Tennessee Valley Authority

(Wholly Owned Corporate Agency and Instrumentality of the United States of America)

Quarterly Report

For the quarterly period ended December 31, 2004

Tennessee Valley Authority

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For the quarterly period ended December 31, 2004

This document contains the unaudited Quarterly Report of TVA for the quarterly period ended December 31, 2004, (this "Quarterly Report"). TVA is not required to register securities under the Securities Act of 1933 and is currently not required to make periodic reports to the Securities and Exchange Commission ("SEC") under the Securities and Exchange Act of 1934. Accordingly, TVA does not intend to file this report with the SEC. Due to legislation enacted in December 2004, beginning with its 2006 annual report, TVA will be required to file annual reports, quarterly reports, and current reports with the SEC under the Securities Exchange Act of 1934. Several portions of this Quarterly Report contain forward-looking statements, and reference is made to page one regarding such statements. This report should be read in conjunction with the 2004 Information Statement dated November 24, 2004 (as may be amended from time to time, the "2004 Information Statement").

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FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions, assumptions or otherwise relating to future events or performance may be forward-looking.

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

Examples of forward-looking statements include, but are not limited to, strategic objectives; estimates of costs for disposing of certain tangible long-lived assets; expectations about the adequacy of TVA’s nuclear decommissioning fund; expectations about reaching a settlement in TVA’s litigation with Bowater Incorporated and Bowater Newsprint South, Inc; the impact of new accounting pronouncements and interpretations, including Interpretation No. 46, “*Consolidation of Variable Interest Entities*,” which was amended by Financial Accounting Standards Board Interpretation No. 46R, and SFAS No. 151, “*Inventory Costs - an amendment of ARB No. 43, Chapter 4*”; TVA’s plans to continue using short-term debt to meet current obligations; and the anticipated cost of returning Browns Ferry Unit 1 to service.

Although 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 restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA’s generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; damage to power production or transmission facilities due to accidental events or terrorist activity; changes in accounting standards; and unforeseeable events. 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 from those contained in any forward-looking statement.

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

FINANCIAL INFORMATION

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF INCOME (unaudited)
For the three months ended December 31
(in millions)

	2004	2003
Operating revenues		
Sales of electricity		
Municipalities and cooperatives	$ 1,525	$ 1,521
Industries directly served	215	198
Federal agencies and other	73	37
Other revenue	21	21
Total operating revenues	1,834	1,777
Operating expenses		
Fuel and purchased power	477	430
Operating and maintenance	582	558
Depreciation and accretion	285	275
Tax-equivalents	91	84
Loss on project cancellation (see note 1)	–	35
Total operating expenses	1,435	1,382
Operating income	399	395
Other income, net	5	7
Unrealized gain (loss) on derivative contracts, net	4	(1)
Interest expense		
Interest on debt	339	348
Amortization of debt discount, issue, and reacquisition costs, net	5	7
Allowance for funds used during construction	(26)	(22)
Net interest expense	318	333
Net income	$ 90	$ 68

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

TENNESSEE VALLEY AUTHORITY
BALANCE SHEETS (unaudited)
(in millions)

ASSETS	December 31 2004	September 30 2004
Current assets		
Cash and cash equivalents	$ 242	$ 519
Short-term investments	449	335
Accounts receivable, net	996	1,034
Inventories at average cost and other		
Fuel	189	193
Other, net	316	305
Total current assets	2,192	2,386
Property, plant, and equipment		
Completed plant	34,854	34,786
Less accumulated depreciation	(13,684)	(13,424)
Net completed plant	21,170	21,362
Construction in progress	2,160	1,923
Nuclear fuel and capital leases	550	504
Total property, plant, and equipment	23,880	23,789
Deferred nuclear generating units	3,910	3,909
Investment funds	823	744
Deferred charges and other assets		
Loans and other long-term receivables	86	144
Reacquisition costs	273	277
Other deferred charges	1,276	974
Regulatory assets (note 1)	1,998	2,057
Total deferred charges and other assets	3,633	3,452
Total assets	$ 34,438	$ 34,280
LIABILITIES AND PROPRIETARY CAPITAL		
Current liabilities		
Accounts payable	$ 608	$ 761
Accrued liabilities	204	284
Accrued interest	309	402
Current portion of lease/leaseback obligations	33	35
Current portion of energy prepayment obligations	106	105
Short-term debt	1,989	1,924
Current maturities of long-term debt	2,000	2,000
Total current liabilities	5,249	5,511
Other liabilities		
Deferred liabilities	3,030	2,893
Asset retirement obligations	1,807	1,782
Lease/leaseback obligations	1,142	1,143
Energy prepayment obligations	1,323	1,350
Total other liabilities	7,302	7,168
Long-term debt		
Public bonds	19,326	19,326
Unamortized discount and other adjustments	150	11
Total long-term debt	19,476	19,337
Total liabilities	32,027	32,016
Commitments and contingencies (see note 6)		
Proprietary capital		
Appropriation investment	4,798	4,803
Retained earnings of power program	1,251	1,162
Accumulated net expense of nonpower programs	(3,652)	(3,649)
Accumulated other comprehensive income (loss) (note 2)	14	(52)
Total proprietary capital	2,411	2,264
Total liabilities and proprietary capital	$ 34,438	$ 34,280

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CASH FLOWS (unaudited)
For the three months ended December 31
(in millions)

	2004	2003
Cash flows from operating activities		
Net income	$ 90	$ 68
Items not requiring (providing) cash		
Depreciation, amortization, and accretion	321	293
Allowance for funds used during construction	(26)	(22)
Nuclear fuel amortization	34	31
Loss on project cancellation	–	35
Other, net	53	37
Changes in current assets and liabilities		
Short-term investments	(114)	–
Accounts receivable, net	38	36
Inventories and other	(19)	7
Accounts payable and accrued liabilities	(234)	(213)
Accrued interest	(93)	(80)
Proceeds from energy prepayments	–	1,504
Refueling outage costs	(28)	(53)
Other	(19)	(8)
Net cash provided by operating activities	3	1,635
Cash flows from investing activities		
Construction expenditures	(329)	(388)
Allowance for funds used during construction	26	22
Nuclear fuel expenditures	(84)	(1)
Loans and other receivables		
Advances	5	6
Repayments	(2)	(4)
Proceeds from sale of loans	55	–
Other, net	(2)	(6)
Net cash used in investing activities	(331)	(371)
Cash flows from financing activities		
Long-term debt		
Issues	–	93
Redemptions and repurchases	(3)	(415)
Short-term issues/(redemptions), net	65	(1,184)
Payments on lease/leaseback obligations	(3)	(3)
Proceeds from other financing activities	1	–
Financing costs, net	–	(1)
Payments to U.S. Treasury	(9)	(10)
Net cash provided by/(used in) financing activities	51	(1,520)
Net change in cash and cash equivalents	(277)	(256)
Cash and cash equivalents at beginning of period	519	533
Cash and cash equivalents at end of period	$ 242	$ 277

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (unaudited)
For the three months ended December 31, 2004 and 2003
(in millions)

	Appropriation Investment	Retained Earnings - Power Program	Accumulated Net Expense of Nonpower Programs	Accumulated Other Comprehensive Income/(Loss)	Total	Comprehensive Income
Balance at September 30, 2003	$ 4,823	$ 783	$ (3,638)	$ (74)	$ 1,894	$ –
Net income (loss)	–	71	(3)	–	68	68
Return on appropriation investment	–	(5)	–	–	(5)	–
Other comprehensive income (note 2)	–	–	–	15	15	15
Return of appropriation investment	(5)	–	–	–	(5)	–
Balance at December 31, 2003	$ 4,818	$ 849	$ (3,641)	$ (59)	$ 1,967	$ 83
Balance at September 30, 2004	$ 4,803	$ 1,162	$ (3,649)	$ (52)	$ 2,264	$ –
Net income (loss)	–	93	(3)	–	90	90
Return on appropriation investment	–	(4)	–	–	(4)	–
Other comprehensive income (note 2)	–	–	–	66	66	66
Return of appropriation investment	(5)	–	–	–	(5)	–
Balance at December 31, 2004	$ 4,798	$ 1,251	$ (3,652)	$ 14	$ 2,411	$ 156

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

NOTES TO FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Organization

TVA is a wholly owned corporate agency and instrumentality of the United States. It was established by Congress in 1933 by the TVA Act with the objective of developing the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense by providing: (1) an ample supply of power within the region, (2) navigable channels and flood control for the Tennessee River System, and (3) agricultural and industrial development and improved forestry in the region. TVA carries out these regional and national responsibilities in a service area that centers on Tennessee and includes parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina, and Virginia.

