quarantines, strikes, freight embargoes or delays in transportation, unforeseeable severe weather or floods, or applicable Laws, regulations, orders, or other acts or failures to act of Governmental Authorities, or any causes, whether or not of the same class or kind of those specifically above named, that are not within the control of that Party or its contractors.

12.5(b) A Party required to perform under this Lease shall give the other Party notice within seven (7) days after such Party knows (or reasonably should have known) of any such Force Majeure and shall give the other Party notice within seven (7) days after such Force Majeure ceases to exist. If the Party required to perform under this Lease gives such notice after the expiration of such seven (7) -day period, then such Party shall have the right to claim Force Majeure for only the seven (7) days prior to the date of such Notice as opposed to the date on which such Force Majeure arose. Force Majeure shall only extend the time permitted for such performance by the number of days by which such Force Majeure actually delayed such performance.

ARTICLE 13. INDEMNIFICATION .

13.1 By TVA to Seven States . TVA shall indemnify, defend, and hold harmless Seven States, its officers, agents, contractors, subcontractors, and employees from any and all claims, based on any Laws whatsoever, for personal injury including death, property damage, and any and all fines or penalties to the extent such arise from the negligent acts, omissions or willful misconduct of TVA, its contractors, subcontractors, officers, employees, and agents (collectively, the TVA Parties) acting in the course and scope of their employment in performing activities on the Leased Premises. This indemnification shall not extend to any damages to the Leased Premises or claims of any sort relating to the Leased Premises caused solely by the Seven States Parties' (as defined in section 13.2, below) negligence or willful misconduct.

13.2 By Seven States to TVA . Seven States shall indemnify, defend, and hold harmless the TVA Parties from any and all claims based on any Laws whatsoever, for personal injury, including death, property damage, and any fines or penalties to the extent such arise from the

negligent acts, omissions, or willful misconduct of Seven States, its officers, agents, employees, contractors, subcontractors, successors, and/or assigns and their respective employees and agents (collectively, the Seven States Parties) acting in the course and scope of their employment in performing activities on the Leased Premises. This indemnification shall not extend to any damages to the Leased Premises or claims of any sort relating to the Leased Premises that were caused solely by the TVA Parties' negligence or willful misconduct.

ARTICLE 14. MISCELLANEOUS .

14.1 Assignment .

14.1(a) Each Party, for itself, its executors, administrators, legal representatives, successors, and assigns, expressly covenants that it shall not sell, assign, transfer, mortgage, pledge, or otherwise dispose of or encumber its rights in the Leased Premises, or assign or otherwise transfer any right or obligation under this Lease, to any Person (collectively, Transfer) without the prior written consent of the other Party in each instance; *pro vided, however*, that Seven States may Transfer rights as provided in Section 19 of the Joint Ownership Agreement (Assignment). Notwithstanding the other Party's consent, if given, to any proposed Transfer, the assigning Party shall at all times remain liable to the other Party for all of the assigning Party's obligations hereunder unless otherwise agreed by the other Party in the exercise of its sole discretion and in a manner consistent with the covenant of good faith dealings imposed by Law.

14.1(b) If the Transferring Party shall desire to Transfer its interest in this Lease, the assigning Party shall submit to the other Party a written request for the other Party's consent to such Transfer, which request shall be accompanied by the following: (i) the name and address of the proposed Transferee; (ii) the form, terms, and conditions of the

proposed Transfer and Transfer agreement; (iii) the nature and character of the business of the proposed Transferee and information relating to the proposed Transferee's experience and involvement in the business of owning and managing energy production assets in accordance with Good Utility Practice; (iv) current financial information evidencing a financial standing consistent with the standards for entities engaged in the business of owning and managing energy production assets in accordance with Good Utility Practice; and (v) any other information the other Party may reasonably request with respect to the proposed Transferee.

14.1(c) The effectiveness of any Transfer and any consent to a Transfer by the other Party pursuant to this Section 14.1 shall be further conditioned on the following:

14.1(c)(i) The Transferring Party shall reimburse the other Party on demand for any Commercially Reasonable documented out-of-pocket costs, including reasonable attorneys' fees and disbursements, that may be incurred by the other Party in connection with said Transfer;

14.1(c)(ii) The Transferring Party shall promptly deliver to the other Party a copy of the fully executed Transfer agreement consented to by the other Party and any related agreements promptly after the full execution thereof;

14.1(c)(iii) the proposed Transferee, and, if the Transferee is a general partnership, the individual partners thereof, shall execute and deliver to the other Party an agreement in recordable form, whereby such Transferee agrees unconditionally to be personally bound by and to perform all of the obligations of the Transferring Party hereunder and further expressly agrees that

notwithstanding such Transfer the provisions of this Section 14.1 shall continue to be binding upon such Transferee with respect to all future Transfers;

14.1(c)(iv) The Transferring Party shall, in connection with such Transfer, have obtained any third-party consents required in accordance with applicable Law, and all applicable Governmental Approvals;

14.1(c)(v) No Change in Law has occurred that would (A) make it illegal for either Party to permit or cause such a Transfer, or (B) reasonably be expected to result in a Material Adverse Effect; and

14.1(c)(vi) Subject to Section 14.1(a), above, the Transferring Party shall remain fully liable for the performance of all of the Transferring Party's obligations hereunder notwithstanding any Transfer and, without limiting the generality of the foregoing, shall remain fully responsible and liable to the other Party for all acts and omissions of any Transferee or anyone claiming by, through, or under any Transferee that violates any of the obligations of this Lease, and any such violation shall be deemed to be a violation by the Transferring Party. Notwithstanding any Transfer and assumption by the Transferee of the obligations of the Transferring Party hereunder, the Transferring Party, and each immediate or remote successor in interest of the Transferring Party, shall remain liable jointly and severally (as a primary obligor) with its Transferee and all subsequent Transferees for the performance of the Transferring Party's obligations hereunder, and shall remain fully and directly responsible and liable to the other Party for all acts and omissions on the part of any Transferee subsequent to it in violation of any of the obligations of this Lease.

14.1(d) To the extent that TVA is not the lessee hereunder, any transfer, by operation of law or otherwise, of the interest of TVA in this Lease (in whole or in part) or of a fifty percent (50%) or greater interest in TVA (whether stock, partnership interest, or otherwise) shall be deemed a Transfer within the meaning of this Section 14.1. The issuance of shares of such stock to other than the United States government shall be deemed to be a transfer of such stock for the purposes of this Section 14.1(d).

14.1(e) The consent of the other Party to any Transfer shall not relieve the Transferring Party from obtaining the express consent in writing of the other Party to any further assignment.

14.2 Amendments and Waivers . No term, covenant, agreement, or condition of this Lease may be terminated or amended or have compliance therewith waived (either generally or in a particular instance, retroactively or prospectively) except by an instrument in writing executed by each Party hereto.

14.3 Notices . All notices, confirmations, and other communications required or permitted by the terms of this Lease shall be given in English and in writing and shall be deemed to have been duly given: (a) if sent by certified mail postage prepaid, return receipt requested, five (5) days after being deposited in the United States mail; (b) if sent by standard overnight carrier (such as Federal Express), upon the date of delivery indicated in the records of such carrier; (c) if transmitted by facsimile, when received by the recipient in legible form (with machine confirmation); and (d) if hand-delivered, when delivered by hand; and, in the case of each of the foregoing methods (a) through (d) addressed or transmitted as follows:

For TVA: Tennessee Valley Authority
Attn: Executive Vice President, Customer Resources
One Century Place, 26 Century Blvd., OCP 1F-NST
Nashville, TN 37229
615-232-6011
Fax: 615-232-6014

With copy to: Tennessee Valley Authority
Attn: Office of General Counsel
400 West Summit Hill Drive, WT 6A-K
Knoxville, TN 37902
Phone: 865-632-4131
Fax: 865-632-3307

For Seven States: Seven States Southaven, LLC
Attn: President and CEO
1206 Broad Street
Chattanooga, TN 37402
Phone: 423-756-6511
Fax: 423-267-9424

With a copy to:` Carlos Smith
Miller & Martin, PLLC
832 Georgia Avenue
Chattanooga, TN 37402
Phone: 423-785-8359
Fax: 423-321-1659

14.4 Survival . Termination of this Lease shall not relieve the Parties of obligations that by their nature should survive such termination, including final billing, billing adjustment and payments, warranties, remedies, and confidentiality obligations, as well as the compliance obligations under Section 2.4 above, the apportionment of Impositions under Section 3.8 above, and environmental matters under Section 7.3 above.

14.5 Successors and Assigns . This Lease shall be binding upon and shall inure to the benefit of, and shall be enforceable by, the Parties and their respective successors and assigns as permitted by and in accordance with the terms hereof.

14.6 Governing Law . In all respects, including matters of construction, validity, and performance, this Lease shall be governed by, and construed in accordance with, the Federal Laws of the United States of America; *provided* , *however* , that (a) the Laws of the State of Mississippi shall govern as to matters affecting real property in the State of Mississippi where there is no such applicable Federal Law or Federal Law requires adoption of state Law for a rule of decision with respect to such matters, and (b) the Laws of the State of Tennessee shall govern where there is no such applicable Federal Law or Federal Law requires adoption of state Law for a rule of decision as to matters other than with respect to matters affecting real property in the State of Mississippi. To the fullest extent permitted by Law, TVA and Seven States hereby unconditionally and irrevocably waive any claim to assert that the Law of any other jurisdiction governs this Lease, except as expressly otherwise provided above.

14.7 Consent to Jurisdiction; Waiver of Trial by Jury .

14.7(a) Each of the Parties (i) hereby irrevocably submits to the exclusive jurisdiction of the United States District Court for the Eastern District of Tennessee for the purposes of any suit, action, or other proceeding arising out of this Lease, the Assignment and Assumption Agreement, or the Joint Ownership Agreement that is brought by either of the Parties or their successors or assigns, (ii) hereby irrevocably agrees that all claims with respect to such suit, action, or other proceeding shall be heard and determined in the above-named court, and (iii) to the extent permitted by applicable Law, hereby irrevocably waives, and agrees not to assert, by way of motion, as a defense,

or otherwise in any such suit, action, or other proceeding, any claim that: (A) it is not personally subject to the jurisdiction of the above-named court; (B) that the suit, action, or other proceeding is brought in an inconvenient forum; (C) that the venue of the suit, action, or other proceeding is improper; or (D) that this Lease, the Assignment and Assumption Agreement, or the Joint Ownership Agreement, may not be enforced in or by the above-named court.

14.7(b) TO THE EXTENT PERMITTED BY APPLICABLE LAW, EACH OF THE PARTIES HEREBY IRREVOCABLY WAIVES THE RIGHT TO DEMAND A TRIAL BY JURY IN ANY SUCH SUIT, ACTION, OR OTHER PROCEEDING ARISING OUT OF THIS LEASE, THE ASSIGNMENT AND ASSUMPTION AGREEMENT OR THE SUBJECT MATTER HEREOF OR THEREOF OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY BROUGHT BY ANY OF THE PARTIES OR THEIR SUCCESSORS OR ASSIGNS.

14.8 Merger . To the extent permitted by applicable Law, this Lease shall not terminate, nor shall TVA's interest be extinguished, lost, conveyed, or otherwise impaired, or be merged into or with any other interest or estate in the Leased Premises or any other property interest, in whole or in part, other than as expressly provided in this Lease by any cause or for any reason whatsoever, including (a) any damage to or destruction of all or any part of the Leased Premises or the taking of the Leased Premises or any portion thereof by condemnation, requisition, eminent domain, or otherwise, (b) any prohibition, limitation, or restriction of Seven States' or TVA's use of all or any part of the Leased Premises or the interference of such use by any Person, (c) the coincident ownership by any Person (including Seven States) of any estate or interest in the Leased Premises or any other rights granted or conveyed pursuant to this Lease

with any estate or interest in the Leased Premises, (d) any inadequacy, incorrectness, or failure of the description of the Leased Premises or any property or rights intended to be granted or conveyed by this Lease, (e) any default in the performance or the observance by Seven States or TVA of any of their respective covenants and agreements to be performed and observed by such party hereunder, (f) the insolvency, bankruptcy, reorganization, or similar proceedings by or against Seven States or TVA, or (g) any other reason whatsoever, whether similar or dissimilar to any of the foregoing. The Parties intend and agree that the rights granted and conveyed hereunder shall be separate and independent covenants and agreements of the Parties and that this Lease and any other right granted or conveyed pursuant to this Lease may be terminated only as provided in this Lease and may not be terminated without notice.

14.9 Severability . Any provision of this Lease that is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

14.10 Counterparts . This Lease may be executed by the Parties in separate counterparts, each of which, when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

14.11 Headings and Table of Contents . The headings of the sections of this Lease and the Table of Contents are inserted for purposes of convenience only and shall not be construed to affect the meaning or construction of any of the provisions hereof.

14.12 Further Assurances . Each Party shall promptly and duly execute and deliver such further documents and assurances for and take such further action reasonably requested by the

other Party, all as may be reasonably necessary to carry out more effectively the intent and purpose of this Lease.

14.13 Effectiveness . This Lease has been dated as of the date first above written for convenience only. This Lease shall be effective on the date of execution and delivery by TVA and Seven States.

14.14 Entire Agreement . This Lease, the Assignment and Assumption Agreements, the Joint Ownership Agreement, and related nondisclosure agreements constitute the entire agreement of the Parties with respect to the subject matter hereof and thereof and supersede all oral and all prior written agreements and understandings with respect to such subject matter.

14.15 No Partnership, Etc . Except as set forth herein and under the Joint Ownership Agreement, the Parties intend that nothing contained in this Lease or the Assignment and Assumption Agreement or the Joint Ownership Agreement shall be deemed or construed to create a partnership, joint venture, or other co-ownership arrangement by and among any of them. The Parties hereby acknowledge and agree that for United States Federal income tax purposes, Seven States is the owner of the Leased Premises and this Lease is a “true lease.” Further, this Lease shall constitute an agreement of lease only and nothing herein shall be construed as conveying to TVA any right, title, or interest in and to the Leased Premises except solely as lessee hereunder.

14.16 Memorandum of Lease . Upon request by either Party, the other Party shall promptly execute, acknowledge, and deliver duplicate originals of a Memorandum of Lease. Either Party may record such Memorandum of Lease. Any taxes imposed upon such recording shall be paid by the Party that bears primary liability under applicable Law for payment of such

taxes. If the Parties amend this Lease, then the Parties have the same rights and obligations regarding a memorandum of such amendment that they do for the Memorandum of Lease.

14.17 Estoppel Certificates . From time to time, each Party to this Lease (a Requesting Party) may, up to twice a year, require the other Party (a Certifying Party) to execute, acknowledge, and deliver to the Requesting Party (or directly to a third party whose name and address are provided by the Requesting Party) up to four original counterparts of an Estoppel Certificate. The Certifying Party shall sign, acknowledge, and return such Estoppel Certificate within fifteen (15) days after request. Any third party to whom an Estoppel Certificate is directed may rely on such Estoppel Certificate.

14.18 Consent and Waiver . It is understood and agreed that one Party's granting of any consent to the other Party to perform any act requiring the first Party's consent or approval under the terms of this Lease, or the failure on the part of the first Party to object to any such action taken by the other Party without the first Party's consent, shall not be deemed a waiver by the first Party of its rights to require such consent for any further similar act by the other Party. The Parties hereby expressly covenant and warrant that as to all matters requiring the other Party's consent under the terms of this Lease, the Party requiring consent shall secure such consent for each and every happening of the event requiring such consent, and shall not claim any waiver by the other Party of the requirement to secure such consent. If the Party withholding or delaying consent is determined to have done so unreasonably (in violation of an express obligation to be reasonable as expressly set forth in this Lease), then such Party's consent shall be deemed granted and such Party shall have no liability as a result of its withholding or delaying of consent.

14.19 Seven States Required Federal Contracting Covenants . So long as this Lease shall remain in effect, Seven States (or any successor thereto) hereby agrees and covenants to comply with the applicable provisions of 41 C.F.R. § 60-1.4, 41 C.F.R. § 60-250.4, and 41 C.F.R. § 60-741.5.