Substantially all TVA revenues and assets are attributable to its power program. The revenues and expenses of the power program have historically been segregated and distinct from TVA's nonpower programs. The TVA Act requires the power program to be self-supporting from power revenues and proceeds from power program financings, such as proceeds from the issuance of debt. Although TVA no longer receives 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. Until 2000, most of the funding for TVA's nonpower programs was provided by congressional appropriations. These programs are now funded largely with power funds. Certain nonpower activities are also funded with various revenues and user fees. Prior to 2004, TVA presented information separately on its power program and nonpower programs in its financial statements. Because of the change in funding explained above, beginning with the fourth quarter of 2004, TVA presents consolidated financial statements which include both power and nonpower activities.

Power rates are established by the TVA Board of Directors ("Board") as authorized by the TVA Act. The TVA Act requires TVA to charge rates for power that, among other things, 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; and annual payments to the U.S. Treasury in repayment of, and as a return on, the government's appropriation investment in TVA's power facilities. Rates set by the Board are not subject to review or approval by any state or federal regulatory body. In a future restructured electric power industry, it is possible that the ability of the Board to set TVA's rates as specified in the TVA Act could be adversely affected by legislative changes or by competitive pressures.

Basis of Presentation

TVA prepares its interim financial statements in conformity with generally accepted accounting principles accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Because the accompanying interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements, they should be read in conjunction with the audited financial statements for the year ended September 30, 2004, and the notes thereto.

The amounts included in the interim financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary to fairly present TVA's financial position and results of operations for the interim periods. Due to seasonal weather variations and the timing of planned maintenance and refueling outages of electric generating units, the results of operations for interim periods are not necessarily indicative of amounts expected for the entire year.

In preparing financial statements that conform to generally accepted accounting principles, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates.

As discussed in Note 1—*Project Cancellation*, in the first quarter of 2004 TVA recorded a project cancellation loss of $36 million which included an estimated $1 million in contingency costs related to the Regenesys project cancellation. In April 2004, Regenesys Technologies Limited ("RTL") reimbursed TVA for early termination on the contract in the amount of $15 million. In the fourth quarter of 2004, TVA determined that the $1 million contingency liability no longer existed and reduced the loss on project cancellation previously recorded from $21 million to $20 million.

Fiscal Year
TVA's fiscal year ends September 30. Unless otherwise indicated, years (2005, 2004, etc.) refer to TVA's fiscal years.

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

	At December 31 2004	At September 30 2004
	(in millions)	
Power receivables billed	$ 232	$ 288
Power receivables unbilled	732	713
Total power receivables	964	1,001
Other receivables	40	41
Allowance for uncollectible accounts	(8)	(8)
Net accounts receivable	$ 996	$ 1,034

Cost-Based Regulation
Regulatory assets represent costs capitalized under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, "*Accounting for the Effects of Certain Types of Regulation*." TVA's regulatory assets are shown as REGULATORY ASSETS, REACQUISITION COSTS, and DEFERRED NUCLEAR GENERATING UNITS on the Balance Sheets. These assets consist of certain charges related to the closure and removal of nuclear generating units, unrealized losses related to mark-to-market valuations of certain derivative contracts, adjustments related to minimum pension liability, reacquisition costs of debt instruments, and deferred nuclear generating units. TVA's regulatory assets consist of the following:

	At December 31 2004	At September 30 2004
	(in millions)	
Decommissioning costs	$ 701	$ 755
Changes in fair value of derivative contracts	54	59
Adjustment to accrue minimum pension liability		
TVA Retirement System	1,235	1,235
Supplemental executive retirement plan	8	8
Subtotal	1,998	2,057
Reacquisition costs	273	277
Deferred nuclear generating units	3,910	3,909
Total	$ 6,181	$ 6,243

Regulatory liabilities accounted for under provisions of SFAS No. 71 consist of unrealized gains related to mark-to-market valuations of coal contracts. The balances of TVA's regulatory liabilities at December 31, 2004 and September 30, 2004, were $575 million and $478 million, respectively, and are included in DEFERRED LIABILITIES on the Balance Sheets.

Although Bellefonte Nuclear Plant ("Bellefonte") remains in a deferred status, TVA continues to evaluate recovery options for the deferred nuclear generating units. The Board believes that the deferred nuclear generating units associated with the Bellefonte site have value to TVA and will develop a specific plan during 2005 to recover Bellefonte site costs upon receiving TVA management's recommendation.

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 at the time the legal obligation arises or costs are actually incurred.

The following table summarizes for each asset retirement obligation ("ARO") category the original asset cost, the ARO liability as of September 30, 2004, and December 31, 2004, the fair market value of any assets legally restricted for purposes of settling the obligations, and the estimated future liability at the time of retirement.

ARO Category	Original Asset Cost	September 30 2004 Obligation	December 31 2004 Obligation	Fair Market Value of Assets	Estimated Future Liability
			(in millions)		
Nuclear Plants	$ 470	$ 1,555	$ 1,577	$ 799	$ 10,212
Coal-Fired Plants	19	225	228	N/A	1,021
Gas/Oil Turbine Plants	1	2	2	N/A	45
Total	$ 490	$ 1,782	$ 1,807	$ 799	$ 11,278

TVA's total ARO liability increased $25 million during the first three months of 2005 due to accretion of the obligations. The nuclear accretion of $22 million was deferred and charged to a regulatory asset in accordance with SFAS No. 71. The remaining accretion expense of $3 million, related to coal-fired and gas/oil plants, was expensed during 2005.

During the first quarter of 2005, there was a change in the estimated closure date related to the Bellefonte diesel generator. The original estimate assumed plant closure in 2029 and a six year waiting period before closure work would begin in 2035. The new estimate assumes that closure work will begin at the date the plant ceases to operate in 2029. This change in estimate resulted in a decrease in the total future liability of nearly $1 million, and an increase in the current net present value of the ARO asset and liability of less than $0.1 million. Additionally, TVA is evaluating the potential implications of the Financial Accounting Standards Board's exposure draft, "*Accounting for Conditional Asset Retirement Obligations–an Interpretation of SFAS No. 143*."

Energy Prepayment Obligations

During October 2002, TVA introduced the Discounted Energy Units ("DEU") program. Under this program, TVA customers may purchase DEU, generally in $1 million increments, which entitle them to a $0.025/kilowatt-hour discount on a specified quantity of firm load over a period of years (five, ten, 15, or 20) for each kilowatt-hour in the prepaid block. The remainder of the price of the kilowatt-hours delivered is due upon billing.

As of December 31, 2004, TVA had entered into sales agreements for 54.5 DEU totalling $54.5 million of which $7.25 million is for the 2004 program. There have been no energy prepayment transactions during 2005. Total credits applied to power billings on a cumulative basis during the life of the program total over $10 million. Of this amount, over $1 million was recognized as revenue for the quarterly period ended December 31, 2004.

In November 2003, TVA, Memphis Light, Gas and Water Division ("MLGW"), and the City of Memphis entered into an arrangement whereby MLGW prepaid a portion of its power requirements for 15 years for a fixed amount of kilowatt-hours. The prepayment will be applied to MLGW's monthly power bill on a straight-line basis over the same 15-year period. The amount of the prepayment was $1.5 billion. Total credits applied to power billings on a cumulative basis during the life of the program exceed $115 million. Of this amount, $25 million was recognized as revenue for the quarterly period ended December 31, 2004. This amount was based on the ratio of kilowatt-hours of electricity delivered to the total kilowatt-hours under contract.

TVA is reporting the December 31, 2004, and September 30, 2004, obligations of $1,429 million and $1,455 million, respectively, to deliver power under these programs as ENERGY PREPAYMENT OBLIGATIONS and CURRENT PORTION OF ENERGY PREPAYMENT OBLIGATIONS on the December 31, 2004 and September 30, 2004 Balance Sheets.