14.20 Waiver of Partition . So long as the Purchased Assets or any part thereof as originally constructed, reconstructed, or added to are used or useful for the generation of electrical power and energy, or to the end of the period permitted by applicable Law, whichever first occurs, the Parties waive any right to partition (whether by partition in kind or sale and division of the proceeds thereof), and agree that they will not resort to any action at law or in equity to partition and further waive the benefit of all Laws that may now or hereafter authorize such partition of the properties comprising the Purchased Assets. It is agreed that this covenant shall be deemed to run with the land. All instruments of conveyance which effect, evidence, or vest the ownership interest of Seven States in the Purchased Assets shall contain this waiver of right to partition.

14.21 Interpretation . In this Lease, unless otherwise provided herein, the terms set forth in Article 1 have the meanings provided for herein. Any term defined in Article 1, above, by reference to another document, instrument, or agreement shall continue to have the meaning ascribed thereto whether or not such other document, instrument, or agreement is in effect. Words in the singular include the plural and vice versa. Words referring to one gender include any gender. A reference to any statute, regulation, proclamation, ordinance, or other Law includes all statutes, regulations, proclamations, ordinances, and other Laws varying, consolidating, or replacing the same from time to time, and a reference to a statute includes all

regulations, policies, protocols, codes, proclamations, and ordinances issued or otherwise applicable under that statute unless, in any such case, otherwise expressly provided in any such statute. A definition of or reference to any document, instrument, or agreement includes each amendment or supplement to, or restatement, replacement, substitution, successor, modification, or novation of, any such document, instrument, or agreement unless otherwise specified in such definition or in the context in which such reference is used; *provided, however* , that such documents were not amended in breach of a covenant contained in any agreement to which TVA or Seven States is a party. A reference to a particular section, paragraph, or other part of a particular statute shall be deemed to be a reference to any other section, paragraph, or other part substituted therefor from time to time unless otherwise specified. A reference to any Person (as hereinafter defined) includes such Person's successors and permitted assigns. Any reference to "days" means calendar days unless "Business Days" are expressly specified. If the date as of which any right, option, or election is exercisable, or the date upon which any amount is due and payable, is stated to be on a day that is not a Business Day, such right, option, or election may be exercised, and such amount shall be deemed due and payable, on the next succeeding Business Day, with the same effect as if the same was exercised or made on such date or day and no interest shall accrue or be payable with respect to such payment. Words such as "hereunder," "hereto," "hereof," and "herein" and other words of similar import shall, unless the context requires otherwise, refer to the whole of the applicable document and not to any particular article, section, subsection, paragraph, or clause thereof. A reference to "including" means including without limiting the generality of any description preceding such term, and for purposes hereof the rule of *ejusdem generi s* shall not be applicable to limit a general statement, followed by or referable to an enumeration of specific matters, to matters similar to those

specifically mentioned. Unless otherwise expressly stated, references in this Lease to “Articles,” “Sections,” and “Subsections” are to Articles, Sections, and Subsections of this Lease.

14.22 TVA’s Access to Seven States’ Financial Statements . Upon written request by TVA, Seven States shall provide access during normal working hours to its records as necessary to permit TVA to verify the accuracy or appropriateness of Seven States’ financial records. TVA shall keep the information examined confidential. Nothing in this Section shall be construed as in any way impairing the ability pursuant to statutory authority of the Office of the Inspector General of TVA or of any other Federal agency having auditing jurisdiction over TVA to examine the records of Seven States to the extent relating to any amount billed to TVA by Seven States.

14.23 Fees and Expenses . Except as expressly provided elsewhere in this Lease, each Party shall bear its own costs and expenses incurred by it in connection with the negotiation, preparation, execution, and implementation of this Lease, including the costs of accounting and financial reporting.

14.24 Dispute Resolution . If a dispute arises out of or relates to this Lease, the Parties agree to use their best efforts to resolve such a dispute informally at the lowest possible levels of decision-making. If such a dispute is not resolved at the working level, it shall be referred to higher levels of management of both Parties for consideration, as necessary. If the dispute cannot be so settled within sixty (60) days, the Parties will consider the development and use of consensual alternative dispute resolution processes (“ADR”), such as facilitation and mediation, to try in good faith to settle the dispute before resorting to litigation. It is expressly recognized and agreed, however, that (a) nothing in this Section 14.24 shall be construed to require the use or completion of ADR prior to resorting to litigation or to otherwise limit the Parties from

resorting to litigation, and (b) this Section 14.24 is not a "Disputes" clause within the meaning of the Contract Disputes Act of 1978, 41 U.S.C. §§ 601-613 (CDA), and that this Lease is not subject to the provisions of the CDA.

IN WITNESS WHEREOF, Seven States and TVA have caused this Lease to be duly executed and delivered under seal by their duly authorized officers.

SEVEN STATES SOUTHAVEN, LLC

By: /s/ Jack W. Simmons
Title: President and Chief Executive Officer

TENNESSEE VALLEY AUTHORITY

By: /s/ Tom D. Kilgore
Title: President and CEO

EXHIBIT A
LEGAL DESCRIPTION

SOUTHAVEN COMBUSTION TURBINE SITE

Mississippi Parcel 1 (Acquisition Tract SCBTS-1)

A parcel of land lying in the SW1/4 of Section 15 Township 1 South Range 8 West in Desoto County, State of Mississippi, being on the Southaven Combustion Turbine Site and at the intersection of Tulane Road and Stateline Road, as shown on US-TVA Drawing No. 112 MS 422 B 100(D) R.0 and being more particularly described as follows:

Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S42°05'16"E, 13,353.72 feet to an angle iron (set) on the accepted Mississippi-Tennessee state line being corner No. SCBTS-1 and the Point of Beginning:

Thence leaving the point of beginning and said Mississippi-Tennessee state line S02°11'31"W, 1,100.72 feet to a rebar (found) in the northern right of way of Stateline Road, being corner No. SCBTS-2; thence continuing with said right of way for the following two calls;
N87°47'07"W, 304.06 feet to a rebar (found), being corner No. SCBTS-3;
thence N87°47'41"W, 104.99 feet to a (3/8") rebar (found), being corner No. SCBTS-6;
thence leaving said right of way N02°12'24"E, 206.98 feet to a (3/8") rebar (found), being corner No. SCBTS-5; thence parallel with north right of way of Stateline Road N87°48'27"W, 1,260.36 feet to rebar with cap (found) and stamped “THY INC. #888” in the eastern right of way of Tulane Road, being corner No. SCBTS-7; thence with said right of way N02°15'03"E, 899.31 feet to a rebar with cap (found) on the accepted Mississippi-Tennessee state line, being corner No. SCBTS-8; thence leaving said right of way and with said state line S87°36'39"E, 1,668.44 feet to the point of beginning and containing 36.29 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

Mississippi Parcel 2 (Acquisition Tract SCBTS-2)

A parcel of land lying in the SE1/4 of Section 16 Township 1 South Range 8 West in Desoto County, State of Mississippi, being on the Southaven Combustion Turbine Site and at the intersection of Tulane Road and Stateline Road, as shown on US-TVA Drawing No. 112 MS 422 B 100(D) R.0 and being more particularly described as follows:

Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S33°33'03"E, 12,943.26 feet to a rebar (found) in the west right of way of Tulane Road, being corner No. SCBTS-9 and the Point of Beginning:

Thence leaving the point of beginning and said right of way N87°55'13"W, 225.69 feet to a nail (60d) (found), being corner No. SCBTS-10;
thence N87°42'13"W, 420.76 feet to a rebar without cap (found), being corner No. SCBTS-11;
thence N02°36'46"E, 209.28 feet to a rebar without cap (found), being corner No. SCBTS-12; thence N87°28'38"W, 210.14 feet to an iron pipe (1.5") (found), being corner No. SCBTS-13;
thence S02°13'39"W, 209.42 feet to a pin (found), being corner No. SCBTS-14;
thence S02°43'42"W, 155.47 feet to a rebar with cap (found) in the north right of way of Stateline Road, being corner No. SCBTS-15;
thence with road said right of way N87°43'40"W, 415.16 feet to a rebar (found), being corner No. SCBTS-16;
thence N02°24'39"E, 673.73 feet to an iron pipe (1.5") (found), being corner No. SCBTS-17; thence S87°35'36"E, 434.83 feet to a rebar (found), being corner No. SCBTS-18;
thence N02°19'08"E, 435.00 feet to a rebar (found) on the accepted Mississippi-Tennessee state line, being corner No. SCBTS-19;
thence with said state line for the following calls:
S87°35'34"E, 311.41 feet to an angle iron (set), being corner No. SCBTS-26;
thence S87°35’28”E, 523.19 feet to an iron pipe (found) in the west right of way of Tulane Road, being Corner No. SCBTS-20;
thence leaving said state line and with said road right of way S02°15'57"W, 206.15 feet to a rebar (found), being corner No. SCBTS-21;
thence leaving said right of way N87°38'49"W, 158.80 feet to a rebar (found), being corner No. SCBTS-22;
thence S02°07'35"W, 209.14 feet to an iron pipe (found), being corner No. SCBTS-23;
thence S87°29'48"E, 158.20 feet to a rebar (found) in the western right of way of Tulane Road, being corner No. SCBTS-24;
thence with said road right of way S02°15'14"W, 534.74 feet to the point of beginning and containing 23.14 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

Mississippi Parcel 3 – Transmission Line Easement (Acquisition Tract SCBTS-4-TL)

An easement for transmission line purposes as described in that certain Transmission Line Easement dated November 21, 2000, between Entergy Mississippi, Inc. and Southaven Power, LLC, recorded December 8, 2000 in Deed Book 384, page 81 over, under and across a parcel of land lying in the SE1/4 of Section 16 Township 1 South Range 8 West in Desoto County, State of Mississippi, being on the Southaven Combustion Turbine Site, as shown on US-TVA Drawing No. 112 MS 422 B 100(D) R.0 and being more particularly described as follows:

Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S29°12'19"E, 12,075.19 feet to a point in the western line of tract SCBTS-2, being corner SCBTS-33 and the Point of Beginning:

Thence leaving the point of beginning and said western line of tract SCBTS-2 N89°54'39"W, 417.53 feet to a point, being corner No. SCBTS-34;
thence N44°04'03"W, 81.72 feet to a point, being corner No. SCBTS-35;
thence N45°55'57"E, 150.00 feet to a point, being corner No. SCBTS-36;
thence S44°04’03”E, 18.29 to a point, being Corner No. SCBTS-37;
thence S89°54’39”E, 360.18 to a point, being Corner No. SCBTS-38;
thence S02°24’35”W, 150.12 feet to the point of beginning and containing 1.51 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

Tennessee Parcel 1 (Acquisition Tract SCBTS-3)

A parcel of land lying in the in the Third Civil District of Shelby County, State of Tennessee, being on the Southaven Combustion Turbine Site and at the intersection of Tulane Road and Windsor Road, as shown on US-TVA Drawing No. 112 MS 422 B 100(D) R.0 and being more particularly described as follows:

Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S41°31'41"E, 10,982.12 feet to an iron pipe with cap (found) in the west right of way of Tulane Road being corner No. SCBTS-32 and the Point of Beginning:

Thence leaving the point of beginning and with said right of way S02°12'12"W, 1,617.62 feet to a rebar (found), being corner No. SCBTS-25;
thence N88°17'26"W, 27.82 feet to an iron pipe (found), being corner No. SCBTS-20
thence N87°35’28”W, 523.19 feet to an angle iron (set), being Corner No. SCBTS-26;
thence N02°21'10"E, 126.18 feet to an angle iron (set), being Corner No. SCBTS-27;
thence N02°21’15”E, 238.59 feet to an angle iron (set), being Corner No. SCBTS-30;
thence N02°20'30"E, 1,271.29 feet to an iron pipe (2") (found) in the south line of Windsor Road, being corner No. SCBTS-31;
thence with said south line S85°41'42"E, 547.38 feet to the point of beginning and containing 20.51 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

Tennessee Transmission Line Corridor

A parcel of land lying in the in the Third Civil District of Shelby County, State of Tennessee, being on the Southaven Combustion Turbine Site and at the intersection of Tulane Road and Windsor Road, as shown on US-TVA Drawing No. 112 MS 421 B 99(D) R.0 and being more particularly described as follows:

Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S34°33'26"E, 11,764.90 feet to an angle iron (set) being corner No. SCBTS-27 and the Point of Beginning:

Thence leaving the point of beginning N54°36'16"W, 480.01 feet to an angle iron (set),being Corner No. SCBTS-28;
thence N35°24'01"E, 200.01 feet to an angle iron (set), being Corner No. SCBTS-29
thence S54°36'16"E, 349.90 feet to an angle iron (set), being Corner No. SCBTS-30;
thence S02°21'15"W, 238.59 feet to the point of beginning and containing 1.91 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

EXHIBIT B

TVA ’ S PE OPLE WITH ACTUAL KNOWLEDGE

1. James D. Clayton, Plant Manager
2. Louis Chip Diamond (solely with respect to such person’s knowledge of environmental matters applicable under this Lease)

[End of Exhibit B]

EXHIBIT C

SEVEN STATES ’ PE OPLE WITH ACTUAL KNOWLEDGE

1. Jack W. Simmons
2. James S. Adams, Jr.
3. John I. Cooke

[End of Exhibit C]

SCHEDULE 10.1

INSURANCE REQUIREMENTS

1. Insurance Coverage . Without limiting any of the other liabilities of TVA under the Lease, TVA shall at all times carry and maintain at least the minimum insurance coverage set forth below in this Schedule. All insurance carried pursuant to this Lease shall be placed with insurers having a minimum A.M. Best rating of A, or as may otherwise be acceptable to Seven States.

(a) All Risk Property Insurance . All risk property insurance covering against physical loss or damage to the Leased Premises, including fire and extended coverage, collapse, flood, earth movement, terrorism, and comprehensive boiler and machinery coverage (including electrical malfunction and mechanical breakdown). Coverage shall be written on a replacement cost basis; and

(b) Commercial General Liability . Third-party liability insurance written on an occurrence basis with a limit of not less than One Million Dollars ($1,000,000). Such coverage shall include premises/operations, explosion, collapse, underground hazards, contractual liability, independent contractors, products/completed operations, property damage, and personal injury liability; and

(c) Workers' Compensation / Employer's Liability . A compensation program as required by law under the Federal Employees Compensation Act or, in the alternative, workers' compensation insurance in accordance with statutory provisions covering accidental injury, illness, or death of a TVA employee while at work or in the scope of his employment with TVA and employer's liability insurance in an amount not less than One Million Dollars ($1,000,000); and

(d) Automobile Liability . In the event TVA utilizes vehicles on the Leased Premises, automobile liability insurance covering owned, non-owned, leased, hired, or borrowed vehicles against bodily injury or property damage. Such coverage shall have a limit of not less than One Million Dollars ($1,000,000); and

(e) Excess/Umbrella Liability . Excess/umbrella insurance written on an occurrence basis and providing coverage limits in excess of the primary limits applying under policies described in Subsections 1(b), 1(c) (employer's liability only), and 1(d) of this Schedule, above. The limit of such excess/umbrella coverage shall not be less than Ten Million Dollars ($10,000,000). Such insurance shall contain a drop-down provision in the event of exhaustion of underlying limits or aggregates and apply on a following form basis.

2. Operator Insurance Coverage . TVA shall cause any operator (if other than TVA) of the Purchased Assets to maintain, or cause to be maintained, in full force and effect such insurance as such operator is contractually required to maintain. Furthermore, the operator shall cause its liability insurance policies to be endorsed with the following clauses: additional insured status in favor of TVA, Seven States, and any mortgagee; waiver of subrogation in favor of TVA and Seven States; severability of interests in favor of TVA and Seven States; primary and non-contributory working in favor of TVA and Seven States; and a thirty (30) -day cancellation clause in favor of TVA, Seven States, and any mortgagee. TVA shall cause any such operator,

prior to the Lease Commencement Date and upon request from time to time, to deliver to Seven States such evidence of insurance as may be requested by Seven States or any mortgagee.