Sale of Loans

On December 2, 2004, TVA sold a portfolio of 51 power distributor loans receivable. The portfolio was sold for $55 million without recourse and contained loans with maturities ranging from less than one year to over 34 years. The principal amount due on the loans at the time of the sale was $57 million. The $2 million loss is reported in OTHER INCOME, NET on the Income Statement for the quarter ended December 31, 2004.

Reduction in Workforce

During 2004, organizations within TVA performed program and staffing reviews to identify surplus staffing situations. For the areas identified, TVA provided the opportunity for certain qualifying employees to apply for voluntary resignations beginning in February 2004. In conjunction with the voluntary reduction process, TVA also instituted an involuntary reduction in force ("RIF") for certain employees. As of December 31, 2004, there were 707 employees impacted by the combined RIF actions, including 17 during the first quarter of 2005. TVA has recognized total expense in the amount of $37 million for termination costs incurred through December 31, 2004, of which $1 million is for the first

quarter of 2005. Payout of benefits occurs as employees retire from TVA, and substantially all affected employees will have retired by the end of 2005.

Changes in the associated liability are as follows:

	Termination Costs Liability Activity
	(in millions)
Termination costs liability at January 1, 2004	$ –
Liability incurred	23
Actual costs paid	(3)
Estimated medical benefits paid	–
Termination costs liability at March 31, 2004	20
Liability incurred	6
Actual costs paid	(12)
Estimated medical benefits paid	(1)
Termination costs liability at June 30, 2004	13
Liability incurred	7
Actual costs paid	(5)
Estimated medical benefits paid	(1)
Termination costs liability at September 30, 2004	14
Liability incurred	1
Actual costs paid	(5)
Estimated medical benefits paid	–
Termination costs liability at December 31, 2004	$ 10

Project Cancellation

In December 2003, TVA was notified that RTL would not proceed with manufacturing of the fuel cells to be installed in the partially completed Regenesys energy storage plant in Columbus, Mississippi. TVA had invested approximately $35 million in the Regenesys project and, accordingly, recognized a $35 million loss during the first quarter of 2004. Subsequently, RTL reimbursed TVA for early termination on the contract in the amount of $15 million in April 2004 resulting in a net project loss of $20 million for 2004.

Other

Certain reclassifications have been made to the 2004 financial statements to conform to the 2005 presentation.

Impact of New Accounting Pronouncements and Interpretations

Variable Interest Entities. In January 2003, the Financial Accounting Standards Board (“FASB”) published FASB Interpretation No. 46, “*Consolidation of Variable Interest Entities*,” which was revised by FASB Interpretation No. 46R (“46R”) in December 2003. The interpretation explains how to identify a variable interest entity (“VIE”) and how an enterprise assesses its interests in a VIE to decide whether to consolidate that entity. It also clarifies the application of Accounting Research Bulletin No. 51, “*Consolidated Financial Statements*,” to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation applies to nonpublic enterprises, and it becomes effective for TVA beginning October 1, 2005, for VIEs created on or before December 31, 2003, and immediately for VIEs created after December 31, 2003.

TVA has not identified any material VIEs created, or interests in VIEs obtained, after December 31, 2003, which require consolidation or disclosure under FIN 46R. TVA continues to assess the existence of any interests in VIEs created on or prior to December 31, 2003, which may or may not be material to its results of operations or financial position.

Pension and Other Postretirement Benefit Disclosures. In December 2003, the FASB issued SFAS No. 132 (revised), “*Employers’ Disclosures about Pensions and Other Postretirement Benefits*,” which improves financial statement disclosures for defined benefit plans and replaces existing FASB disclosure requirements for pensions. The guidance is effective for fiscal years ending after December 15, 2003, and for quarters beginning after December 15, 2003. TVA adopted this standard for the quarter beginning January 1, 2004, by making the required disclosures (see note 5).

Medicare Prescription Drug, Improvement and Modernization Act of 2003. In May 2004, the FASB issued Staff Position (“FSP”) FAS 106-2, “*Accounting for Disclosure Requirements Related to the Medicare Prescription Drug,*

Improvement and Modernization Act of 2003." This FSP provides accounting guidance for employers that sponsor defined benefit postretirement health care plans that provide prescription drug benefits, and requires those employers to provide certain disclosures regarding the effect of the federal subsidy provided by this act. TVA has elected to continue its study of the particulars contained in the accounting guidance and, accordingly, has not determined either the existence of a subsidy or an estimate of the value of any such subsidy at this time. TVA adopted the nonpublic disclosure requirements of the FSP for interim reporting periods beginning after January 1, 2004, and subsequently transitioned to the disclosure requirements for public entities for the reporting periods ended September 30, 2004, and thereafter. It is likely that during 2005, TVA will not only make a determination of the propriety and amount of any such subsidy but also the manner in which it will account for such a subsidy, should it exist.

Inventory Costs. In November 2004, the FASB issued SFAS No. 151, "*Inventory Costs—an amendment of ARB No. 43, Chapter 4*." This statement amends the guidance in ARB ("Accounting Research Bulletin") No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). The statement requires that those items be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement shall become effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted. The adoption of SFAS No. 151 is not expected to have a material impact on TVA's results of operations or financial condition.

Exchanges of Nonmonetary Assets. In December 2004, the FASB published SFAS No. 153, "*Exchanges of Nonmonetary Assets – an amendment of APB Opinion No. 29*," which eliminates the exception to fair value for exchanges of similar productive assets and replaces it with a general exception for exchange transactions that do not have commercial substance—that is, transactions that are not expected to result in significant changes in the cash flows of the reporting entity. This statement is intended to produce financial reporting that more faithfully represents the economics of the transactions. This guidance is effective for fiscal periods beginning after June 15, 2005, and shall be applied prospectively. The adoption of SFAS No. 153 is not expected to have a material impact on TVA's results of operations or financial condition.

2. Proprietary Capital

Accumulated Other Comprehensive Income

SFAS No. 130, "*Reporting Comprehensive Income*," requires the disclosure of comprehensive income to reflect changes in capital that result from transactions and economic events from non-owner sources. The increase for the three months ended December 31, 2004 and 2003, is due to unrealized gains related to mark-to-market valuation adjustments for certain derivative instruments.

Total Other Comprehensive Income (Loss) Activity

	2004	2003
	(in millions)	
Accumulated other comprehensive loss, September 30	$ (52)	$ (74)
Changes in fair value of interest rate swaps	–	(3)
Changes in fair value of foreign currency swaps	66	18
Accumulated other comprehensive income, December 31	$ 14	$ (59)

3. Debt Securities

TVA issues power bonds pursuant to Section 15d of the TVA Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution. Power Bonds in each series must be further authorized by Supplemental Resolution.

The table below summarizes TVA's debt securities activity for the period from October 1, 2004 to December 31, 2004.

Activity from October 1, 2004 to December 31, 2004
(in millions)

Redemptions/Maturities:	Date	Amount	Interest Rate
electronotes®	First Quarter 2005	$ 3	5.06%

Issues:
none

In December 2004, TVA notified bondholders that on January 15, 2005, it will redeem at par all of its 2002 6.125 percent electronotes® due January 15, 2017 with a par amount of $62 million (see note 9).

4. Risk Management Activities and Derivative Transactions

TVA is exposed to market risks including changes in interest rates, foreign currency exchange rates and certain commodity and equity market prices. To manage the volatility attributable to these exposures, TVA has entered into various nontrading derivative transactions, principally interest rate swap agreements, foreign currency swap contracts and option and swaption contracts.

The recorded amounts of these derivative financial instruments are as follows:

Mark-to-Market Values of Derivative Transactions

	Asset/(Liability)	
	At December 31 2004	**At September 30 2004**
	(in millions)	
Interest rate swaps:		
Inflation bond issue	$ 5	$ 2
$476 million notional	(130)	(140)
Currency swaps:		
Deutschemark (DM1.5 billion)	43	(62)
Sterling (GBP200 million)	49	13
Sterling (GBP250 million)	128	79
Sterling (GBP150 million)	60	32
Swaption:		
$1 billion notional	(237)	(225)
Emission allowance call options	–	6
Coal contracts	575	478
Purchase power contracts	(54)	(59)

5. Benefit Plans

TVA sponsors a noncontributory defined benefit pension plan for substantially all employees. In addition, TVA sponsors a substantially contributory postretirement plan for health care and other benefits for retirees of TVA that meet certain eligibility requirements and who elect participation at the time of retirement.