3. Endorsements . TVA shall cause all insurance maintained in accordance with this Lease to be endorsed as follows:

(a) TVA shall be the named insured and Seven States and any mortgagee shall be additional named insureds with respect to the property policies described in section 1(a) above. TVA shall be the named insured and Seven States shall be an additional insured with respect to the liability policies described in sections 1(b), 1(c) (employer's liability only), and 1(e) of this Schedule, above; and

(b) inasmuch as the liability policies are written to cover more than one insured, all terms, conditions, insuring agreements, and endorsements, with the exception of the limits of liability, shall operate in the same manner as if there were a separate policy covering each insured; and

(c) the insurers shall waive all rights of subrogation against Seven States; and

(d) such insurance shall be primary without right of contribution of any other insurance carried by or on behalf of Seven States with respect to its interest as such in the Leased Premises; and

(e) if such insurance is canceled for any reason whatsoever, including for nonpayment of premium, or any changes are initiated by TVA or the insurance carrier that affect the interest of Seven States, Seven States, and any mortgagee shall be notified thirty (30) days prior (ten (10) days prior in the case of non-payment of premium) by the insurer.

4. Certifications . Within ten (10) days of the Lease Commencement Date, and at each policy renewal, but not less than annually, TVA shall provide to Seven States approved certification from each insurer or by an authorized representative of each insurer. Such certification shall identify the underwriters, the type of insurance, the limits, deductibles, and term thereof and shall specifically list the special provisions delineated in Section 3 of this Schedule, above, for such insurance required under this Section 4. Upon reasonable request, TVA shall allow Seven States to review the insurance policies, binders, or other evidence of such insurance at the TVA Risk Management Chattanooga office.

5. Self Insurance . Notwithstanding anything to the contrary contained in this Schedule, TVA may elect to self-insure with respect to the insurance required by Subsections 1(a), 1(b), 1(c), 1(d), and1(e) of this Schedule.

Exhibit 10.19

This Buy-Back Agreement has been filed to provide investors with information regarding its terms. It is not intended to provide any other factual information about the Tennessee Valley Authority. The representations and warranties of the parties in this Buy-Back Agreement were made to, and solely for the benefit of, the other parties to this Buy-Back Agreement. The assertions embodied in the representations and warranties may be qualified by information included in schedules, exhibits, or other materials exchanged by the parties that may modify or create exceptions to the representations and warranties. Accordingly, investors should not rely on the representations and warranties as characterizations of the actual state of facts at the time they were made or otherwise.

EXECUTION COPY

BUY-BACK ARRANGEMENTS

(Including Loan Purchase)

DATED AS OF SEPTEMBER 30, 2008

by and among

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION,
as Administrative Agent, Lead Arranger and a Lender,

the other Lenders referred to herein,

and

TENNESSEE VALLEY AUTHORITY

8017069.8

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EXHIBIT B	Form of Loan Purchase Notice
EXHIBIT C	Form of Assignment of Collateral Assignment Agreement
EXHIBIT D	Form of Escrow Agreement
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EXHIBIT F	Form of UCC-3 Assignment
EXHIBIT G	How to Find TVA's Annual and Quarterly Reports
EXHIBIT H	Form of Purchase Price Notice

INDEX OF DEFINED TERMS

Capitalized terms used and not otherwise defined herein shall have the meanings given to them in the Credit Agreement.

Defined Term	Defined in Section
Administrative Agent	Preamble
Borrower	Preamble
Buy-Back Option	§ 2.2
Default Date	§ 1.1
Loan Purchase Notice	§ 1.1
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BUY-BACK ARRANGEMENTS (Including Loan Purchase)

This **AGREEMENT** is entered into as of September 30, 2008, by and among (i) **JPMORGAN CHASE BANK, NATIONAL ASSOCIATION** , as Administrative Agent (in such capacity, the " **Administrative Agent** "), Lead Arranger and a Lender, (ii) such other Lenders as may from time to time become a party to this Agreement (collectively, with the Administrative Agent, the " **Lenders** "), and (iii) the **TENNESSEE VALLEY AUTHORITY** (" **TVA** "), a corporate agency and instrumentality of the United States Government created and existing under and by virtue of the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (2006). Capitalized terms used and not otherwise defined herein shall have the meanings given to them in that certain Credit Agreement (the " **Credit Agreement** "), dated as of even date herewith, by and among Seven States Southaven LLC (the " **Borrower** "), Seven States Power Corporation (the " **Guarantor** "), the Administrative Agent, and the Lenders.

R E C I T A L S :

WHEREAS, TVA holds in the name of the United States the Southhaven Power Plant, an 810 megawatt (nominal) gas-fired combined cycle electric generating facility located in DeSoto County, Mississippi, including all equipment, buildings, structures, fixtures, and other improvements (the **"Generating Facility"**) and said Generating Facility was acquired by TVA subject to the Guarantor option to purchase described below; and

WHEREAS, TVA and Guarantor have entered into a Joint Ownership Agreement dated April 30, 2008, numbered as TVA Contract No. 00069956, as amended (the **"JOA"**), by which Guarantor or Borrower (as Guarantor's designee) has an option to purchase between a fifty percent (50%) and ninety percent (90%) ownership interest in the Generating Facility; and

WHEREAS, Borrower wishes to borrow funds from Lenders to purchase an ownership interest in the Generating Facility; and

WHEREAS, under the JOA, TVA, Guarantor, Borrower, and Lenders may exercise Buy-Back Arrangements pursuant to which TVA would reacquire Borrower's ownership interest in the Generating Facility under terms, conditions, and circumstances as defined in the JOA and as defined in the lease agreement of even date herewith, entered into between TVA and Borrower (the **"Lease"**); and

WHEREAS, under the Lease TVA leases and operates all of Borrower's right, title, and interest in the Generating Facility (the **"Leased Premises"**); and

WHEREAS, pursuant to the Credit Agreement, the Lenders have agreed to extend a term loan and to provide for the extension of two incremental term loans (collectively, the " **Loan** ") to the Borrower upon the condition that, in accordance with the Buy-Back Arrangements in Section 5 of the JOA as amended by Supplement No. 1 thereto, TVA agrees, as provided herein, to buy

the Loan at par upon the election of the Administrative Agent upon any exercise of a Buy-Back Option in any circumstance permitted under the JOA, including an Event of Default under the Credit Agreement or other Loan Documents; and

WHEREAS, this Agreement is required by Section 5 of the JOA; and

WHEREAS, the execution and delivery of this Agreement is a condition precedent to the Loan;

NOW THEREFORE, in consideration of the premises and the agreements, provisions, and covenants herein contained, and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto agree as follows:

SECTION 1

DEFINITIONS

1.1 Certain Defined Terms .

The terms defined below are used in this Agreement as so defined, as are the terms defined in the preamble and recitals to this Agreement:

"Default Date" means the date on which any one or more Events of Defaults occurs under the Credit Agreement or any one or more of the other Loan Documents.

"Escrow Agent" means the third-party agent set forth in the Escrow Agreement to hold the Transfer Documents in escrow pursuant to the terms thereof.

"Escrow Agreement" means that certain Escrow Agreement, dated as of even date herewith, among TVA, the Administrative Agent, the Borrower, the Lenders, and the Escrow Agent, the form of which is attached hereto as Exhibit D .

"Exchange Act" means the Securities Exchange Act of 1934.

"Loan Claims" means all claims, suits, causes of action, and any other right of any Lender against any person, whether known or unknown, arising under or in connection with the Loan Documents or in any way based on or related to any of the foregoing, including, but not limited to, contract claims, tort claims, malpractice claims, statutory claims, and all other claims at law or in equity related to the rights and obligations assigned pursuant to this Agreement.

"Loan Indebtedness" means the unpaid outstanding principal amount of the Loan; accrued and unpaid interest, including default interest but only to the extent TVA receives notice of default pursuant to Section 2.1 below, or comparable notice of default from Borrower; and all other amounts due in connection with the Loan, including break-funding charges, if any, owed to the Administrative Agent or any Lender under the Credit Agreement or under any of the other Loan Documents.

"Loan Purchase" means the sale by each of the Lenders and the purchase by TVA of all of the Loan Rights of each of the Lenders pursuant to Section 2 of this Agreement.

"Loan Purchase Notice" means a notice delivered by the Administrative Agent in the form of Exhibit B to each of the Borrower, TVA, and the Escrow Agent to trigger the obligation of TVA to consummate the Loan Purchase.

"Loan Rights" means all rights of each and every Lender and their assignees, transferees, and successors in interest under the Credit Agreement and the Loan Documents, including, without limitation, the rights to payment of the Loan Indebtedness and all other obligations and indebtedness owed by Borrower under such agreements, but expressly excluding the Reserved Indemnity Rights, which shall not be transferred to TVA but shall be retained by the Administrative Agent and the Lenders.

"Purchase Price" means the aggregate price to be paid by TVA for all of the Loan Rights and shall equal the Loan Indebtedness on the date of the Loan Purchase.

" **Purchase Price Notice** " means a notice delivered by the Administrative Agent in the form of Exhibit H to TVA to evidence the Purchase Price to be paid by TVA to the Administrative Agent for the benefit of the Lenders at the closing of a Loan Purchase.

"Reserved Indemnity Rights" means all rights of each Lender against the Borrower and the Guarantor under Section 8.1 of the Credit Agreement, which rights shall be retained by each Lender after the Loan Purchase and not assigned to TVA pursuant to the Transfer Documents. For the avoidance of all doubt, the parties agree that TVA shall have no liability for or be under any obligation with respect to such Reserved Indemnity Rights or provide any indemnity to any Indemnitees.

"SEC" means the United States Securities and Exchange Commission, or any governmental authority succeeding to any of its principal functions.

"Statement" means the Statement of Auditing Standards No. 58, as amended, entitled "Reports on Audited Financial Statements."

"Transfer Documents" means (i) the Assignment and Assumption Agreements between each Lender and TVA, the form of which is attached hereto as Exhibit A ; (ii) the Assignment of Collateral Assignment Agreement, the form of which is attached hereto as Exhibit C ; (iii) allonges to the Notes, the form of which is attached hereto as Exhibit E ; and (iv) Uniform Commercial Code assignment documents, the form of which is attached hereto as Exhibit F .

"TVA Act" means the Tennessee Valley Authority Act of 1933, *as amended* , 16 U.S.C. §§ 831-831ee (2006).

1.2 Other Interpretive Provisions. References to “Sections” and “Exhibits” shall be to Sections and Exhibits, respectively, of this Agreement unless otherwise specifically provided. Any of the terms defined in Section 1.1 may, unless the context otherwise requires, be used in the singular or the plural depending on the reference. In this Agreement, “hereof,” “herein,” “hereto,” “hereunder,” and the like mean and refer to this Agreement as a whole and not merely to the specific section, paragraph, or clause in which the respective word appears; words importing any gender include the other gender; references to “writing” include printing, typing, lithography, and other means of reproducing words in a tangible visible form; the words “including,” “includes,” and “include” shall be deemed to be followed by the words “without limitation”; references to agreements and other contractual instruments shall be deemed to include subsequent amendments, supplements, assignments, and other modifications thereto, but only to the extent such amendments, supplements, assignments, and other modifications are not prohibited by the terms of this Agreement or any other Loan Document and, provided further, that no such amendment, supplement, assignment, or other modification shall change, modify, or affect TVA’s rights or obligations under this Agreement unless TVA has given its prior consent in writing; references to Persons include their respective permitted successors and assigns or, in the case of governmental Persons, Persons succeeding to the relevant functions of such Persons; and all references to statutes and related regulations shall include any amendments of same and any successor statutes and regulations.

SECTION 2

BUY-BACK ARRANGEMENTS INCLUDING PURCHASE OF THE LOAN

2.1 Notice of Default .

If the Lenders send notice of any Event of Default on the Loan to Borrower, the Lenders shall give TVA comparable, timely, concurrent notice of such default as specified in Section 6.4 of this Agreement below.

2.2 Buy-Back Arrangements .

Section 5 of the JOA, as amended by Supplement No. 1 and Supplement No. 2 thereto, is incorporated herein by reference and the arrangements provided for by said Section shall be deemed to be separate Buy-Back Arrangements agreed to by the parties to this Agreement. TVA and the Lenders expressly recognize that under circumstances as defined in the JOA (“ **Buy-Back Option** ”), said Section 5 grants to Lenders, Borrower, Guarantor, and TVA certain specified rights to trigger a Buy-Back under which TVA would be obligated to purchase the Loan from the Lenders as a part of repurchasing the Leased Premises from Borrower. It is further expressly recognized and agreed that as provided for in Section 6 of Supplement No. 1 to the JOA and in Section 8.20 of the Credit Agreement, Lenders are obligated to cooperate with TVA in enforcing any exercise of the Buy-Back Arrangements and in consummating any Buy-Back Closing (as provided for in both the JOA and the separate Buy-Back Arrangements of this Section 2.2), by

(i) promptly executing all documents necessary to confirm TVA's purchase of the Loan under Section 5(e) of the JOA as amended Supplement No. 1 thereto, (ii) not opposing the exercise of said Buy-Back Arrangements and the consummation of said Buy-Back Closing, and (iii) not opposing any motion to lift the stay or any other action in bankruptcy to allow exercise of said Buy-Back Arrangements and the consummation of said Buy-Back Closing. Finally, TVA and the Lenders also expressly recognize and agree that purchase of the Loan by TVA pursuant to JOA Section 5(e)(i) and Section 2.3 below is a precondition to the actions described in JOA Sections 5(e)(ii) and 5(e)(iii).

2.3 Purchase of the Loan .

(A) Except as described in Section 2.3(B), so long as any Loan Indebtedness is outstanding, upon any exercise of a Buy-Back Option, including upon the occurrence of one or more Events of Default, and regardless of whether consummation of such Buy-Back Option at such time is stayed by a bankruptcy court at the election of the Administrative Agent exercised by its delivery to each of the Borrower, TVA, and the Escrow Agent of a Loan Purchase Notice, each Lender shall sell all of its interest in, and TVA shall purchase all of, the Loan Rights, for the Purchase Price (as set forth in a Purchase Price Notice delivered by the Administrative Agent to TVA, which shall be conclusive evidence of the amounts due and owing to the Administrative Agent and the Lenders, absent manifest error), which shall be paid by TVA to the Administrative Agent for the benefit of the Administrative Agent and the Lenders in immediately available funds electronically transmitted no later than twenty (20) Business Days after the Loan Purchase Notice is received by TVA.

(B) TVA and the Lenders expressly recognize that JOA Section 5(c) provides that if a Buy-Back Option has not been exercised by the end of the period provided in the JOA for such exercise, an automatic exercise of a Buy-Back Option shall be deemed to occur. Accordingly, if any Loan Indebtedness is outstanding on the Maturity Date, each Lender shall sell all of its interest in, and TVA shall purchase all of, the Loan Rights, for the Purchase Price, which shall be paid by TVA to the Administrative Agent for the benefit of the Administrative Agent and the Lenders in immediately available funds electronically transmitted on the Maturity Date.

(C) Any payment by TVA to the Administrative Agent for the benefit of the Administrative Agent and the Lenders under this Agreement shall also be deemed to be a payment by TVA to the Administrative Agent and Lenders. TVA is not responsible, and shall not be held responsible, for any failure or delay by the Administrative Agent to make any payment of funds received from TVA to any Lender or other third party.

2.4 Closing and Escrow of Transfer Documents .

(A) The closing of the Loan Purchase will be effected at the offices of the Escrow Agent by the delivery to TVA by the Escrow Agent, on behalf of all the Lenders, of all Transfer Documents and Notes upon the Escrow Agent's receipt of written notice from the Administrative Agent that it has received payment of immediately available funds equal to the full Purchase Price. All of the Loan Rights shall be transferred to and purchased by TVA and paid for in a single closing.

(B) So as to effectuate a Loan Purchase as soon as possible after the Administrative Agent has elected to trigger a Loan Purchase, the Administrative Agent, the current Lenders and TVA have executed the Transfer Documents and delivered them, along with the Notes, to the Escrow Agent for it to hold pursuant to the terms of the Escrow Agreement. Each Lender party hereto irrevocably authorizes the Administrative Agent, without further notice to, or consent or authorization from, any Lender, to instruct the Escrow Agent to take all actions necessary and appropriate to effect a Loan Purchase, including, without limitation, dating and delivering to TVA all of the Transfer Documents, together with the Notes. Any future Lender that joins the Credit Agreement by assignment of an interest in all or a portion of another Lender's Loan Rights will be required, as a condition to such assignment and simultaneously therewith, to join into this Agreement by executing a counterpart of the same and to deliver to the Escrow Agent all Notes and Transfer Documents for such Lender's interest in the Loan Rights for retention by the Escrow Agent pursuant to the Escrow Agreement.

(C) Pursuant to the Escrow Agreement, after delivery of the Loan Purchase Notice, the Administrative Agent will direct the Escrow Agent to date the Transfer Documents as of the closing date and to deliver to TVA all of the Transfer Documents, together with the Notes, upon receipt by the Escrow Agent of written notice from the Administrative Agent that it has received payment of immediately available funds equal to the full Purchase Price. The Administrative Agent will receive such Purchase Price for the benefit of the Lenders. Upon the Escrow Agent's receipt of written notice from the Administrative Agent that it has received payment of immediately available funds equal to the full Purchase Price, the Escrow Agent shall immediately deliver to TVA all of the Transfer Documents and Notes.

2.5 Escrow of Notes .

In addition to the Transfer Documents, each Lender has delivered to the Escrow Agent possession of its respective Note(s) from the Borrower. Notwithstanding the delivery of the Note(s) to the Escrow Agent, each Lender retains all rights under the Credit Agreement and the Notes, and all payments and dealings with respect to the Notes are to continue as provided in the Credit Agreement, as if the Notes were not held in escrow, until this Agreement and the Escrow Agreement have been terminated.

SECTION 3

REPRESENTATIONS AND WARRANTIES

3.1 Representations and Warranties of the Administrative Agent and Lenders .

(A) The Loan Purchase will be effected **WITHOUT RECOURSE TO, OR WARRANTY OR REPRESENTATION, EXPRESSED OR IMPLIED, BY, THE ADMINISTRATIVE AGENT OR ANY LENDER,** except that through the execution of this Agreement, and upon delivery of the Transfer Documents by the Escrow Agent to TVA, the Administrative Agent and each Lender will be deemed to represent that:

(i) The Administrative Agent or such Lender is duly organized, validly existing, and in good standing under the laws of the United States and has taken all necessary corporate, governmental, and other action to authorize the execution, delivery, and performance of this Agreement and the Escrow Agreement;

(ii) The Administrative Agent or such Lender is the owner and holder of its portion of the Loan Rights and the Loan Documents evidencing the Loan Indebtedness and has full and good title to its portion of the Loan Rights, and the Administrative Agent or such Lender has full right, power, and authority (subject to all Applicable Laws limiting the assignment or transfer of Loan Claims) to transfer all of its portion of the Loan Rights to TVA, and all of its Loan Rights and the Loan Documents evidencing the Loan Indebtedness are subject to Transfer Documents that have been executed by the Administrative Agent or such Lender and delivered to the Escrow Agent;

(iii) The Administrative Agent or such Lender has not executed any release or subordination agreement relating to the Credit Agreement or the Loan Documents and has not transferred or assigned any portion of its Loan Rights prior to the delivery of the Transfer Documents to the Escrow Agent; and

(iv) The Administrative Agent or such Lender has the full power and authority to engage in the business which it is conducting and to enter into and perform its obligations under this Agreement and the Escrow Agreement.

(B) Without limiting the generality of the foregoing, neither the Administrative Agent nor any Lender will assume any responsibility with respect to (i) statements, warranties, or representations made in or in connection with the Loan Documents, (ii) the execution, legality, validity, enforceability, genuineness, sufficiency, or value of the Loan Documents or any collateral thereunder, (iii) the financial condition of the Borrower or the Guarantor, or (iv) the performance or observance of the Borrower or the Guarantor of any of their respective obligations under any Loan Document.

3.2 Representations and Warranties of TVA .

The Loan Purchase will be effected **WITHOUT RECOURSE TO, OR WARRANTY OR REPRESENTATION, EXPRESSED OR IMPLIED, BY TVA,** except that through the execution of this Agreement, and upon delivery of the Transfer Documents by the Escrow Agent to TVA, TVA will be deemed to represent that:

(A) TVA is a corporate agency and instrumentality of the United States Government created and existing under and by virtue of the TVA Act, and has the full power and authority under the TVA Act to engage in the business that it is conducting and to enter into and perform its obligations under this Agreement and the Escrow Agreement.

(B) TVA has taken all necessary corporate, governmental, and other action to authorize the execution, delivery, and performance of this Agreement and the Escrow Agreement.

(C) TVA has furnished to the Administrative Agent and each Lender by the means described in Exhibit G which is attached, hereto, its most recent filings with the SEC on Forms 10-K and 10-Q filed pursuant to the Exchange Act. TVA and the Administrative Agent and each Lender acknowledge and agree that such forms are or may in the future be subject to restatement by TVA and that upon any such restatement, such forms will be provided to the Administrative Agent and each Lender by the means described in Exhibit G . When restated, such Forms 10-K and 10-Q will not contain any untrue statement of a material fact or omit to state a material fact necessary to make any statement therein, in light of the circumstances under which it was made, not misleading. Each of the financial statements in such restated Forms 10-K and 10-Q will have been prepared in accordance with GAAP as applicable to annual and quarterly periods, respectively, and will fairly present in all material respects the financial position of TVA as of the date thereof and the results of the operations of TVA for the period then ended.

(D) To the extent that in the future TVA furnishes the Administrative Agent and each Lender by the means described in Exhibit G Forms 10-K and 10-Q pursuant to Section 4.1 of this Agreement, the financial statements concerning TVA included in such Forms 10-K and 10-Q will have been prepared in accordance with GAAP as applicable to annual and quarterly periods, respectively, and present fairly the financial condition of TVA as of the date thereof and the results of its operations for the periods covered thereby and disclose all material liabilities and material contingent obligations of TVA as at the dates thereof required by GAAP to be disclosed therein.

(E) Without limiting the generality of the foregoing, TVA will not assume any responsibility, except as expressly set forth in this Agreement with respect to the Loan Purchase, with respect to (i) any statements, warranties, or representations made in or in connection with the Loan Documents, (ii) the execution, legality, validity, enforceability, genuineness, sufficiency, or value of the Loan Documents or any collateral thereunder, (iii) the financial condition of the Borrower or the Guarantor, or (iv) the performance or observance of the Borrower or the Guarantor of any of their respective obligations under any Loan Document.

SECTION 4

ONGOING REPORTING COVENANT; LOAN PURCHASE COVENANT

4.1 TVA Financial Reporting .

TVA will maintain a system of accounting established and administered in accordance with sound business practices to permit preparation of financial statements in conformity with GAAP (it being understood that GAAP provides for correction of errors and that quarterly financial statements are subject to year-end adjustments and are not required to have footnote disclosures). TVA hereby covenants and agrees that so long as this Agreement is in effect, it shall furnish the periodic reports described below to the Administrative Agent and to each Lender in the manner described in Exhibit G .

4.2 Consummation of Loan Purchase .

TVA hereby covenants and agrees that so long as this Agreement is in effect, it shall not purchase any of the Borrower's ownership interest in the Generating Facility prior to it consummating a purchase of all of the Loan Rights in accordance with Section 2.1 of this Agreement.

SECTION 5

OBLIGATIONS

5.1 Modification of the Loan .

The obligations of TVA under this Agreement, including, without limitation, the obligation to effect the Loan Purchase and pay the Purchase Price, will not in any manner be directly or indirectly affected, changed, or revised in any way without TVA's prior written consent. TVA may withhold such consent, in TVA's sole and exclusive discretion, with respect to any matter affecting its obligations, including but not limited to matters related to this Agreement, the Loan Rights, the Purchase Price, or the renewal, extension, or modification of the terms of any of the Loan Indebtedness or any instrument or agreement evidencing the same, including an increase in the principal amount of the Loan Indebtedness or an increase in the interest rate charged thereon, in accordance with the terms and provisions of the Credit Agreement and the other Loan Documents or the acceptance by the Administrative Agent or any Lender of other credit support or security for the Loan Indebtedness (collectively a "Loan Modification"). Any Loan Modification made without TVA's prior written consent shall not affect or be binding upon TVA or increase, alter, amend, modify, or affect TVA's obligations and liabilities under this Agreement in any respect. Any waiver of, or delay in exercising any rights or remedies against the Borrower or the Guarantor, by the Administrative Agent or the Lenders, any amendment or

supplement to the Credit Agreement and any other Loan Documents in connection with the establishment of an Incremental Term Loan Facility in accordance with the terms set forth in the

Credit Agreement, and any change to the LIBO Rate or the Base Rate that occurs without amendment to the provisions of the Credit Agreement shall not constitute a Loan Modification.

5.2 Direct Proceeding Against TVA .

The obligations of TVA to effect the Loan Purchase under this Agreement are not contingent upon the pursuit by the Administrative Agent or any Lender of any remedies against the Borrower, the Guarantor, or any other Person, nor against any security or lien available to the Administrative Agent or any Lender, their successors, successors-in-title, endorsees, or assigns.

5.3 Security .

The obligations of TVA under this Agreement shall not in any manner be affected by the partial or complete unenforceability or invalidity of any other guaranty or surety agreement, pledge, assignment, or other security for any of the Loan Indebtedness.

5.4 Cumulative Rights .

All of the rights and remedies of a party to this Agreement shall be cumulative, and any failure of such a party to exercise any right hereunder shall not be construed as a waiver of the right to exercise the same or any other right at any time, and from time to time, thereafter.

5.5 Continuing Obligation .

This Agreement shall be a continuing one and shall be binding upon TVA until the Loan Indebtedness is paid finally and in full.

SECTION 6

MISCELLANEOUS

6.1 Survival of Agreement .

This Agreement shall survive and have continuing effect until (i) termination by an express writing signed by the Administrative Agent and TVA or (ii) the full consummation of the Buy-Back Arrangements provided for by the JOA or by this Agreement.

6.2 Expenses .

All legal and other costs incurred in connection with this Agreement and the transactions contemplated hereby shall be the responsibility of the party incurring such expense, except as otherwise expressly provided herein.

6.3 Amendments and Waivers .

. Except as otherwise provided herein, no amendment, modification, termination, or waiver of any provision of this Agreement, or consent to any departure by any party therefrom, shall in any event be effective unless the same shall be in writing and signed by TVA and the Requisite Lenders.

6.4 Notices .

Any required notice or other communication shall be in writing addressed to the respective party as set forth below and may be personally delivered, telecopied, sent by overnight courier service, or U.S. mail and shall be deemed to have been given: (i) if delivered in person, when delivered; (ii) if delivered by telecopy, on the date of transmission if transmitted on a Business Day before 2:00 p.m. (New York City time) and otherwise on the Business Day next succeeding the date of transmission; (iii) if delivered by overnight courier, two days after delivery to the courier properly addressed; or (iv) if delivered by U.S. mail, four Business Days after deposit with postage prepaid and properly addressed.

Notices shall be addressed as follows:

If to TVA: Treasurer
Tennessee Valley Authority
400 W. Summit Hill Drive, WT 4C-K
Knoxville, TN 37902

Fax: 865-632-6673

With a copy to: Tennessee Valley Authority
One Century Plaza, 26 Century Blvd., OCP 1F-NST
Nashville, TN 37229

Attn: Executive Vice President, Customer Resources

Fax: 615-232-6014

If to a Lender or the Administrative Agent: To the address set forth on the signature page hereto

6.5 Severability .

The invalidity, illegality, or unenforceability in any jurisdiction of any provision under this Agreement shall not affect or impair the remaining provisions in this Agreement or any such invalid, unenforceable, or illegal provision in any jurisdiction in which it is not invalid, unenforceable, or illegal.

6.6 Governing Law .

This Agreement shall, to the extent not inconsistent with Federal law, be governed by and shall be construed and enforced in accordance with the internal laws of the State of New York without regard to conflicts of law principles that require or permit application of the laws of any other state or jurisdiction.

6.7 Successors and Assigns .

This Agreement shall be binding upon and inure to the benefit of the parties hereto, each of the Incremental Term Loan Lenders (as defined in the Credit Agreement) and their respective successors and assigns; provided , however , that (a) without the prior specific written consent of TVA, neither the Administrative Agent nor any Lender may assign any of its rights or delegate any of its duties under this Agreement and (b) without the prior specific written consent of the Administrative Agent and each Lender, TVA may not assign any of its rights or delegate any of its duties under this Agreement; provided, however, that TVA's consent to any such assignment shall not be required in connection with an assignment by any Lender of all or a portion of its Loan Commitments or Loans in accordance with the terms of the Credit Agreement and Section 2.4(B) of this Agreement.

6.8 Construction .

The Administrative Agent, each Lender, and TVA acknowledge that each of them has had the benefit of legal counsel of its own choice and has been afforded an opportunity to review this Agreement with its legal counsel and that this Agreement shall be construed as if jointly drafted by the Administrative Agent, each Lender, and TVA.

6.9 Remedies .

The rights and remedies specified in any provision of this Agreement are in addition to all other rights and remedies that TVA, the Administrative Agent, and the Lenders may have, including any right to equitable relief and any right to sue for damages as a result of a breach of this Agreement (whether or not any such party elects to terminate this Agreement), and all such rights and remedies are cumulative. Without limiting the foregoing, no exercise of a remedy shall be deemed an election excluding any other remedy (any such claim by any party to this Agreement being hereby waived). Each party to this Agreement acknowledges and agrees that in the event it fails to fulfill its obligations under this Agreement, each party to this Agreement affected by such failure would suffer irreparable harm and damages would not be an adequate remedy, and accordingly such affected parties shall be entitled to an injunction or injunctions to prevent a breach of this Agreement and to enforce specifically the terms and provisions of this Agreement.

6.10 Consent to Jurisdiction and Service of Process .

(A) The parties to this Agreement hereby irrevocably submit to the non-exclusive jurisdiction of any United States Federal Court, Southern District of New York with respect to any action or proceeding arising out of or relating to this Agreement, the Escrow Agreement, or any Loan Documents. Each such party hereby irrevocably agrees that all claims in respect of such action or proceeding may be heard and determined in such courts and irrevocably waives any objection it may now or hereafter have as to the venue of any such suit, action, or proceeding brought in any such court, personal jurisdiction of such courts, or that such court is an inconvenient forum. Nothing herein shall limit the right of any such party to bring proceedings against any other such party or parties in the courts of any other jurisdiction.

(b) Each party to this Agreement hereby agrees that service of the summons and complaint and all other process that may be served in any such suit, action, or proceeding may be effected by mailing by registered mail, return receipt requested, a copy of such process to TVA at the address to which notices to TVA are then to be sent pursuant to Section 6.4 and, with respect to such a party not listed in Section 6.4, pursuant to any other notice provision in the Credit Agreement or any of the Loan Documents, and that personal service of process shall not be required. Nothing herein shall be construed to prohibit service of process by any other method permitted by law.

6.11 Waiver of Jury Trial .

TVA, the Administrative Agent, and each Lender hereby waive their respective rights to a jury trial of any claim or cause of action based upon or arising out of this Agreement, any of the other Loan Documents, or any dealings between them relating to the subject matter of this Agreement. The scope of this waiver is intended to be all-encompassing of any and all disputes that may be filed in any court and that relate to the subject matter of this Agreement, including without limitation, contract claims, tort claims, breach of duty claims, and all other common law and statutory claims. TVA, the Administrative Agent, and each Lender acknowledge that this waiver is a material inducement to enter into a business relationship, that each has already relied on the waiver in entering into this Agreement, and that each will continue to rely on the waiver in their related future dealings. TVA, the Administrative Agent, and each Lender further warrant and represent that each has reviewed this waiver with its legal counsel, and that each knowingly and voluntarily waives its jury trial rights following consultation with legal counsel. This waiver is irrevocable, meaning that it may not be modified either orally or in writing, and the waiver shall apply to any subsequent amendments, renewals, supplements, or modifications to this Agreement, the Loan Documents, or to any other documents or agreements relating to the Loan. In the event of litigation, this Agreement may be filed as a written consent to a trial by the court. TVA, the Administrative Agent, and each Lender also waive any bond or surety or security upon such bond that might, but for this waiver, be required of the Administrative Agent and each Lender.

6.12 Survival of Warranties and Agreements .

All agreements, representations, and warranties made herein shall survive the execution and delivery of this Agreement.

6.13 Entire Agreement .

This Agreement and the exhibits attached hereto embody the final, entire agreement among the parties hereto and supersede any and all prior commitments, agreements, representations, understandings, whether oral or written, relating to the subject matter hereof and may not be contradicted or varied by evidence of prior, contemporaneous, or subsequent oral agreements or discussions of the parties hereto.