The following table provides the components of net periodic benefit cost for the plans:

	Pension Benefits Three Months Ended December 31		Other Benefits Three Months Ended December 31	
	2004	2003	2004	2003
	(in millions)			
Service Cost	$ 31	$ 28	$ 2	$ 1
Interest Cost	109	102	6	5
Expected return on plan assets	(114)	(116)	–	–
Amortization of prior service costs	9	9	1	1
Amortization of losses	33	22	2	–
Cost of special events	–	–	–	2
Net periodic benefit	$ 68	$ 45	$ 11	$ 9

During the three months ended December 31, 2004, TVA did not make contributions to its pension plan. However, the Board approved $53 million in pension contributions during 2005 with scheduled contributions of $27 million and $26 million to be made in March and September, respectively. TVA does not separately set aside assets to fund other benefit costs, but rather funds such costs on an as-paid basis. TVA provided approximately $6 million during the three months ended December 31, 2004, to fund other benefits costs.

6. Commitments and Contingencies

The estimated commitments for TVA as of December 31, 2004 are as follows:

	2005*	2006	2007	2008	2009	Thereafter	Total
				(in millions)			
Debt	$ 3,989	$ 2,621	$ 961	$ 91	$ 2,031	$ 13,622	$ 23,315
Leases	56	73	65	60	58	89	401
Lease/leaseback	75	85	85	89	84	1,301	1,719
Power purchase obligations	130	165	156	130	130	3,610	4,321
Other obligations	914	460	265	149	59	68	1,915
Fuel purchase obligations	602	396	237	216	143	392	1,986
Pension contribution	53	–	–	–	–	–	53
Total	$ 5,819	$ 3,800	$ 1,769	$ 735	$ 2,505	$ 19,082	$ 33,710

* Period January 1 – September 30, 2005

In addition to the cash requirements above, TVA has contractual obligations related to energy prepayments (see note 1—*Energy Prepayment Obligations*).

	2005*	2006	2007	2008	2009	Thereafter	Total
				(in millions)			
Energy prepayment obligations	$ 79	$ 106	$ 106	$ 106	$ 105	$ 927	$ 1,429

* Period January 1 – September 30, 2005

7. Legal Proceedings

In the fall of 1999, the Environmental Protection Agency ("EPA") commenced judicial or administrative actions against a number of utilities in the eastern United States, including TVA, alleging that they modified their coal-fired units without complying with the new source review ("NSR") requirements under the Clean Air Act ("CAA"). EPA issued an administrative order directing TVA to install additional pollution control equipment on 14 of its coal-fired units and evaluate whether more controls should be installed on other units. TVA challenged the validity of this order, and on June 24, 2003, the Court of Appeals for the Eleventh Circuit issued its decision in the case. Although the Eleventh Circuit did not rule on the merits of the case, the court held that the procedure used by EPA against TVA was unconstitution-

al because it allowed EPA to decide that a regulated party like TVA violated the law and could be liable for severe penalties without ever allowing the regulated party to present evidence on whether the law was in fact violated. On May 3, 2004, the United States Supreme Court denied a petition for review filed on behalf of EPA, refusing to review the Eleventh Circuit's decision. EPA has taken no legal action against TVA on these allegations since this decision by the United States Supreme Court.

On November 10, 2004, North Carolina sent the EPA a Notice of Intent to Sue TVA for violations of the Clean Air Act (the "Notice"). North Carolina may file a lawsuit in federal court 60 days after November 15, the date TVA received the Notice. North Carolina alleges that TVA violated the NSR requirements of the Clean Air Act (among other state and federal regulations) by modifying nine fossil plants located in Alabama, Kentucky, and Tennessee, without having these modifications reviewed by the EPA or the states to determine if new emission controls or technologies needed to be put in place. North Carolina asserts that these actions have contributed to the degradation of air quality in North Carolina. These allegations are similar to those involved in the EPA's administrative order dismissed by the Eleventh Circuit.

The National Parks Conservation Association ("NPCA") and the Sierra Club filed cases in two federal district courts in 2001 alleging similar NSR violations to those in EPA's administrative order at TVA's Bull Run Fossil Plant ("Bull Run") and Colbert Fossil Plant Unit 5 ("Colbert"). These cases had been stayed pending the Supreme Court's decision on the Eleventh Circuit's ruling, but in light of the Supreme Court's action, the stays have been lifted. Trial in both cases has been bifurcated between liability and remedies, and the liability trial has been set in Sierra Club's action involving the Bull Run case for September 20, 2005. In the Bull Run case, the parties have each filed motions for summary judgment or partial summary judgment on various issues. In the Sierra Club's Colbert case, a final pretrial scheduling conference is set for November 30, 2005, and the liability trial is scheduled to begin four to eight weeks thereafter.

The Alabama Environmental Council and the Sierra Club filed a lawsuit in federal district court in Florence, Alabama, alleging that TVA violated Clean Air Act ("CAA") opacity limits applicable to Colbert Fossil Plant between July 1, 1997, and June 30, 2002. The groups sought a court order that could require TVA to incur substantial costs in addition to the costs TVA is already planning to incur for environmental controls, and to pay civil penalties of up to approximately $250 million. On September 14, 2004, the court found that TVA had not violated the CAA, and the complaint was dismissed in its entirety. The plaintiffs have appealed the district court's decision to the Court of Appeals for the Eleventh Circuit.

On July 25, 2003, TVA received a notice of intent to sue from Our Children's Earth Foundation ("OCE"). OCE alleges that TVA violated the NSR requirements of the CAA by undertaking major modifications of TVA's Allen Unit 3, Bull Run, Cumberland Units 1 and 2, Kingston Units 6 and 8, John Sevier Unit 3, Paradise Units 1, 2, and 3, Shawnee Units 1 and 4, Colbert Unit 5, and Widows Creek Unit 5. OCE also alleges the CAA new source performance standards at Colbert Unit 5 and the operations at TVA's Johnsonville Fossil Plant have not met the applicable opacity requirements. This notice does not allege a specific amount of damages. OCE's allegations about Bull Run and Colbert Unit 5 are already the subject of litigation in federal district courts initiated by the NPCA and the Sierra Club. In October 2004, OCE obtained the district court's permission to join as a plaintiff in the Bull Run NSR suit. It made a similar request in the Colbert NSR suit, which the court denied as untimely.

The Sierra Club gave notice in a September 26, 2002, letter that it intends to sue TVA for violating CAA opacity limits applicable to the John Sevier and Kingston Fossil Plants. The notice claims that TVA violated opacity standards at the two plants from July 1, 1997, to the present. The alleged opacity violations substantially overlap those that were challenged in a lawsuit filed by the NPCA three years ago in federal court in Knoxville, Tennessee. TVA ultimately prevailed in that lawsuit.

On December 28, 2001, Bowater Incorporated and Bowater Newsprint South, Inc. (together, "Bowater") filed a lawsuit against TVA in federal court in Knoxville challenging TVA's charges for Economy Surplus Power ("ESP") and Testing and Restart Power ("TRP") for two Bowater plants. The lawsuit seeks, among other things, compensatory damages in excess of $45 million, plus interest. TVA and Bowater have reached agreement in principle to settle the lawsuit by entering into revised and extended power supply arrangements at the two plants. Additionally, as part of the settlement, the litigation would be dismissed with prejudice, and TVA would not be liable to Bowater for the damages sought. The settlement and revised contracts are expected to be finalized in the near future.