6.14 Counterparts; Effectiveness .

This Agreement and any amendments, waivers, consents, or supplements may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed an original, but all of which counterparts together shall constitute but one and the same instrument. This Agreement shall become effective upon the execution of a counterpart hereof by each of the parties hereto.

6.15 Waiver .

No waiver by any party of one or more defaults in the performance of this Agreement shall operate or be construed as a waiver of any future default or defaults, whether of a like kind or different character.

[Signature pages follow]

IN WITNESS WHEREOF, the parties hereto have each executed this Agreement on the dates set forth below to be effective for all purposes as of the date first written above.

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION, as
Administrative Agent, Lead Arranger and a Lender

By: /s/ Michael Mak
Name: Michael Mak
Title: Executive Director
Date: September 30, 2008

Address:
JPMorgan Chase Bank, National Association
270 Park Avenue
New York, New York 10017
Attn: Michael Mak
Fax (212) 270-4251

COBANK, ACB, as a Lender

By: /s/ Brett A. Challenger
Name: Brett A. Challenger
Title: Vice President
Date: September 30, 2008

BRANCH BANKING AND TRUST COMPANY, as a Lender

By: /s/ R. Andrew Beam
Name: R. Andrew Beam
Title: Senior Vice President
Date: September 30, 2008

TENNESSEE VALLEY AUTHORITY

By: /s/ Kim S. Greene _____
Name: Kimberly S. Greene
Title: EVP, Financial Services
Date: September 30, 2008

EXHIBIT A

Form of Assignment and Assumption Agreement

This Assignment and Assumption (the " **Assignment and Assumption** ") is dated as of the Effective Date set forth below and is entered into by and between the Assignor identified in item 1 below (the " **Assignor** ") and the Assignee identified in item 2 below (the " **Assignee** "). Capitalized terms used but not defined herein shall have the meanings given to them in the Credit Agreement identified below (as amended, the " **Credit Agreement** "), receipt of a copy of which is hereby acknowledged by the Assignee. The Standard Terms and Conditions set forth in Annex 1 attached hereto are hereby agreed to and incorporated herein by reference and made a part of this Assignment and Assumption as if set forth herein in full.

For an agreed consideration, the Assignor hereby irrevocably sells and assigns to the Assignee, and the Assignee hereby irrevocably purchases and assumes from the Assignor, subject to and in accordance with the Standard Terms and Conditions and the Credit Agreement, as of the Effective Date set forth below (i) all of the Assignor's rights and obligations in its capacity as a Lender under the Credit Agreement and any other documents or instruments delivered pursuant thereto to the extent related to the amount and percentage interest identified below of all of such outstanding rights and obligations of the Assignor under the respective facilities identified below and (ii) to the extent permitted to be assigned under applicable law, all claims, suits, causes of action and any other right of the Assignor (in its capacity as a Lender) against any Person, whether known or unknown, arising under or in connection with the Credit Agreement, any other documents or instruments delivered pursuant thereto or the loan transactions governed thereby or in any way based on or related to any of the foregoing, including, but not limited to, contract claims, tort claims, malpractice claims, statutory claims and all other claims at law or in equity related to the rights and obligations sold and assigned pursuant to clause (i) above, but excluding all rights of the Assignor against the Borrower and the Guarantor under Section 8.1 of the Credit Agreement (the " **Reserved Indemnity Rights** ") (the rights and obligations sold and assigned by the Assignor to the Assignee pursuant to clauses (i) and (ii) above, but excluding the Reserved Indemnity Rights, being referred to herein collectively as the " **Assigned Interest** "); provided , that the Assignee shall have no liability for or be under any obligation with respect to such Reserved Indemnity Rights. Each such sale and assignment is without recourse to the Assignor and, except as expressly provided in this Assignment and Assumption, without representation or warranty by the Assignor.

1. Assignor: **[NAME OF LENDER]** .

2. Assignee: Tennessee Valley Authority .

3. Borrower: Seven States Southaven, LLC .

4. Administrative Agent: JPMorgan Chase Bank, National Association , as the administrative agent under the Credit Agreement

5. Credit Agreement: The Credit Agreement, dated as of September 30, 2008, among Seven States Southaven, LLC, Seven States Power Corporation, JPMorgan Chase Bank, National Association, as Administrative Agent, Lead Arranger and a Lender, and the Lenders as may from time to time become a party thereto.

[***Remainder of page intentionally left blank.***]

6. Assigned Interest:

Assignor	Assignee	Facility Assigned	Aggregate Amount of Commitment/ Loans for all Lenders	Amount of Commitment/ Loans Assigned	Percentage Assigned of Commitment/Loans
[NAME OF LENDER]	Tennessee Valley Authority	**[Term Loan]** **[Incremental Term Loan A/B]**	$	$	%

Effective Date: _____ ___, 20___ [TO BE INSERTED BY THE ESCROW AGENT AT THE DIRECTION OF TH ADMINISTRATIVE AGENT AND WHICH SHALL BE THE EFFECTIVE DATE OF RECORDATION OF TRANSFER IN THE REGISTE THEREFOR.]

The terms set forth in this Assignment and Assumption are hereby agreed to:

ASSIGNOR

[NAME OF LENDER]

By:_____
Title:

ASSIGNEE :

TENNESSEE VALLEY AUTHORITY

By:_____
Title:

Consented to and Accepted:

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION ,
as Administrative Agent

By_____
Title:

STANDARD TERMS AND CONDITIONS FOR
ASSIGNMENT AND ASSUMPTION

1. Representations and Warranties .

1.1 Assignor . The Assignor (a) represents and warrants that (i) it is the legal and beneficial owner of the Assigned Interest, (ii) the Assigned Interest is free and clear of any lien, encumbrance or other adverse claim and (iii) it has full power and authority, and has taken all action necessary, to execute and deliver this Assignment and Assumption and to consummate the transactions contemplated hereby; (b) assumes no responsibility with respect to (i) any statements, warranties or representations made by other parties in or in connection with the Credit Agreement or any other Loan Document, (ii) the execution, legality, validity, enforceability, genuineness, sufficiency or value of the Loan Documents or any collateral thereunder, (iii) the financial condition of the Borrower or the Guarantor, any of their respective Subsidiaries or Affiliates or any other Person obligated in respect of any Loan Document or (iv) the performance or observance by the Borrower or the Guarantor, any of their respective Subsidiaries or Affiliates or any other Person of any of their respective obligations under any Loan Document; and (c) delivers the Note held by or on behalf of the Assignor together with an allonge containing an endorsement in favor of the Assignee.

1.2. Assignee . The Assignee (a) represents and warrants that (i) it has full power and authority, and has taken all action necessary, to execute and deliver this Assignment and Assumption and to consummate the transactions contemplated hereby and to become a Lender under the Credit Agreement, (ii) it meets all the requirements to be an assignee under Section 7.1(B) of the Credit Agreement (subject to such consents, if any, as may be required under Section 7.1(B)(3) of the Credit Agreement), (iii) from and after the Effective Date, it shall be bound by the provisions of the Credit Agreement as a Lender thereunder and, to the extent of the Assigned Interest, shall have the obligations of a Lender thereunder, (iv) it is sophisticated with respect to decisions to acquire assets of the type represented by the Assigned Interest and either it, or the person exercising discretion in making its decision to acquire the Assigned Interest, is experienced in acquiring assets of such type, (v) it has received a copy of the Credit Agreement, and has received or has been accorded the opportunity to receive copies of the most recent financial statements delivered pursuant to Section 2.11 thereof, as applicable, and such other documents and information as it deems appropriate to make its own credit analysis and decision to enter into this Assignment and Assumption and to purchase the Assigned Interest, and (vi) it has, independently and without reliance upon the Administrative Agent or any other Lender and based on such documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Assignment and Assumption and to purchase the Assigned Interest; and (b) agrees that (i) it will, independently and without reliance on the Administrative Agent, the Assignor or any other Lender, and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under the Loan Documents, and (ii) it will perform in accordance with their terms all of the obligations which by the terms of the Loan Documents are required to be performed by it as a Lender.

2. Payments . From and after the Effective Date, the Assignee, in its capacity as the Administrative Agent, shall make all payments in respect of the Assigned Interest (including payments of principal, interest, fees and other amounts) to the Assignor for amounts which have accrued to but excluding the Effective Date.

3. General Provisions . This Assignment and Assumption shall be binding upon, and inure to the benefit of, the parties hereto and their respective successors and assigns. This Assignment and Assumption may be executed in any number of counterparts, which together shall constitute one instrument. Delivery of an executed counterpart of a signature page of this Assignment and Assumption by telecopy shall be effective as delivery of a manually executed counterpart of this Assignment and Assumption. This Assignment and Assumption shall be governed by, and construed in accordance with, the law of the State of New York.

EXHIBIT B

Form of Loan Purchase Notice

_____ __, 20__

Tennessee Valley Authority
400 W. Summit Hill Drive, WT 4C-K
Knoxville, TN 37902
Attn: Treasurer
Fax: 865-632-6673

Tennessee Valley Authority
One Century Plaza, 26 Century Blvd., OCP 1F-NST
Nashville, TN 37229
Attn: Executive Vice President, Customer Resources
Fax: 615-232-6014

Seven States Southaven, LLC
1206 Broad Street
Chattanooga, Tennessee 37402
Attn: President and CEO

[Escrow Agent]
[Address]

Re: Loan Purchase Notice

Ladies and Gentlemen:

Reference is made to that certain Buy-Back Arrangements (Including Loan Purchase), dated as of September 30, 2008 (as amended, restated, supplemented or otherwise modified, the " **Agreement** "; capitalized terms used but not otherwise defined herein shall have the meanings assigned thereto in the Agreement), among Tennessee Valley Authority, JPMorgan Chase Bank, National Association, and the other Lenders identified therein.

This notice constitutes a "Loan Purchase Notice" delivered pursuant to Section 2.3(A) of the Agreement. The undersigned will separately deliver a Purchase Price Notice indicating the Purchase Price to be paid by TVA on the closing of the Loan Purchase to occur no later than twenty (20) Business Days after this Loan Purchase Notice is received by TVA.

Very truly yours,

JPMORGAN CHASE BANK,
NATIONAL ASSOCIATION,
as Administrative Agent

By: _____
Name:
Title:

EXHIBIT C

Form of Assignment of Collateral Assignment Agreement

This Instrument Prepared By:
Brennan A. Posner, Esq.
Sutherland Asbill & Brennan LLP
999 Peachtree St., NE
Atlanta, Georgia 30309-3996
Telephone Number: (404) 853-8000

Indexing Instructions:
Part of Section 15, Township 1 South,
Range 8 West
DeSoto County, Mississippi
Part of Section 16, Township 1 South
Range 8 West
DeSoto County, Mississippi

ASSIGNMENT OF COLLATERAL ASSIGNMENT OF CERTAIN RIGHTS UNDER, AND CERTAIN AGREEMENTS AS TO, JOINT OWNERSHIP AGREEMENT AND LEASE AGREEMENT

FOR VALUE RECEIVED, the undersigned, **JPMORGAN CHASE BANK, NATIONAL ASSOCIATION** , a national banking association (" **Assignor** "), having a mailing address at 270 Park Avenue, New York, New York 10017, hereby grants, assigns, sells, conveys, transfers, delivers and sets over unto **TENNESSEE VALLEY AUTHORITY** , a corporate agency and instrumentality of the United States Government, created and existing under and by virtue of the Tennessee Valley Authority Act of 1933 (" **Assignee** "), having a mailing address at 400 West Summit Hill Drive, WT 6A-K, Knoxville, TN 37902, without representation or warranty, express or implied, the following:

> All right, title and interest of Assignor under that certain Collateral Assignment of Certain Rights Under, and Certain Agreements as to, Joint Ownership Agreement and Lease Agreement, by Seven States Southaven, LLC in favor of Assignor, dated as of September 30, 2008.

Executed as of (but not necessarily on) the effective date specified below.

Effective _____, 2008.

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION ,

a national banking association

(SEAL)

By:_____
[NAME, TITLE]

STATE OF_____ §

COUNTY OF _____ §

Acknowledged before me this _____ day of September, 2008, by _____, _____ of **JPMORGAN CHASE BANK, NATIONAL ASSOCIATION** , a national banking association, on behalf of said entity.

(Notary Seal)

Printed Name:
Notary Public for State of _____
My Commission expires:

EXHIBIT A

SOUTHAVEN COMBUSTION TURBINE SITE

Mississippi Parcel 1 (Acquisition Tract SCBTS-1)

A parcel of land lying in the SW1/4 of Section 15 Township 1 South Range 8 West in Desoto County, State of Mississippi, being on the Southaven Combustion Turbine Site and at the intersection of Tulane Road and Stateline Road, as shown on US-TVA Drawing No. 112 MS 422 B 100(D) R.0 and being more particularly described as follows:

Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S42°05'16"E, 13,353.72 feet to an angle iron (set) on the accepted Mississippi-Tennessee state line being corner No. SCBTS-1 and the Point of Beginning:

Thence leaving the point of beginning and said Mississippi-Tennessee state line S02°11'31"W, 1,100.72 feet to a rebar (found) in the northern right of way of Stateline Road, being corner No. SCBTS-2; thence continuing with said right of way for the following two calls;
N87°47'07"W, 304.06 feet to a rebar (found), being corner No. SCBTS-3;
thence N87°47'41"W, 104.99 feet to a (3/8") rebar (found), being corner No. SCBTS-6;
thence leaving said right of way N02°12'24"E, 206.98 feet to a (3/8") rebar (found), being corner No. SCBTS-5; thence parallel with north right of way of Stateline Road N87°48'27"W, 1,260.36 feet to rebar with cap (found) and stamped “THY INC. #888” in the eastern right of way of Tulane Road, being corner No. SCBTS-7; thence with said right of way N02°15'03"E, 899.31 feet to a rebar with cap (found) on the accepted Mississippi-Tennessee state line, being corner No. SCBTS-8; thence leaving said right of way and with said state line S87°36'39"E, 1,668.44 feet to the point of beginning and containing 36.29 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

Said real estate was acquired by virtue of the deed executed simultaneously herewith, from the United States of America, by and through its legal agent, the Tennessee Valley Authority, and filed of record in Deed Book ____, page ____, in the office of the Chancery Court Clerk of DeSoto County, Mississippi.

Mississippi Parcel 2 (Acquisition Tract SCBTS-2)

A parcel of land lying in the SE1/4 of Section 16 Township 1 South Range 8 West in Desoto County, State of Mississippi, being on the Southaven Combustion Turbine Site and at the intersection of Tulane Road and Stateline Road, as shown on US-TVA Drawing No. 112 MS 422 B 100(D) R.0 and being more particularly described as follows:

Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S33°33'03"E, 12,943.26 feet to a rebar (found) in the west right of way of Tulane Road, being corner No. SCBTS-9 and the Point of Beginning:

Thence leaving the point of beginning and said right of way N87°55'13"W, 225.69 feet to a nail (60d) (found), being corner No. SCBTS-10;
thence N87°42'13"W, 420.76 feet to a rebar without cap (found), being corner No. SCBTS-11;
thence N02°36'46"E, 209.28 feet to a rebar without cap (found), being corner No. SCBTS-12; thence N87°28'38"W, 210.14 feet to an iron pipe (1.5") (found), being corner No. SCBTS-13;
thence S02°13'39"W, 209.42 feet to a pin (found), being corner No. SCBTS-14;
thence S02°43'42"W, 155.47 feet to a rebar with cap (found) in the north right of way of Stateline Road, being corner No. SCBTS-15;
thence with road said right of way N87°43'40"W, 415.16 feet to a rebar (found), being corner No. SCBTS-16;
thence N02°24'39"E, 673.73 feet to an iron pipe (1.5") (found), being corner No. SCBTS-17; thence S87°35'36"E, 434.83 feet to a rebar (found), being corner No. SCBTS-18;
thence N02°19'08"E, 435.00 feet to a rebar (found) on the accepted Mississippi-Tennessee state line, being corner No. SCBTS-19;
thence with said state line for the following calls:
S87°35'34"E, 311.41 feet to an angle iron (set), being corner No. SCBTS-26;
thence S87°35’28”E, 523.19 feet to an iron pipe (found) in the west right of way of Tulane Road, being Corner No. SCBTS-20;
thence leaving said state line and with said road right of way S02°15'57"W, 206.15 feet to a rebar (found), being corner No. SCBTS-21;
thence leaving said right of way N87°38'49"W, 158.80 feet to a rebar (found), being corner No. SCBTS-22;
thence S02°07'35"W, 209.14 feet to an iron pipe (found), being corner No. SCBTS-23;
thence S87°29'48"E, 158.20 feet to a rebar (found) in the western right of way of Tulane Road, being corner No. SCBTS-24;
thence with said road right of way S02°15'14"W, 534.74 feet to the point of beginning and containing 23.14 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

Said real estate was acquired by virtue of the deed executed simultaneously herewith, from the United States of America, by and through its legal agent, the Tennessee Valley Authority, and filed of record in Deed Book ____, page ____, in the office of the Chancery Court Clerk of DeSoto County, Mississippi.

Mississippi Parcel 3 – Transmission Line Easement (Acquisition Tract SCBTS-4-TL)

An easement for transmission line purposes as described in that certain Transmission Line Easement dated November 21, 2000, between Entergy Mississippi, Inc. and Southaven Power, LLC, recorded December 8, 2000 in Deed Book 384, page 81 over, under and across a parcel of land lying in the SE1/4 of Section 16 Township 1 South Range 8 West in Desoto County, State of Mississippi, being on the Southaven Combustion Turbine Site, as shown on US-TVA Drawing No. 112 MS 422 B 100(D) R.0 and being more particularly described as follows:
Commencing at a concrete monument (found) (Coordinates: N. 275,703.11, E. 750,567.00), being NGS MON 153; thence S29°12'19"E, 12,075.19 feet to a point in the western line of tract SCBTS-2, being corner SCBTS-33 and the Point of Beginning:

Thence leaving the point of beginning and said western line of tract SCBTS-2 N89°54'39"W, 417.53 feet to a point, being corner No. SCBTS-34;
thence N44°04'03"W, 81.72 feet to a point, being corner No. SCBTS-35;
thence N45°55'57"E, 150.00 feet to a point, being corner No. SCBTS-36;
thence S44°04’03”E, 18.29 to a point, being Corner No. SCBTS-37;
thence S89°54’39”E, 360.18 to a point, being Corner No. SCBTS-38;
thence S02°24’35”W, 150.12 feet to the point of beginning and containing 1.51 acres.

Located on VTM Quad Horn Lake, MS.

Positions of corners and directions of lines are referred to the Tennessee Lambert State Coordinate System and NAD 83 (2007) Horizontal Datum.

This description was prepared from an ALTA survey dated May 1, 2000 and a survey dated December 18, 2007 by:

Tennessee Valley Authority
MR 4B-C
Chattanooga, TN 37402-2801

Said real estate was acquired by virtue of the deed executed simultaneously herewith, from the United States of America, by and through its legal agent, the Tennessee Valley Authority, and filed of record in Deed Book ____, page ____, in the office of the Chancery Court Clerk of DeSoto County, Mississippi.

EXHIBIT D

Form of Escrow Agreement

ESCROW AGREEMENT

DATED AS OF SEPTEMBER 30, 2008

by and among

SEVEN STATES SOUTHAVEN, LLC

TENNESSEE VALLEY AUTHORITY

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION,
as Administrative Agent, Lead Arranger and a Lender,

the other Lenders referred to herein,

and

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION, as Escrow Agent

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EXHIBITS

EXHIBIT A	Loan Purchase Documents
EXHIBIT B	Buy-Back Documents
EXHIBIT C	Form of Loan Purchase Notice
EXHIBIT D	Form of Buy-Back Notice
EXHIBIT E	Fees

ESCROW AGREEMENT

This **ESCROW AGREEMENT** (the " **Agreement** "), dated as of September 30, 2008, is entered into by and among (i) **SEVEN STATES SOUTHAVEN, LLC** (" **Seven States** "), (ii) **TENNESSEE VALLEY AUTHORITY** (" **TVA** "), (iii) **JPMORGAN CHASE BANK, NATIONAL ASSOCIATION** (individually, " **JPMorgan** "), as administrative agent under the Credit Agreement (as defined below) (in such capacity, the " **Administrative Agent** ") and as escrow agent (in such capacity, the " **Escrow Agent** "), and (iv) such other Lenders as may from time to time become a party to this Agreement (together with the Administrative Agent, the " **Lenders** ") (each, a " **Party** " and collectively, the " **Parties** "). Capitalized terms used herein but not otherwise defined shall have the meanings ascribed to such terms in that certain Credit Agreement, dated as of the date hereof, among Seven States, Seven States Power Corporation, as guarantor, JPMorgan, as administrative agent, lead arranger and a lender, and the Lenders (the " **Credit Agreement** ").

RECITALS:

WHEREAS, Seven States has agreed to purchase between a fifty percent (50%) and ninety percent (90%) undivided ownership interest in the Southaven Power Plant from TVA;

WHEREAS, pursuant to the Credit Agreement, JPMorgan and the Lenders have agreed to extend a term loan and provide for the extension of two incremental term loans, the proceeds of which are to be used by Seven States to purchase an ownership interest of up to ninety percent (90%) of the Southaven Power Plant and to finance Seven States' ownership share of capitalized improvements to the Southaven Power Plant;

WHEREAS, (a) under the Joint Ownership Agreement, Seven States may, at any time, require TVA to repurchase all of Seven States' ownership interest in the Southaven Power Plant, (b) upon the occurrence of certain circumstances described in the Joint Ownership Agreement, TVA may require that Seven States sell such ownership interests to TVA, and (c) under the Joint Ownership Agreement and the Credit Agreement, the Administrative Agent may cause TVA to repurchase such ownership interests upon the occurrence of an "Event of Default" under the Credit Agreement (any such repurchase or sale being referred to herein as a " **Buy-Back** ");

WHEREAS, TVA, the Administrative Agent and the Lenders have entered into an agreement titled Buy-Back Arrangements (Including Loan Purchase), dated as of the date hereof (the " **Buy-Back Arrangements Agreement** "), pursuant to which TVA has agreed to purchase all Loan Rights (as defined therein) under the Credit Agreement (a " **Loan Purchase** ") upon any election to cause a Buy-Back;

WHEREAS, the parties to the Buy-Back Arrangements Agreement have agreed to deliver to the Escrow Agent executed copies of each of the documents necessary to consummate a Loan Purchase, each of which is listed on **Exhibit A** hereto (collectively, the " **Loan Purchase Documents** ");

WHEREAS, TVA and Seven States have agreed to deliver to the Escrow Agent executed copies of each of the documents necessary to consummate TVA's purchase of all of Seven States' ownership interest in the Southaven Power Plant to consummate a Buy-Back, each of which is listed on **Exhibit B** hereto (collectively, the " **Buy-Back Documents** " and, together with the Loan Purchase Documents, the " **Escrow Documents** "); and

WHEREAS, the Parties desire that the Escrow Agent act as escrow agent in accordance with the terms hereof, and the Escrow Agent is willing to act in such capacity.

NOW, THEREFORE, IN CONSIDERATION of the premises and the mutual covenants and agreements contained herein, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties hereby agree as follows:

SECTION 7

ESCROW

7.1 Appointment of Escrow Agent.

The Parties hereby appoint and designate the Escrow Agent as the escrow agent to receive, hold, and distribute the Escrow Documents in accordance with the terms of this Agreement. The Escrow Agent hereby accepts such appointment and agrees to hold the Escrow Documents in safekeeping and release and transfer the Escrow Documents only in accordance with the terms of this Agreement. The Escrow Agent shall have no obligation or responsibilities in connection with the Buy-Back Arrangements Agreement, the Joint Ownership Agreement, the Credit Agreement, or any other agreement between any of the parties to any such agreement, other than obligations or responsibilities arising under this Agreement.

7.2 Delivery of Escrow Documents to Escrow Agent.

(A) Initial Delivery . The Parties (excluding the Escrow Agent) will deliver the Escrow Documents to the Escrow Agent contemporaneously with the execution of this Agreement. Each of the Lenders irrevocably authorizes the Administrative Agent, without further notice to, or consent or authorization from, any Lender, to instruct the Escrow Agent to take all actions necessary and appropriate to effect a Loan Purchase, including, without limitation, dating and delivering to TVA all of the Loan Purchase Documents.

(B) Delivery of Documents Pursuant to an Assignment or Establishment of Incremental Term Loan Facility . Any future Lender that joins the Credit Agreement by assignment of an interest in any Lender's rights and obligations under the Credit Agreement and any Incremental Term Loan Lender will be required, as a condition to such assignment or establishment of an Incremental Term Loan Facility, as applicable, to deliver to the Administrative Agent, who in turn shall deliver to the Escrow Agent, (i) each of the Loan Purchase Documents and (ii) a counterpart to this Agreement executed by the assignee naming the assignee as a party hereto in its capacity as a Lender. In the case of any partial assignment of any Lender's rights and obligations under the Credit Agreement, the assigning Lender shall deliver to the Administrative Agent, who in turn shall deliver to the Escrow Agent, an assignment and assumption agreement in the form attached to the Buy-Back Arrangements Agreement as Exhibit A reflecting such assigning Lender's reduced pro rata share of such rights and obligations, which shall supersede and replace in its entirety any prior assignment and assumption agreement delivered by such Lender to the Escrow Agent (which prior assignment and assumption agreement shall be identified with specificity in a written notice from the Administrative Agent accompanying the replacement assignment and assumption agreement).

SECTION 8

RELEASE OF ESCROW DOCUMENTS; TERM OF AGREEMENT

8.1 Loan Purchase Documents.

Upon the Escrow Agent's receipt of a notice from the Administrative Agent in the form attached hereto as **Exhibit C** (a " **Loan Purchase Notice** "), the Escrow Agent shall deliver the Loan Purchase Documents to TVA in accordance with the instructions set forth in the Loan Purchase Notice.

8.2 Buy-Back Documents.

Upon the Escrow Agent's receipt of a notice from TVA and Seven States in the form attached hereto as **Exhibit D** (a " **Buy-Back Notice** "), the Escrow Agent shall deliver the Buy-Back Documents to TVA in accordance with the instructions set forth in the Buy-Back Notice.

8.3 Consummation of Loan Purchase Condition Precedent to Consummation of Buy-Back.

Notwithstanding anything to the contrary contained herein, under no circumstances shall a Buy-Back be permitted to occur prior to a consummation of a Loan Purchase. The Escrow Agent hereby covenants and agrees that so long as this Agreement is in effect, it will not, under any circumstance, release any Buy-Back Document to TVA or any other party at any time prior to the consummation of a Loan Purchase.

8.4 Termination of Escrow.

The escrow provided for hereunder shall terminate upon the earlier to occur of the following (the " **Termination Date** "):

(A) Upon the mutual written consent of Seven States, TVA and the Administrative Agent (written notice of which shall be given jointly to the Escrow Agent); or

(B) Upon the release of all of the Escrow Documents and the payment of all wires pursuant to this Section 2 .

SECTION 9

THE ESCROW AGENT

9.1 Escrow Agent.

The Escrow Agent shall be obligated for the performance of only such duties as are specifically set forth in this Agreement and may rely and shall be protected in acting or refraining from acting on any written notice, request, waiver, consent, or instrument furnished to it in accordance with the terms of this Agreement and reasonably believed by it to be genuine and to have been signed or presented by the proper party or parties. The Escrow Agent shall have no duty to determine or inquire into the happening or occurrence of any event or contingency, and it is agreed that its duties are purely ministerial in nature. The Escrow Agent may consult with and obtain advice from legal counsel as to any provision hereof or its duties hereunder. Except for gross negligence or willful misconduct, the Escrow Agent shall not be liable for any action taken or omitted by it in good faith and reasonably believed by it to be authorized hereby, nor for action taken or omitted by it in accordance with the advice of its counsel. Anything in this Agreement notwithstanding, in no event shall the Escrow Agent be liable for special, indirect, or consequential loss or damage of any kind whatsoever (including but not limited to lost profits), even if the Escrow Agent has been advised of such loss or damage and regardless of the form of action.

9.2 Indemnification.

(A) TVA, Seven States and each of the Lenders jointly and severally agree to indemnify, defend and hold the Escrow Agent, its officers, directors, partners, employees and agents (each, an " **Indemnified Party** ") harmless from and against any and all losses, claims, damages, demands, expenses and costs, causes of action, judgments or liabilities that may be incurred by the Indemnified Parties arising directly or indirectly out of or in connection with the Escrow Agent's acceptance or appointment as Escrow Agent hereunder, including the out-of-pocket legal costs and expenses as such expenses are incurred (including, without limitation, the expenses of any experts, counsel or agents) of investigating, preparing for or defending itself against any action, claim or liability in connection with its performance hereunder. In no event, however, shall TVA, Seven States or any of the Lenders be obligated to indemnify the Indemnified Parties and save the Indemnified Parties harmless from any fees, expenses, charges and/or liabilities incurred by the Indemnified Parties as a result of their own willful misconduct or gross negligence.

(B) The Parties agree that neither the payment by TVA, Seven States or any of the Lenders of any claim by the Escrow Agent for indemnification hereunder shall impair, limit, modify, or affect, as between TVA, Seven States and the Lenders, the respective rights and obligations of TVA, Seven States and the Lenders under this Agreement, the Buy-Back Arrangements Agreement or the Credit Agreement. TVA, Seven States and the Lenders agree solely among themselves that any obligation for indemnification under this Section 3.2 shall be borne by TVA, Seven States and the Lenders in proportion to each Party's respective responsibility, if any, of such loss, damage, liability, cost or expense for which the Escrow Agent is entitled to indemnification, the causation to be determined by mutual agreement, arbitration (if TVA, Seven States and the Lenders agree in writing to submit the dispute to arbitration) or litigation; provided , however , that if no such Party is determined to be responsible for such loss, damage, liability, cost or expense, any obligation for indemnification under this Section 3.2 shall be borne equally between TVA, Seven States and the Lenders.

(C) The Parties agree and acknowledge that the terms of this Section 3.2 shall survive the resignation or removal of the Escrow Agent as provided herein or the termination of this Agreement.

9.3 Resignation of Escrow Agent.

The Escrow Agent may resign from the performance of its duties hereunder at any time by giving at least fifteen (15) Business Days' prior written notice to TVA, the Administrative Agent, and Seven States or may be removed, with or without cause, by TVA, the Administrative Agent, and Seven States, acting jointly, at any time by the giving of fifteen (15) Business Days' prior written notice to the Escrow Agent, and in either the event of such resignation or removal, such written notice shall specify the date by which such resignation or removal is intended to take effect. Such resignation or removal shall take effect, however, only upon the appointment of a successor escrow agent as provided herein, and no such resignation or removal shall be effective until a successor escrow agent succeeds to and becomes vested with all the rights, powers, privileges, and duties of the retiring Escrow Agent. Upon any such notice of resignation or removal, TVA, the Administrative Agent, and Seven States, acting jointly, shall appoint a successor escrow agent hereunder, which shall be a commercial bank, trust company or other financial institution with a combined capital and surplus in excess of $100,000,000, unless otherwise agreed by TVA, the Administrative Agent, and Seven States as evidenced by written instructions executed by TVA, the Administrative Agent and Seven States. Upon the acceptance in writing of any appointment as the Escrow Agent hereunder by a successor escrow agent, such successor escrow agent shall thereupon succeed to and become vested with all the rights, powers, privileges, and duties of the retiring Escrow Agent, and the retiring Escrow Agent shall be discharged from its duties and obligations under this Agreement, but shall not be discharged from any liability for actions taken as the Escrow Agent hereunder prior to such succession. After any retiring Escrow Agent's resignation or removal, the provisions of this Agreement shall inure to its benefit as to any actions taken or omitted to be taken by it while it was the Escrow Agent under this Agreement. Notwithstanding anything to the contrary herein, if the Escrow Agent provides notice of resignation and a successor Escrow Agent has not been appointed within forty-five (45) days thereafter, the Escrow Agent shall be entitled to deliver all property held hereunder into the registry of any court of competent jurisdiction in New York and thereupon the Escrow Agent shall be discharged from all further duties as Escrow Agent hereunder.