On August 31, 1999, Birmingham Steel Corporation filed a lawsuit in the U.S. District Court for the Northern District of Alabama alleging that TVA overcharged for ESP during the summer of 1998. The lawsuit was filed as a class action on behalf of industrial customers who participated in TVA's ESP program. Under ESP contracts, the hourly ESP energy price is calculated using TVA's actual incremental cost of supplying the ESP load in each hour. The plaintiff alleges that TVA overcharged for ESP during the summer of 1998 by including in the price of ESP some costs that were added

to TVA's incremental cost. The complaint seeks over $100 million in damages on behalf of Birmingham Steel and the other class members. In September 2002, the district court decertified the class and then dismissed Birmingham Steel's individual claim without prejudice on a jurisdictional issue. The class lawyers appealed the ruling on class decertification, and in December 2003, the U.S. Court of Appeals for the Eleventh Circuit reversed that ruling and sent the case back to the district court to allow the class lawyers a reasonable time to find a new class representative. The district court allowed the substitution of Johns Manvill Corporation (the other proposed representative) to represent the class. Pretrial preparations continue while awaiting a trial date.

In July 2004, two lawsuits were filed against TVA in federal court in New York City alleging that global warming is a public nuisance and that carbon dioxide ("CO_2") emissions from TVA's fossil-fired electric generating facilities should be ordered abated because they contribute to causing the nuisance. The first case was filed by the States of California, Connecticut, Iowa, New Jersey, New York, Rhode Island, Vermont, and Wisconsin and the City of New York against TVA, American Electric Power, Inc., American Electric Power Service Corporation, Southern Company, Xcel Energy, Inc., and Cinergy Corporation. The second case, which also alleges private nuisance, was filed against the same defendants by Open Space Institute, Inc., Open Space Conservancy, Inc., and the Audubon Society of New Hampshire. There are no CAA requirements limiting CO_2 emissions, and, accordingly, the suits do not involve allegations of regulatory noncompliance. The theory of the cases is that global warming constitutes a nuisance and defendants' CO_2 emissions are contributing to the nuisance. Plaintiffs do not seek monetary damages, but do seek injunctive relief. Specifically, plaintiffs seek a court order requiring each defendant to cap its CO_2 emissions and then reduce these emissions by a specified percentage each year for at least a decade. The defendants filed motions to dismiss, and briefing on the motions was completed in December 2004. TVA is awaiting decisions on the pending motions.

In December 2004, a federal judge in Nashville, Tennessee, dismissed a lawsuit filed against TVA and 22 electric cooperatives by Tennessee residents and customers of some of the cooperatives, in part challenging TVA's practice of setting rates for electric power charged by distributors via its contracts. Both TVA and the cooperatives had filed motions to dismiss, which the court granted. The judge dismissed the plaintiffs' claims alleging violations of state law because the plaintiffs failed to carry out the steps necessary to bring these claims in court. The dismissal was without prejudice, allowing the plaintiffs to re-file the claims if these steps are carried out and suit is filed within the statutory limitations period. As to the plaintiffs' allegations of federal law violations, the court found that Congress had specifically authorized TVA to set the rates charged by distributors via its contracts. In the face of such express Congressional authorization, the plaintiffs' federal law claims failed as a matter of law and were dismissed with prejudice, precluding them from being brought again.

It is not possible to predict with certainty whether TVA will incur any liability or to estimate the damages, if any, that TVA might incur in connection with the lawsuits described above except as specifically noted.

8. Stewardship Responsibilities

During the first quarter of 2005, TVA continued to conduct certain nonpower programs including managing navigable river channels, providing flood control and overseeing certain recreation facilities. TVA's responsibilities include general stewardship of land, water, and wildlife resources. Historically, Congressional appropriations provided most of the funding for TVA's nonpower programs, and TVA has obtained additional funds from revenues and user fees from the nonpower programs. In October 1997, Congress passed legislation that 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 there were insufficient appropriations or other available funds to pay for such activities in any year. Beginning in 2000, Congress stopped providing appropriations to TVA to fund essential stewardship activities. TVA primarily is using power funds (along with user fees and other forms of nonpower revenues) to continue to fund these stewardship activities. TVA spent approximately $17 million on essential stewardship activities during each of the first three months of 2005 and 2004, and recognized depreciation expense on nonpower assets of $3 million in each period.

9. Subsequent Events

Sale of Buildings
On January 6, 2005, TVA held a public auction for the sale of two buildings in Norris, Tennessee. The winning bidder purchased the property for $0.7 million. The book value of the property is approximately $0.7 million, so TVA will not recognize a gain or loss on the sale.

The party with the option to purchase the East Tower of the Knoxville Office Complex extended the option period for 90 days so that the option now expires on May 23, 2005. (See Board Actions.)

Debt Securities

On January 15, 2005, TVA redeemed all of its 2002 6.125 percent electronotes® due January 15, 2017, with a par amount of $62 million.

In February 2005, TVA made notification that on March 15, 2005, it will redeem at par all of its 2002 5.875 percent electronotes® due March 15, 2017, with a par amount of $10 million. Also in February 2005, TVA made notification that on March 18, 2005, it will redeem at par all of its 2000 Series E 7.75 percent power bonds due March 18, 2030, with a par amount of $100 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") explains the results of operations and general financial condition of TVA. The MD&A should be read in conjunction with the accompanying Financial Statements and the 2004 Information Statement dated November 24, 2004.

Overview

Although the transition to a deregulated market has slowed, TVA continues to prepare for potential changes in the market that could affect TVA, its stakeholders, and the way TVA fulfills its obligations. TVA's financial health in the future will depend on what changes may come and how well it is able to adapt to those changes. TVA continues to evaluate and focus on four strategic areas outlined in the Strategic Plan adopted in 2004:

- Developing new, more highly differentiated prices, services, and contract terms that more closely tie the cost and the risk of the product to its terms and pricing.
- Addressing the range of issues related to wholesale market design and transmission pricing, including how TVA will interface with the markets that are expected to surround it, as well as how TVA will price transmission services within its service area when distributors can choose other suppliers.
- Retiring total financing obligations and driving to higher interest-coverage ratios in order to provide the financial flexibility needed to tolerate the higher levels of revenue and cost volatility associated with a more competitive market.
- Maintaining and operating its generation and transmission assets so that it can continue to fulfill its supply obligations in a safe and reliable manner.

For an in-depth discussion of TVA's business strategy and economic factors, see "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" in TVA's 2004 Information Statement for the year ended September 30, 2004.

Results of Operations

Net income for the first quarter of 2005 was $90 million compared to $68 million for the same period of 2004. Significant items contributing to the $22 million increase in net income for the three months ended December 31, 2004, as compared to December 31, 2003, include:

- A $33 million increase in off-system sales due to increased generation available for sale, and favorable market conditions,
- A one time loss of $35 million recognized in the first quarter of 2004 due to the cancellation of the Regenesys project,
- A $17 million increase in revenue from directly served industries due in large part to increased power demand reflecting favorable economic conditions,
- A $5 million increase in unrealized gains on derivative contracts due to favorable market conditions involving certain derivative contracts which were marked to market, and
- A $16 million decrease in interest expense for long-term debt, due in large part to a lower average outstanding balance of long-term debt.

These items were partially offset by:

- A $42 million increase in fuel expense attributable to a four percent increase in production coupled with higher coal prices, and
- A $23 million increase in pension expense (a component of Operating and Maintenance) due primarily to increased interest cost coupled with increased amortization of actuarial loss.

Operating Revenues
A detailed table of operating revenue for the three month periods is as follows:

	Three months ended December 31		
	2004	2003	Percent Change
	(in millions)		
Operating revenues			
Sales of electricity			
Municipalities and cooperatives	$ 1,525	$ 1,521	0.3%
Industries directly served	215	198	8.6%
Federal agencies and other	73	37	97.3%
Other revenue	21	21	(0.0%)
Total operating revenues	$ 1,834	$ 1,777	3.2%

Significant items contributing to the $57 million increase in operating revenue for the three months ended December 31, 2004, as compared to December 31, 2003, include:

- A $33 million increase in off-system sales due to increased generation available for sale and market prices which were higher than TVA's incremental cost, and
- A $17 million increase in sales to industries directly served, attributable to higher consumption reflecting favorable economic conditions.

A detailed table of electricity sales for the three month periods ended December 31, 2004, and 2003 is as follows:

	Three months ended December 31		
	2004	2003	Percent Change
	(millions of kWh)		
Sales of electricity			
Municipalities and cooperatives	31,485	30,787	2.3%
Industries directly served	8,242	7,687	7.2%
Federal agencies and other	1,876	982	91.0%
Total sales of electricity	41,603	39,456	5.4%

Significant items contributing to the 2,147 million kilowatt-hour increase in electricity sales include:

- A 698 million kilowatt-hour, or 2.3 percent, increase in sales to municipalities and cooperatives reflecting normal demand growth,
- An 850 million kilowatt-hour increase in off-system electricity sales due to available generation and market prices that were higher than TVA's incremental cost, and
- A 555 million kilowatt-hour increase in sales to directly served industries due in large part to increased demand for electricity products that are based on TVA's incremental cost.

Operating Expenses

A detailed table of operating expenses for the three month periods is as follows:

	Three months ended December 31		
	2004	2003	Percent Change
	(in millions)		
Operating expenses			
Fuel and purchased power	$ 477	$ 430	10.9%
Operating and maintenance	582	558	4.3%
Depreciation and accretion	285	275	3.6%
Tax-equivalents	91	84	8.3%
Loss on project cancellation	–	35	–
Total operating expenses	$ 1,435	$ 1,382	3.8%

Significant items contributing to the $53 million increase in operating expenses include:

- A $38 million increase in fossil fuel expense attributable to higher coal prices and increased generation at coal fired plants,
- A $4 million increase in nuclear fuel cost due primarily to higher nuclear generation reflecting fewer refueling outages at TVA's nuclear plants in the first quarter of 2005,
- A $6 million increase in purchased power which can be attributed to higher market prices,
- A $23 million increase in pension expense due primarily to increased interest cost coupled with an increased amortization of actuarial loss, and
- A $10 million increase in depreciation expense attributable to capital projects placed in service.

These items are partially offset by:

- Increased hydro generation of 717 million kilowatt-hours (or 16 percent), and
- A one time loss of $35 million recognized in the first quarter of 2004 due to the cancellation of the Regenesys project.

Other Income, Net
Significant items contributing to the $2 million decrease in other income for the three months ended December 31, 2004, as compared to December 31, 2003, include a $2 million loss related to the sale of the receivables associated with the distributor loan program.

Unrealized Gain (Loss) on Derivative Contracts, Net
Significant items contributing to the $4 million unrealized net gain on derivative contracts for the three months ended December 31, 2004, as compared to the $1 million unrealized net loss on derivative contracts for the three months ended December 31, 2003, include a $9 million unrealized gain related to the mark-to-market valuation adjustment of an interest rate swap contract, partially offset by a $5 million unrealized loss related to the mark-to-market valuation of SO_2 emissions allowance call options.

Interest Expense
A detailed table of interest expense for the three month periods is as follows:

	Three months ended December 31		
	2004	**2003**	**Percent Change**
Interest expense	(in millions)		
Interest on debt	$ 339	$ 348	(2.6%)
Amortization of debt discount, issue, and reacquisition costs, net	5	7	(28.6%)
Allowance for funds used during construction	(26)	(22)	18.2%
Net interest expense	$ 318	$ 333	(4.5%)

Significant items contributing to the $15 million decrease in interest expense include:

- A reduction of approximately $1.3 billion in the average balance of long-term debt outstanding,
- A $4 million increase in Allowance for Funds Used During Construction due to a higher level of construction work-in-progress in 2005.

These items are partially offset by:

- An increase in the average long-term interest rate from 6.23 percent to 6.45 percent, and
- An increase of approximately $308 million in the average balance of short-term debt outstanding and an increase in average short-term interest rates from 1.00 percent to 1.93 percent.

Material Changes in Liquidity and Capital Resources

Comparative Cash Flow Analysis
Net cash provided by operating activities decreased $1,632 million from $1,635 million to $3 million for the three month periods ending December 31, 2003, and 2004, respectively. The decrease is primarily due to:

- Proceeds of $1.5 billion received in 2003 for energy prepayments not present in the current year, and
- An increase in cash paid for fuel and purchased power of $44 million due to higher coal prices for fossil fuel and higher market prices for purchased power; offset by
- A decline in cash outlays for interest of $9 million, primarily due to a reduction in the average balance of long-term debt outstanding,
- A decrease of $25 million in expenditures for nuclear refueling outages due to the number and timing of outages, and
- A decrease in cash outlays for O&M costs of $25 million, primarily due to the reduction in workforce.

Cash used for working capital components increased $172 million, from $250 million in the first quarter of 2004 to $422 million in the first quarter of 2005. This increase resulted from:

- The purchase of short-term investments of $114 million,
- A $19 million increase in inventories and other assets in the first quarter of 2005 as compared to a $7 million decrease in inventories and other assets in the first quarter of 2004, primarily due to the purchase of SO_2 allowances and an increase in certain contract prepayments related to the Browns Ferry Unit 1 restart project,
- A larger reduction in accounts payable and accrued liabilities of $21 million due to timing of accruals made in 2004 and paid in 2005, and
- A larger reduction in accrued interest of $13 million due to a lower level of long-term debt outstanding.

Cash used in investing activities decreased $40 million, from $371 million to $331 million for the three month periods ending December 31, 2003, and 2004, respectively, primarily due to:

- A decrease in expenditures for capital projects of $59 million, primarily due to decreases in clean air expenditures offset by increases in expenditures for the Browns Ferry Unit 1 restart, and
- Proceeds received from the sale of certain power distributor loans receivable of $55 million (see note 1); offset by
- An increase in the fabrication of nuclear fuel of $83 million in preparation for the upcoming reloads during 2005.

In the first quarter of 2004, three nuclear plants completed reloads. In the first quarter of 2005, one nuclear plant completed a reload and two additional reloads are scheduled in the second quarter.

Net cash provided by financing activities was $51 million for the three months ended December 31, 2004, compared with net cash used by financing activities of $1,520 million for the same period of 2003. The change is related primarily to:

- A decrease of $412 million in redemptions of long-term debt, and
- Net short-term debt issues of $65 million in the first quarter of 2005 compared to net short-term debt redemptions of $1,184 million in the first quarter of 2004 due primarily to the approximately $1.5 billion in proceeds received from energy prepayments in the first quarter of 2004; offset by
- A decrease of $93 million in long-term debt issues.

Working Capital
At December 31, 2004, TVA had negative working capital of $3,057 million, largely attributable to current maturities of long-term debt of $2,000 million and short-term indebtedness of $1,989 million. The table below summarizes the components of working capital and discount notes with maturities of less than 90 days. It is TVA's cash management policy to use short-term notes to meet current obligations, and TVA plans to continue to use such financing instruments as long as short-term interest rates remain favorable.

	December 31 2004	September 30 2004
	(in millions)	
Current assets	$ 2,192	$ 2,386
Current liabilities	(5,249)	(5,511)
Working capital	$ (3,057)	$ (3,125)
Discount notes <90 days	$ 1,989	$ 1,924
Current maturities of long-term debt	2,000	2,000
Total short-term debt	$ 3,989	$ 3,924

Financing Activities

Capital Resources. From October 1, 2004, to December 31, 2004, TVA redeemed $3 million of electronotes® carrying an average interest rate of 5.06 percent at par. TVA did not issue any bonds during this period.

Sale of Loans. On December 2, 2004, TVA sold a portfolio of 51 power distributor loans receivable. The portfolio was sold for $55 million without recourse and contained loans with maturities ranging from less than one year to over 34 years. The principal amount due on the loans at the time of the sale was $57 million. The $2 million loss is reported in Other Income, Net on the Income Statement for the quarter ended December 31, 2004.

Energy Prepayment Obligations. During October 2002, TVA introduced the Discounted Energy Units ("DEU") program. Under this program, TVA customers may purchase DEU generally in $1 million increments, which entitle them to a $0.025/kilowatt-hour discount on a specified quantity of firm load over a period of years (five, ten, 15, or 20) for each kilowatt-hour in the prepaid block. The remainder of the price of the kilowatt-hours delivered is due upon billing.

As of December 31, 2004, TVA had entered into sales agreements for 54.5 DEU totalling $54.5 million of which $7.25 million is for the 2004 program. There have been no energy prepayment transactions during 2005. Total credits applied to power billings on a cumulative basis during the life of the program exceed $10 million. Of this amount, over $1 million was recognized as revenue for the quarterly period ended December 31, 2004.