9.4 Receipt.

By its execution of this Agreement, the Escrow Agent acknowledges receipt of the Escrow Documents.

9.5 Fees.

TVA, Seven States, and the Lenders shall compensate the Escrow Agent for its services hereunder in accordance with **Exhibit E** attached hereto and, in addition, shall reimburse the Escrow Agent for all of its reasonable out-of-pocket expenses, including attorneys' fees, travel expenses, postage, copying charges, and the like (collectively, the " **Fees** ") in accordance with such **Exhibit E** . All of the compensation and reimbursement obligations set forth in this Section 3.5 shall be payable upon demand by the Escrow Agent and, with respect to the Escrow Agent, shall be a joint and several obligation of TVA, Seven States and the Lenders. TVA, Seven States, and the Lenders agree, solely among themselves, that (i) the Fees shall be borne equally among TVA, Seven States, and the Lenders, and (ii) if any such Party shall pay more than its share of such Fees, such Party shall have a right of contribution from the other with respect to such Fees paid by that Party. The obligations of TVA, Seven States, and the Lenders under this Section 3.5 shall survive any termination of this Agreement and the resignation or removal of the Escrow Agent.

SECTION 10

MISCELLANEOUS

10.1 Notices.

All notices, communications, and deliveries under this Agreement will be made in writing signed by or on behalf of the Party making the same, will specify the Section under this Agreement pursuant to which it is given or being made, and will be delivered personally or sent by first class registered or certified mail (return receipt requested) (with postage and other fees prepaid) or by a national overnight courier service, in each case to the appropriate addresses set forth below (or to such other address as a Party may designate by notice to the other Parties):

If to TVA :

Tennessee Valley Authority
400 West Summit Hill Drive,
WT 4C-K
Knoxville, TN 37902
Attn: Treasurer
Tel: 865-632-3366
Fax: 865-632-6673

With copies to :

Tennessee Valley Authority
400 West Summit Hill Drive,
WT 6A-K
Knoxville, TN 37902
Attn: Office of General Counsel
Tel: 865-632-4131
Fax: 865-632-3307
Tennessee Valley Authority
One Century Plaza, 26 Century
Blvd., OCP 1F-NST
Nashville, TN 37229
Attn: Executive Vice President,
Customer Resources
Tel: 615-232-6011
Fax: 615-232-6014

If to Seven States :

Seven States Southaven, LLC
1206 Broad Street
Chattanooga, TN 37402

Attn: President and CEO
Tel: 423-756-6511
Fax: 423-267-9424

With a copy to :

Miller & Martin, PLLC
832 Georgia Avenue
Chattanooga, TN 37402

Attn: Carlos Smith
Tel: 423-785-8359
Fax: 423-321-1659

If to Escrow Agent, to :

JPMorgan Chase Bank,
National Association
WorldWide Securities Services
4 New York Plaza, 21st Floor
New York, New York 10017

Attn: Iliona A. Kandarova
Fax: 212-623-6168

If to a Lender of the Administrative Agent :

To the address set forth in thesignature page hereto

Any such notice, communication, or delivery shall be deemed given or made (a) on the date of delivery, if delivered in person, (b) on the first business day following delivery to a national overnight courier service, or (c) on the fifth business day following it being mailed by registered or certified mail; provided , however , that notwithstanding anything to the contrary herein provided, the Escrow Agent shall not be deemed to have received any notice hereunder prior to its actual receipt thereof.

10.2 Exhibits.

The Exhibits to this Agreement are hereby incorporated into this Agreement and are hereby made a part of this Agreement as if set out in full in this Agreement.

10.3 Assignment; Successors in Interest.

No assignment or transfer by any Party of such Party's rights and obligations under this Agreement will be made except with the prior written consent of the other Parties. This Agreement will be binding upon and will inure to the benefit of the Parties and their respective successors and permitted assigns, and any reference to a Party will also be a reference to a successor or permitted assign.

10.4 Number; Gender.

Whenever the context so requires, the singular number will include the plural and the plural will include the singular, and the gender of any pronoun will include the other genders.

10.5 Captions.

The titles and captions contained in this Agreement are inserted in this Agreement only as a matter of convenience and for reference and in no way define, limit, extend, or describe the scope of this Agreement or the intent of any provision of this Agreement. Unless otherwise specified to the contrary, all references to Sections are references to Sections of this Agreement and all references to Schedules or Exhibits are references to Schedules and Exhibits, respectively, to this Agreement.

10.6 Controlling Law; Amendment.

This Agreement will be governed by and construed and enforced in accordance with the internal Laws of the State of New York without reference to its choice of law rules. This Agreement may not be amended, modified, or supplemented except by written agreement of the Parties.

10.7 Consent to Jurisdiction.

(A) Each of the Parties hereby irrevocably consents and agrees that any action, suit, or proceeding arising in connection with any disagreement, dispute, controversy, or claim arising out of or relating to this Agreement or any related document that involves the Escrow Agent (for purposes of this Section, a " **Legal Dispute** ") shall be brought only to the exclusive jurisdiction of the courts of the State of New York or the federal courts located in the State of New York. The Parties agree that, after a Legal Dispute is before a court as specified in this Section 4.7 and during the pendency of such Legal Dispute before such court, all actions, suits, or proceedings with respect to such Legal Dispute or any other Legal Dispute, including, without limitation, any counterclaim, cross-claim, or interpleader, shall be subject to the exclusive jurisdiction of such court. Each of the Parties hereby waives, and agrees not to assert, as a defense in any Legal Dispute, that it is not subject thereto or that such action, suit or proceeding may not be brought or is not maintainable in such court or that its property is exempt or immune from execution, that the action, suit or proceeding is brought in an inconvenient forum or that the venue of the action, suit, or proceeding is improper. Each Party irrevocably waives the right to trial by jury. Each Party agrees that a final judgment in any action, suit, or proceeding described in this Section 4.7 after the expiration of any period permitted for appeal and subject to any stay during appeal shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by applicable Laws. Except as otherwise provided herein, any action, suit, or proceeding arising in connection with any disagreement, dispute, controversy, or claim arising out of or relating to the Credit Agreement, the Joint Ownership Agreement, the Buy-Back Arrangements Agreement or any related document that does not involve the Escrow Agent shall be resolved in accordance with the dispute resolution procedures provided in the Credit Agreement, the Joint Ownership Agreement, the Buy-Back Arrangements Agreement or such related document, or if no dispute resolutions procedures are provided in such related document, by any court having venue and jurisdiction with respect to such disagreement, dispute, controversy, or claim.

(B) Each Party to this Agreement hereby agrees that service of the summons and complaint and all other process that may be served in any such suit, action, or proceeding may be effected by mailing by registered mail, return receipt requested, a copy of such process to the address of such Party set forth herein. Nothing herein shall be construed to prohibit service of process by any other method permitted by law.

10.8 Severability.

Any provision of this Agreement that is prohibited or unenforceable in any jurisdiction will, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions of this Agreement, and any such prohibition or unenforceability in any jurisdiction will not invalidate or render unenforceable such provision in any other jurisdiction. To the extent permitted by Law, the Parties waive any provision of Law that renders any such provision prohibited or unenforceable in any respect.

10.9 Counterparts.

This Agreement may be executed in two or more counterparts, each of which will be deemed an original, and it will not be necessary in making proof of this Agreement or the terms of this Agreement to produce or account for more than one of such counterparts, provided that a counterpart is executed by the Party against whom enforcement is sought.

10.10 Waiver.

Any agreement on the part of a Party to any extension or waiver of any provision of this Agreement will be valid only if set forth in an instrument in writing signed on behalf of such Party. A waiver by a Party of the performance of any covenant, agreement, obligation, condition, representation, or warranty will not be construed as a waiver of any other covenant, agreement, obligation, condition, representation, or warranty. A waiver by any Party of the performance of any act will not constitute a waiver of the performance of any other act or an identical act required to be performed at a later time.

10.11 Integration.

This Agreement and the documents executed pursuant to this Agreement supersede all negotiations, agreements, and understandings among the Parties with respect to the subject matter of this Agreement.

10.12 Force Majeure.

No party to this Agreement shall be liable to any other party for losses due to, or if it is unable to perform its obligations under the terms of this Agreement because of, acts of God, fire, war, terrorism, floods, strikes, electrical outages, equipment or transmission failure, or other causes reasonably beyond its control.

10.13 Security Procedures.

In the event transfer instructions are given (other than in writing at the time of execution of this Agreement), whether in writing, by facsimile or otherwise, the Escrow Agent is authorized to seek confirmation of such instructions by telephone call-back to the person or persons designated on **Exhibit F** hereto and the Escrow Agent may rely upon the confirmation of anyone purporting to be the person or persons so designated. Each transfer instruction shall be executed by an authorized signatory, a list of such authorized signatories is set forth on **Exhibit F** . The persons and telephone numbers for call-backs may be changed only in a writing actually received and acknowledged by the Escrow Agent. If the Escrow Agent is unable to contact any of the authorized representatives identified in **Exhibit F** , the Escrow Agent is hereby authorized to seek confirmation of such instructions by telephone call-back to any one or more of TVA or Seven States executive officers (the " **Executive Officers** "), as the case may be, as the Escrow Agent may select, which shall include the titles of Chief Financial Officer and Executive Vice President, Financial Services, Senior Vice President and Treasurer, and Vice President, Strategy, Pricing and Contracts, with respect to TVA, and the titles of President and Chief Executive Officer, Vice President, Secretary, and Treasurer, with respect to Seven States. Such Executive Officer shall deliver to the Escrow Agent a fully executed incumbency certificate, and the Escrow Agent may rely upon the confirmation of anyone purporting to be any such officer. The Parties acknowledge that these security procedures are commercially reasonable.

10.14 Patriot Act Disclosure.

Section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (" **USA PATRIOT Act** ") requires the Escrow Agent to implement reasonable procedures to verify the identity of any person that opens a new account with it. Accordingly, the Parties acknowledge that Section 326 of the USA PATRIOT Act and the Escrow Agent's identity verification procedures require the Escrow Agent to obtain information which may be used to confirm the Parties identity including without limitation name, address and organizational documents (" **identifying information** "). The Parties agree to provide the Escrow Agent with and consent to the Escrow Agent obtaining from third parties any such identifying information required as a condition of opening an account with or using any service provided by the Escrow Agent.

IN WITNESS WHEREOF , the Parties have executed and delivered this Agreement as of the date first written above.

SEVEN STATES SOUTHAVEN, LLC

By:
Name:
Title:

TENNESSEE VALLEY AUTHORITY

By:
Name:
Title:

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION ,
as Administrative Agent and a Lender

By:
Name:
Title:

Address :
[JPMorgan Address]

COBANK, ACB,
as a Lender

By:
Name:
Title:

Address :
[CoBank Address]

BRANCH BANKING AND TRUST COMPANY,
as a Lender

By:
Name:
Title:

Address :
[BB&T Address]

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION , as Escrow Agent

By:
Name:
Title:

EXHIBIT A

LOAN PURCHASE DOCUMENTS

1. Assignment and Assumption Agreement between JPMorgan Chase Bank, National Association, as administrative agent and assignor, and Tennessee Valley Authority, as assignee.

2. Assignment and Assumption Agreement between CoBank, ACB, as assignor, Tennessee Valley Authority, as assignee, and JPMorgan Chase Bank, National Association, as administrative agent.

3. Assignment and Assumption Agreement between Branch Banking and Trust Company, as assignor, Tennessee Valley Authority, as assignee, and JPMorgan Chase Bank, National Association, as administrative agent.

4. Certificate of Acceptance of Appointment of Administrative Agent, executed by Tennessee Valley Authority.

5. Promissory Note, dated as of September 30, 2008, in the principal face amount of $124,999,891.50, by Seven States Southaven, LLC in favor of JPMorgan Chase Bank, National Association.

6. Promissory Note, dated as of September 30, 2008, in the principal face amount of $149,998,569.80, by Seven States Southaven, LLC in favor of CoBank, ACB.

7. Promissory Note, dated as of September 30, 2008, in the principal face amount of $49,997,356.70, by Seven States Southaven, LLC in favor of Branch Banking and Trust Company.

8. Assignment of Collateral Assignment Agreement executed by JPMorgan Chase Bank, National Association.

9. Allonge to Promissory Note executed by JPMorgan Chase Bank, National Association.

10. Allonge to Promissory Note executed by CoBank, ACB.

11. Allonge to Promissory Note executed by Branch Banking and Trust Company.

12. UCC-3 Assignment (Delaware) naming Tennessee Valley Authority as assignee with respect to UCC file number 2008 3305651.

13. Assignment of Collateral Assignment Agreement executed by JPMorgan Chase Bank, National Association.

EXHIBIT B

BUY-BACK DOCUMENTS

1. Closing Statement

2. Special Warranty Deed, executed by Seven States Southaven, LLC, with respect to certain real property located in Desoto County, Mississippi.

3. Special Warranty Deed, executed by Seven States Southaven, LLC, with respect to certain real property located in Shelby County, Tennessee.

4. Bill of Sale executed by Seven States Southaven, LLC and Tennessee Valley Authority.

5. Assignment and Assumption Agreement executed by Seven States Southaven, LLC and Tennessee Valley Authority.

EXHIBIT C

FORM OF LOAN PURCHASE NOTICE

[Escrow Agent]
[Address]

Re: Loan Purchase Notice

Ladies and Gentlemen:

Reference is made to that certain Escrow Agreement (as amended, restated, supplemented, or otherwise modified, the " **Agreement** "; capitalized terms used but not otherwise defined herein shall have the meanings assigned thereto in the Agreement), dated September 30, 2008, among you, Seven States Southaven, LLC, Tennessee Valley Authority, and JPMorgan Chase Bank, National Association. This Notice constitutes a Loan Purchase Notice as described in and delivered pursuant to Section 2.1 of the Agreement.

Notice is hereby given that the undersigned has received electronically transmitted payment of immediately available funds equal to the full Purchase Price (as defined in the Buy-Back Arrangements Agreement). You are hereby instructed to take the following actions in the following order:

(1) First , date each of the documents described as items 1 through **[14]** of Exhibit A to the Agreement as of the Effective Date

(2) Second , complete Section 6 of each of the Assignment and Assumption Agreements described as items 1 through **[3]** of Exhibit A to the Agreement with the following information:

(a) With respect to item 1 of Exhibit A (JPMorgan):

Assignor	Assignee	Facility Assigned	Aggregate Amount of Commitment/Loans for all Lenders	Amount of Commitment/ Loans Assigned	Percentage Assigned of Commitment/Loans
JPMorgan Chase Bank, National Association	Tennessee Valley Authority	**[Term Loan]** **[Incremental Term Loan A/B]**	$	$	%

(b) With respect to item 2 of Exhibit A (CoBank)

Assignor	Assignee	Facility Assigned	Aggregate Amount of Commitment/Loans for all Lenders	Amount of Commitment/ Loans Assigned	Percentage Assigned of Commitment/Loans
CoBank, ACB	Tennessee Valley Authority	**[Term Loan] [Incremental Term Loan A/B]**	$	$	%

(c) With respect to item 3 of Exhibit A (BB&T)

Assignor	Assignee	Facility Assigned	Aggregate Amount of Commitment/Loans for all Lenders	Amount of Commitment/ Loans Assigned	Percentage Assigned of Commitment/Loans
Branch Banking and Trust Company	Tennessee Valley Authority	**[Term Loan] [Incremental Term Loan A/B]**	$	$	%

[(d) Complete for each Incremental Term Loan Lender and all Assignees]

(3) Third , deliver each of the Loan Purchase Documents described on Exhibit A to the Agreement by national overnight courier service to Tennessee Valley Authority at the following address:

Tennessee Valley Authority
One Century Plaza, 26 Century Blvd., OCP 1F-NST
Nashville, TN 37902
Attn: Executive Vice President, Customer Resources

(5) Fourth , deliver a copy of each of the Loan Purchase Documents described on Exhibit A to the Agreement by national overnight courier service to JPMorgan Chase Bank, National Association, at the following address:

JPMorgan Chase Bank, National Association
270 Park Avenue
New York, New York 10017
Attn: Michael Mak

Very truly yours,

JPMORGAN CHASE BANK,

NATIONAL ASSOCIATION , as Administrative Agent

By: _____
Name:
Title:

cc:

Tennessee Valley Authority
One Century Plaza, 26 Century Blvd., OCP 1F-NST
Nashville, TN 37902
Attn: Executive Vice President, Customer Resources

8017069.8

EXHIBIT D

FORM OF BUY-BACK NOTICE

[Escrow Agent]
[Address]

Re: Buy-Back Notice

Ladies and Gentlemen:

Reference is made to that certain Escrow Agreement (as amended, restated, supplemented, or otherwise modified, the " **Agreement** "; capitalized terms used but not otherwise defined herein shall have the meanings assigned thereto in the Agreement), dated September 30, 2008, among you, Seven States Southaven, LLC, Tennessee Valley Authority, and JPMorgan Chase Bank, National Association. This Notice constitutes a Buy-Back Notice as described in and delivered pursuant to Section 2.2 of the Agreement.

You are hereby instructed to take the following actions in the following order:

(1) First , comply with and complete all instructions set forth in any Loan Purchase Notice you receive or have received from JPMorgan Chase Bank, National Association

(2) Second , date each of the documents described as items **[1]** through **[5]** of Exhibit B to the Agreement as of **[INSERT BUY-BACK PURCHASE DATE]** and (b) insert the amount of $ **[INSERT BUY-BACK PRICE]** on the Closing Statement where indicated therein

(3) Third , deliver each of the Buy-Back Documents described on Exhibit B to the Agreement by national overnight courier service to Tennessee Valley Authority at the following address:

Tennessee Valley Authority
One Century Plaza, 26 Century Blvd., OCP 1F-NST
Nashville, TN 37902
Attn: Executive Vice President, Customer Resources

Very truly yours,

TENNESSEE VALLEY AUTHORITY

By: _____
Name:
Title:

SEVEN STATES SOUTHAVEN, LLC

By: _____
Name:
Title:

EXHIBIT E

FEES

The annual administration fee of $2,500 for administering this Escrow Agreement will be payable upon invoice. Such fee is non-refundable and will not be pro rated.

Out of pocket expenses such as, but not limited to postage, courier, overnight mail, insurance, money wire transfer, long distance telephone charges, facsimile, stationery, travel, legal or accounting, and other out of pocket costs, will be billed at cost and shall be promptly paid.

These fees do not include extraordinary services which will be priced according to time and scope of duties and shall be promptly paid. The fees shall be deemed earned in full upon receipt by the Escrow Agent, and no portion shall be refundable for any reason, including without limitation, termination of the Escrow Agreement.

EXHIBIT F

TELEPHONE NUMBER(S) AND AUTHORIZED SIGNATURE(S) FOR

PERSON(S) DESIGNATED TO GIVE TRANSFER INSTRUCTIONS

Tennessee Valley Authority:

Name	Telephone Number	Signature
1. _____	_____	_____
2. _____	_____	_____
3. _____	_____	_____

Seven States Southaven, LLC:

Name	Telephone Number	Signatur e
1. _____	_____	_____
2. _____	_____	_____
3. _____	_____	_____

JPMorgan Chase Bank, National Association:

Name	Telephone Number	Signature
1. _____	_____	_____
2. _____	_____	_____
3. _____	_____	_____

EXHIBIT E

Form of Allonge

FORM OF ALLONGE TO PROMISSORY NOTE

_____ ___, 20___

Pay to the order of TENNESSEE VALLEY AUTHORITY, WITHOUT REPRESENTATION, WARRANTY OR RECOURSE, the promissory note described below to which this Allonge is affixed:

Promissory Note, dated September 30, 2008, made by Seven States Southaven, LLC payable to the order of **[LENDER]** in the original principal amount of _____ ($_____).

[LENDER]

By:_____
Name:
Title:

EXHIBIT F

Form of UCC Assignment Documents

(Form omitted)

EXHIBIT G

How to Find TVA's Annual and Quarterly Reports

TVA files annual and quarterly reports with the SEC. Annual financial information about TVA can be found in TVA's Annual Report filed on Form 10-K. Interim financial information can be found in TVA's Quarterly Reports filed on Form 10-Q. TVA's annual and quarterly reports are available to the public from the SEC's website at www.sec.gov and from TVA's website at www.tva.gov. Additionally, TVA's annual and quarterly reports may be read and copied at the SEC's public reference room in Washington, D.C. Information about the public reference room may be obtained by calling the SEC at 1-800-SEC-0330.

EXHIBIT H

Form of Purchase Price Notice

_____ __, 20__

Tennessee Valley Authority
400 W. Summit Hill Drive, WT 4C-K
Knoxville, TN 37902
Attn: Treasurer
Fax: 865-632-6673

Tennessee Valley Authority
One Century Plaza, 26 Century Blvd., OCP 1F-NST
Nashville, TN 37229
Attn: Executive Vice President, Customer Resources
Fax: 615-232-6014

Re: Purchase Price Notice

Ladies and Gentlemen:

Reference is made to that certain Buy-Back Arrangements (Including Loan Purchase), dated as of September 30, 2008 (as amended, restated, supplemented or otherwise modified, the " **Agreement** "; capitalized terms used but not otherwise defined herein shall have the meanings assigned thereto in the Agreement), among Tennessee Valley Authority, JPMorgan Chase Bank, National Association, and the other Lenders identified therein.

This notice constitutes a "Purchase Price Notice" delivered pursuant to the Agreement and the Loan Purchase Notice previously delivered by the undersigned to you. The Purchase Price is **[INSERT PURCHASE PRICE]** , consisting of the following amounts as of **[_____ __, 20__]** [1] (the " **Loan Purchase Date** "):

Principal: $_____
Accrued Interest: $_____
Fees and Expenses: $_____

If the Purchase Price is received after [_____], Eastern Standard Time on the Loan Purchase Date, the additional per diem interest will be $[_____] per day. The amounts set forth above are based on the assumption that after the date hereof, no new loans are made, no payments are made on any loans and there is no change in the interest rate on the loans, in each case, under the Credit Agreement. In the event that any such events occur on or prior to the Loan Purchase Date, the undersigned will deliver to TVA a substitute Purchase Price Notice reflecting the adjusted Loan Purchase Amount.

Upon receipt of the Purchase Price in immediately available funds no later than the Loan Purchase Date, the undersigned will direct the Escrow Agent to complete and deliver the Loan Purchase Documents (as defined in the Escrow Agreement) to you.

Very truly yours,

JPMORGAN CHASE BANK,
NATIONAL ASSOCIATION,
as Administrative Agent

By: _____
Name:
Title:

---

[1] Note to Administrative Agent: Insert date for which the Purchase Price payoff was determined.

Exhibit 10.35

March 29, 2007

Mr. William R. Campbell
410 Cortland Cove
Madison, Mississippi 39110

Dear Bill:

The TVA Board has authorized me to offer you the position of Chief Nuclear Officer and Executive Vice President, TVA Nuclear with the Tennessee Valley Authority in Chattanooga, Tennessee. This position is responsible for directing and managing TVA's Nuclear Group and ensuring a stable base load from all of TVA's nuclear operating units. Responsibilities include planning and directing all organizational activities related to nuclear power production, nuclear power plant operations, maintenance, modifications, and all nuclear support services and engineering activities. Upon acceptance of this position, TVA will provide you an annual base salary of $450,000, which will be payable in equal installments every two weeks.

Additionally, you will be included as a participant in TVA's Executive Annual and Long-Term Incentive Plans. Under the Annual Incentive Plan your annual incentive opportunity will be 75 percent of your annual base salary beginning in this fiscal year (FY 2007). Under the Long-Term Incentive Plan, your award opportunity will be 80 percent of your annual base salary beginning with the performance cycle (FY 2005-2007) ending in fiscal year 2007 (FY 2005-2007). Actual annual and long-term incentive awards are based on performance measured against performance goals established at the beginning of each performance period. The incentive awards are generally paid in the first quarter of the fiscal year following the fiscal year in which they are earned. You will have an opportunity to elect to receive these awards in a lump-sum cash payment or have all or part of the awards credited to a deferred compensation account in your name, to the extent permitted by IRS regulations.

Due to the nature of this position, you will also be included as a participant in TVA's Supplemental Executive Retirement Plan (SERP) at the Tier 1 level with the following provisions:

- You will be granted an additional 5 years of credited service and both the "Prior Employer Offset" and "Social Security Offset" will be waived. The additional years of credited service will be for SERP benefit calculation purposes only and will not count toward the minimum five-year vesting requirement.

- The “Qualified Plan Offset” will be calculated based on the pension benefit provided under the TVA Retirement System Cash Balance structure at the time of separation assuming an additional 5 years of credited service.

- In the event of termination (other than for cause as defined below) following the required five years of vesting service, your termination will be considered an approved termination under TVA’s SERP and a benefit equal to that calculated for an “Approved Termination” will be payable upon termination as long as the termination is considered acceptable to TVA.

A general outline of how the SERP calculation works has been furnished to you to use in your consideration of this offer.

For purposes of this offer, termination “for cause” shall be considered to be under circumstances involving (1) conviction of a felony or crime of moral turpitude, or (2) illegal conduct involving dishonesty, fraud, or gross negligence that directly results in significant economic harm to TVA.

In addition, TVA will enter into a Long-Term Deferred Compensation Plan (LTDCP) agreement with you that will provide annual deferred compensation credits to cover a service period of approximately five years and four months. Under the agreement, an initial credit of $70,000 will be made to an account in your name as soon as practicable following the date of your employment with TVA. You will be fully vested in this credit at the time it is contributed to your account. Subsequent credits of $200,000 each will be contributed to your account on October 1, 2007, October 1, 2008, October 1, 2009, October 1, 2010, and October 1, 2011. You will become fully vested in the remaining credits if you remain employed by TVA until the expiration of the agreement on September 30, 2012. All vested credits in your account under this LTDCP agreement will be distributed upon termination of your employment with TVA in five annual installments in accordance with the distribution schedule set out in section 3.A.1.b of TVA’s deferred compensation plan (MISRIP).

TVA will also provide you a biweekly vehicle allowance, totaling approximately $11,700 annually, toward the purchase or lease of a vehicle and operating fees, maintenance, repairs, accidents, and insurance. This allowance is considered a taxable benefit and will be subject to withholding and any other applicable taxes.

In connection with your move to Tennessee, TVA will pay for the actual and reasonable travel and moving expenses for you and your immediate family. TVA’s Relocation Services Program is available to assist you in the sale of your present home. Louise Grishom of our Shared Resources organization will forward information to you regarding this program.

In addition to the relocation expenses, TVA will provide you a one-time relocation incentive payment in the amount of $75,000, which must be repaid to TVA if (1) you voluntarily terminate employment within one year, unless your separation from TVA is for reasons acceptable to TVA, or (2) you are terminated for cause (as defined above).

TVA also provides employee benefits which are described in materials that will be sent to you under separate cover. The TVA Retirement System, of which you will become a member, provides for vesting after five years of full-time service, except that eligibility for death benefits vests immediately. Your employment will be subject to the usual employment procedures and satisfactory results of a security investigation, which will include a drug screen. As we have discussed, this position will also require a top secret security clearance.

If you have questions, or if I can be of assistance in any way, please do not hesitate to call me at (865) 632-2366 or John Long at (865) 632-6307. We look forward to working with you.

Please sign below indicating your acceptance of this offer and confirm your anticipated commencement date.

Sincerely,

/s/ John E. Long, Jr.
John E. Long, Jr.

/s/ William R. Campbell
William R. Campbell

4/4/07
Acceptance Date

5/14/07
Commencement Date

Exhibit 10.41

DEFERRAL AGREEMENT
William R. Campbell

The TVA Board of Directors has approved your participation in TVA's Long-Term Deferred Compensation Plan (Plan) under the following terms:

		Vesting Date(s)	Vesting Amount
Duration of deferral agreement:	5 years and 4 months		
First compensation credit:	$70,000 (05/14/2007)	05/14/2007	$70,000
Second compensation credit:	$200,000 (10/01/2007)	09/30/2012	Balance of account
Third compensation credit:	$200,000 (10/01/2008)	09/30/2012	Balance of account
Fourth compensation credit:	$200,000 (10/01/2009)	09/30/2012	Balance of account
Fifth compensation credit:	$200,000 (10/01/2010)	09/30/2012	Balance of account
Sixth and final compensation credit:	$200,000 (10/01/2011)	09/30/2012	Balance of account
Total credits over deferral period:	$1,070,000		
Expiration date:	09/30/2012		

Please read the following provisions carefully and indicate your approval by signing at the designated place below.

As a participant in the Plan, I hereby agree to be bound by the following terms and conditions:

Annual deferred compensation credits as stated above will be made to an account in my name to cover a service period of approximately 5 years and 4 months, beginning on May 14, 2007, and ending on September 30, 2012, provided that I remain employed by TVA through September 30, 2012. I shall be entitled to compensation credits including interest and returns on the vesting dates as stated in the above schedule provided that I remain employed by TVA through the vesting periods. The first credit shall be made directly to an account in TVA's Merit Incentive Supplemental Retirement Income Plan (MISRIP) and will be paid out to me, upon termination of my employment with TVA, in five annual installments or in accordance with otherwise applicable IRS rules. Upon expiration of this agreement, the balance of the account, including interest and return as provided below, will be transferred to my TVA deferred compensation account and all credits from this agreement will be paid out to me, upon termination of my employment with TVA, in five annual installments or in accordance with otherwise applicable IRS rules.

I understand that I must be an employee of TVA at the time of the vesting dates stated above or no payments or transfers under the Plan will be made by TVA and any credits to my account will be extinguished. However, in the event that TVA terminates my employment during the term of this agreement through no act or delinquency of my own, this agreement is terminated as of the date of my termination and no further credits will be made under it and any credits in my account from this agreement, including interest or return as provided below, at the time of termination will become vested. The balance of my account will be transferred to my TVA MISRIP account and all credits from this agreement will be paid out to me in five annual installments or in accordance with otherwise applicable IRS rules. If TVA terminates my employment for cause prior to the expiration of this agreement, no further credits will be made and my unvested account balance will be forfeited. In the event of my death during the term of this agreement, my account balance will be paid to the person identified on my beneficiary designation form or, in the absence of such designation, to my estate, in a manner permitted by applicable IRS rules.

Interest will be credited to the balance reflected in my deferral account on the same basis as interest is calculated and credited under MISRIP. In the alternative, I may choose to have my balance adjusted based on the return of the funds I select under the same conditions as are contained in MISRIP. I understand that I am solely responsible for the risk associated with any return elections that I make.

I understand that nothing contained in this agreement shall be construed as conferring the right to continue in the employment of TVA as an executive or in any other capacity and that the payment election I have made is final (not revocable).

/s/ William R. Campbell	6/12/07

William R. Campbell	Date
/s/ John E. Long, Jr.	6/15/07
Chief Officer	Date

EXHIBIT 31.1

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Tom D. Kilgore, certify that:

1. I have reviewed this Annual Report on Form 10-K of the Tennessee Valley Authority;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 16, 2008

/s/ Tom D. Kilgore

Tom D. Kilgore
President and Chief
Executive Officer

EXHIBIT 31.2

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Kimberly S. Greene, certify that:

1. I have reviewed this Annual Report on Form 10-K of the Tennessee Valley Authority;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 16, 2008

/s/ Kimberly S. Greene
Kimberly S. Greene
Chief Financial Officer and
Executive
Vice President, Financial
Services

EXHIBIT 32.1

CERTIFICATION FURNISHED PURSUANT TO
SECURITIES EXCHANGE ACT RULE 13a-14(b)
OR RULE 15d-14(b) AND 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of the Tennessee Valley Authority (the "Company") for the year ended September 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Tom D. Kilgore, President and Chief Executive Officer of the Company, certify, for the purposes of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Tom D. Kilgore
Tom D. Kilgore
President and Chief
Executive Officer
December 16, 2008

EXHIBIT 32.2

CERTIFICATION FURNISHED PURSUANT TO
SECURITIES EXCHANGE ACT RULE 13a-14(b)
OR RULE 15d-14(b) AND 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of the Tennessee Valley Authority (the "Company") for the year ended September 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Kimberly S. Greene, Chief Financial Officer and Executive Vice President, Financial Services of the Company, certify, for the purposes of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Kimberly S. Greene
Kimberly S. Greene
Chief Financial Officer and Executive
Vice President, Financial Services
December 16, 2008