In November 2003, TVA, Memphis Light, Gas and Water Division ("MLGW"), and the City of Memphis entered into an arrangement whereby MLGW prepaid a portion of its power requirements for 15 years for a fixed amount of kilowatt-hours. The prepayment will be applied to MLGW's monthly power bill on a straight-line basis over the same 15-year period. The amount of the prepayment was $1.5 billion. Total credits applied to power billings on a cumulative basis during the life of the program total over $115 million. Of this amount, $25 million was recognized as revenue for the quarterly period ended December 31, 2004.

TVA is reporting the December 31, 2004, and September 30, 2004, obligations of $1,429 million and $1,455 million, respectively, to deliver power under these programs as Energy Prepayment Obligations and Current Portion of Energy Prepayment Obligations on the December 31, 2004 and September 30, 2004 Balance Sheets.

Cash Requirements and Contractual Obligations. The estimated cash requirements and contractual obligations for TVA as of December 31, 2004, are as follows:

	2005*	2006	2007	2008	2009	Thereafter	Total
			(in millions)				
Debt	$ 3,989	$ 2,621	$ 961	$ 91	$ 2,031	$ 13,622	$ 23,315
Leases	56	73	65	60	58	89	401
Lease/leaseback	75	85	85	89	84	1,301	1,719
Power purchase obligations	130	165	156	130	130	3,610	4,321
Other obligations	914	460	265	149	59	68	1,915
Fuel purchase obligations	602	396	237	216	143	392	1,986
Pension contribution	53	–	–	–	–	–	53
Total	$ 5,819	$ 3,800	$ 1,769	$ 735	$ 2,505	$ 19,082	$ 33,710

* Period January 1- September 30, 2005

In addition to the cash requirements above, TVA has contractual obligations related to energy prepayments (see note 1—Energy Prepayment Obligations).

	2005*	2006	2007	2008	2009	Thereafter	Total
			(in millions)				
Energy prepayment obligations	$ 79	$ 106	$ 106	$ 106	$ 105	$ 927	$ 1,429

* Period January 1- September 30, 2005

As of December 31, 2004, TVA's decommissioning trust funds totaled approximately $799 million which is less than the present value of the estimated future decommissioning costs calculated in accordance with Nuclear Regulatory Commission ("NRC") requirements. In March 2003, TVA submitted its biennial letter to the NRC on the funding status of the Nuclear Decommissioning Trust versus its liabilities. In the letter, TVA stated that it is considering several alternatives to provide additional funding assurance methods and is assessing the need for future action on an ongoing basis. The current status of the fund has been primarily influenced by declines in market value as well as increases in the projected decommissioning costs. Moderate market recovery along with the achievement of planned license renewal of Browns Ferry Nuclear Plant Unit 1 within the near term is expected to restore overall funding adequacy. These factors will have a significant impact on the status of the fund and prudent planning obligates TVA to take them into account in considering future fund contributions.

Impact of New Accounting Pronouncements and Interpretations

Variable Interest Entities

In January 2003, the Financial Accounting Standards Board ("FASB") published FASB Interpretation No. 46, "*Consolidation of Variable Interest Entities*," which was revised by FASB Interpretation No. 46R ("46R") in December 2003. This interpretation explains how to identify variable interest entities ("VIEs") and how an enterprise assesses its interests in a VIE to decide whether to consolidate that entity. It also clarifies the application of Accounting Research Bulletin No. 51, "*Consolidated Financial Statements*," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation applies to nonpublic enterprises, and it becomes effective for TVA beginning October 1, 2005, for VIEs created on or before December 31, 2003, and immediately for VIEs created after December 31, 2003.

TVA has not identified any material VIEs created, or interests in VIEs obtained, after December 31, 2003, which require consolidation or disclosure under FIN 46R. TVA continues to assess the existence of any interests in VIEs created on or prior to December 31, 2003, which may or may not be material to its results of operations or financial position.

Pension and Other Postretirement Benefit Disclosures

In December 2003, the FASB issued SFAS No. 132 (revised), Employers' Disclosures about Pensions and Other Postretirement Benefits, which improves financial statement disclosures for defined benefit plans and replaces existing FASB disclosure requirements for pensions. The guidance is effective for fiscal years ending after December 15, 2003, and for quarters beginning after December 15, 2003. TVA adopted this standard for the quarter beginning January 1, 2004.

Medicare Prescription Drug, Improvement and Modernization Act of 2003

In May 2004, the FASB issued Staff Position ("FSP") FAS 106-2, "*Accounting for Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*." This FSP provides accounting guidance for employers that sponsor defined benefit postretirement health care plans that provide prescription drug benefits, and requires those employers to provide certain disclosures regarding the effect of the federal subsidy provided by this act. TVA has elected to continue its study of the particulars contained in the accounting guidance and, accordingly, has not determined either the existence of a subsidy or an estimate of the value of any such subsidy at this time. TVA adopted the nonpublic disclosure requirements of the FSP for interim reporting periods beginning after January 1, 2004, and subsequently transitioned to the disclosure requirements for public entities for the reporting periods ended September 30, 2004, and thereafter. It is likely that during 2005, TVA will not only make a determination of the propriety and amount of any such subsidy but also the manner in which it will account for such a subsidy, should it exist.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, "*Inventory Costs--an amendment of ARB No. 43, Chapter 4*." This statement amends the guidance in ARB ("Accounting Research Bulletin") No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). The statement requires that those items be recognized as current-period charges. In addition, this state-

ment requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement shall become effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted. The adoption of SFAS No. 151 is not expected to have a material impact on TVA's results of operations or financial condition.

Exchanges of Nonmonetary Assets
In December 2004, the FASB published SFAS No. 153, "*Exchanges of Nonmonetary Assets–an amendment of APB Opinion No. 29*," which eliminates the exception to fair value for exchanges of similar productive assets and replaces it with a general exception for exchange transactions that do not have commercial substance--that is, transactions that are not expected to result in significant changes in the cash flows of the reporting entity. This statement is intended to produce financial reporting that more faithfully represents the economics of the transactions. This guidance is effective for fiscal periods beginning after June 15, 2005, and shall be applied prospectively. The adoption of SFAS No. 153 is not expected to have a material impact on TVA's results of operations or financial condition.

Risk Factors and Forward-Looking Statements

Weather Risk
TVA is subject to short-term variability in weather, including both temperature variations and drought conditions affecting hydroelectric generation. Over periods of one year or longer, however, the financial risks associated with weather are modest, for reasons including averaging of effects over a large service territory, averaging of effects over different times of the year as TVA is a "double-peaking utility," and nominal changes in hydroelectric availability during high-value periods.

Operational Risk
Due to the size and diversity of the TVA generation fleet and the redundancy and robustness of the transmission system, the financial risks associated with the operation of the system are modest over periods of one year or longer.

Rate Setting
In a future restructured electric power industry, it is possible that the ability of the Board to set TVA's rates as specified in the TVA Act could be adversely affected by legislative changes or by competitive pressures.

Risk of Loss of Customers
The 1959 amendments to the TVA Act provide that, subject to certain minor exceptions, neither TVA nor its distributors may be a source of power supply outside TVA's defined service area. 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 territory that includes most of Tennessee and parts of six other states: Kentucky, Mississippi, Alabama, Georgia, North Carolina, and Virginia.

While the Fence confines TVA to the Tennessee Valley, the so-called "anti-cherrypicking provision" provides that the Federal Energy Regulatory Commission cannot order TVA to deliver power from an outside source to a customer if the power would be consumed within the TVA service territory. Thus, TVA cannot be ordered to provide access to its transmission lines for the purpose of delivering power to wholesale customers within the Valley.

The "anti-cherrypicking provision" minimizes the financial exposure of TVA to loss of distributor customers due to their limited access to transmission resources.

In January 2005, TVA received notice from the Princeton Electric Plant Board ("PEPB") terminating its power contract with TVA effective January 2010. PEPB is a municipal distributor in Princeton, Kentucky. In 2004, less than 0.1 percent of TVA's total operating revenues came from sales to PEPB.

Since October 2002, seven distributors including PEPB have given notice that terminates their power contracts with TVA. Six of these seven distributors are located in Kentucky, where neighboring power suppliers enjoy significant competitive advantages. These six distributors are PEPB, Bowling Green Municipal Utilities, Warren Rural Electric Cooperative Corporation, Monticello Electric Plant Board, Glasgow Electric Plant Board, and Paducah Power System. The seventh distributor, Duck River Electric Membership Corporation, is located in Tennessee.

Another distributor, Meriwether Lewis Electric Cooperative ("MLEC"), gave TVA a notice terminating its power contract, but in 2004, its notice of contract termination was withdrawn and deemed to be of no force and effect by the mutual agreement of TVA and MLEC.

The table below lists PEPB and the other six distributors that have given notice that terminates their power contracts

with TVA, the date that their power contracts with TVA terminate, the amount of revenues that TVA generated by selling power to these distributors in 2004, and the percentage of TVA's total 2004 operating revenues represented by these revenues.

Distributor	Date of Termination of Power Contract	Sales to Distributor in 2004	Percentage of Total Operating Revenues in 2004
		(in millions)	
Bowling Green Municipal Utilities	October 2007	$ 43	0.6%
Warren Rural Electric Cooperative Corporation	April 2008	80	1.1%
Duck River Electric Membership Corporation	August 2008	80	1.1%
Monticello Electric Plant Board	November 2008	5	0.1%
Glasgow Electric Plant Board	December 2008	18	0.2%
Paducah Power System	December 2009	32	0.4%
Princeton Electric Plant Board	January 2010	5	0.1%
Total		$ 263	3.6%

A number of TVA distributors, including some with the largest loads, have expressed interest in further revising their wholesale power contracts to allow them more options with respect to contract term and other matters, such as purchasing a portion of their power requirements from suppliers other than TVA. TVA is working with distributors and the Tennessee Valley Public Power Association, an association which includes all distributors of TVA power, to develop new long-term contract options and future wholesale pricing options.

East Kentucky Power Cooperative ("EKPC") has filed an application with FERC ostensibly seeking an order requiring EKPC to be interconnected with TVA's transmission system. If this interconnection is granted, EKPC would be able to use TVA's transmission system to provide power to Warren Rural Electric Cooperative Corporation ("WRECC") when WRECC's contract with TVA terminates in April 2008. TVA has submitted a response to FERC stating that if FERC grants the requested relief, the actual effect would be to require TVA to provide free transmission service across TVA's transmission system in violation of the Anti-Cherrypicking Provision of the Federal Power Act.

Compliance with Environmental Regulations

TVA has incurred, and continues to incur, significant capital, operating, and other cost associated with compliance with environmental regulations. These costs could be even more significant in the future as a result of changes in legislation and other factors.

TVA continues to consider better, more cost-effective ways to reduce emissions in light of evolving emission reduction requirements. These efforts have led TVA to consider making some changes to its clean air compliance projects, such as delaying the construction at one of its generating plants, accelerating the switch to lower sulfur coal in certain circumstances, and transitioning to a nitrogen oxide ("NOx") emission reduction strategy that depends on selective catalytic reduction technology ("SCRs") and the proven technology of selective non-catalytic reduction ("SNCR"). As TVA moves forward to comply with increasingly stringent NOx and sulfur dioxide ("SO_2") emission reduction requirements, TVA also plans to make use of minimal amounts of purchased emission allowances.

Forward-Looking Statements

This Quarterly Report contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions, assumptions or otherwise relating to future events or performance may be forward-looking.

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

Examples of forward-looking statements include, but are not limited to, strategic objectives; estimates of costs for disposing of certain tangible long-lived assets; expectations about the adequacy of TVA's nuclear decommissioning fund; expectations about reaching a settlement in TVA's litigation with Bowater Incorporated and Bowater Newsprint South, Inc; the impact of new accounting pronouncements and interpretations, including Interpretation No. 46, "*Consolidation of Variable Interest Entities*," which was amended by FASB Interpretation No. 46R, and SFAS No. 151, "*Inventory Costs - an amendment of ARB No. 43, Chapter 4*"; TVA's plans to continue using short-term debt to meet current obligations; and the anticipated cost of returning Browns Ferry Unit 1 to service.

Although 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 restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA's generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; damage to power production or transmission facilities due to accidental events or terrorist activity; changes in accounting standards; and unforeseeable events. 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 from those contained in any forward-looking statement.

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

Legislative Activity

On December 8, 2004, President Bush signed Congress' "omnibus" spending bill, which included legislation on TVA Board governance and Securities and Exchange Commission reporting for TVA. The legislation restructures the Board by increasing the number of directors from three full-time members to nine part-time members, at least seven of whom must be legal residents of the TVA service area. As with the current Board, the future Board members will be appointed by the President and confirmed by the Senate, but will serve five-year terms rather than the current nine-year term. The Board's role will continue to be, among other things, to approve long-term plans and strategies for TVA, approve annual budgets and an employee compensation plan for TVA, and have general responsibility for TVA policies. The Board will also create an audit committee consisting of members of the Board "independent of management" to review reports from TVA's external auditors and Inspector General and make recommendations to the full Board. The legislation also reaffirmed the authority of the Board to set electric rates charged by TVA. These provisions will go into effect on the date when the Board has a quorum of five members or on May 18, 2005, whichever is the later. The members of the Board will select a member to serve as Chairman.

The legislation also creates the position of Chief Executive Officer ("CEO") for TVA. The CEO will be appointed by the Board and will be responsible for development and implementation of TVA's strategic direction.

Additionally, the legislation also amended the Securities Exchange Act of 1934 to provide that beginning with its annual report for fiscal year 2006, TVA must file annual reports (10-Ks), quarterly reports (10-Qs), and current reports (8-Ks) with the Securities and Exchange Commission. Also, TVA will be deemed an issuer for some of the audit-related provisions of section 10A of the Securities Exchange Act of 1934 but not for those provisions of section 10A that are inconsistent with TVA's structure under the TVA Act. TVA is not required to register its securities under either the Securities Act of 1933 or the Securities Exchange Act of 1934. The legislation provides that TVA securities are "government securities" under the Securities Exchange Act of 1934 and that nothing interferes with or affects the Board's authority to carry out its statutory functions under the TVA Act.

The American Jobs Creation Act, H.R. 4520, sometimes referred to as the corporate tax bill, became law in October 2004. It contains provisions designed to limit the future use of sale/leasebacks and lease/leasebacks by tax-exempt entities, such as TVA. During 2002 and 2003, TVA utilized such alternative financing arrangements for combustion turbine units and certain qualified technological equipment ("QTE"). The lease/leaseback arrangements for the combustion turbines resulted in proceeds of $645 million and the QTE lease/leaseback arrangements resulted in proceeds of $389 million. TVA accounted for the respective lease proceeds as financing obligations in accordance with SFAS No. 66, *Accounting for Sales of Real Estate*, and SFAS No. 98, *Accounting for Leases,* which are included on TVA's Balance Sheets at December 31, 2004.

Other

TVA has entered into a contract which required it to secure its payment obligations with a letter of credit. The letter of credit was issued by a commercial institution in the amount of $1.2 million on March 7, 2003. The letter of credit will expire on June 30, 2005, but may be renewed if the project associated with the letter is not complete. As of December 31, 2004, TVA's liability associated with this project was less than $0.7 million. The project is scheduled to be completed in May 2005. Further, TVA does not expect the letter of credit to be drawn upon.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Through the normal course of its business, TVA is exposed to various market risks, including changes in interest rates, foreign currency exchange rates, and certain commodity and equity market prices. TVA is also exposed to losses in the event of counterparties' nonperformance and accordingly has established controls to determine the creditworthiness of counterparties in order to mitigate exposure to credit risk.

Mark-to-Market Valuation

TVA also monitors the mark-to-market ("MTM") fair value of energy assets for the upcoming year. MTM analysis values contracts at their "fair value" (the value a willing third party would pay for the particular contract at the time a valuation is made). These analyses include, but are not limited to, native system load contracts, energy forwards, energy options, and other energy derivative instruments for unit specific generation units. Sensitivity analyses are performed on a weekly basis to determine the market price impact to the energy portfolio when the market price moves beyond TVA's projections.

When available, quoted market prices are used to record a contract's fair value. However, market values for energy trading contracts may not be readily determinable because the duration of the contracts exceeds the liquid activity in a particular market. If no active trading market exists for a commodity, holders of these contracts must calculate fair value using pricing models based on contracts with similar terms and risks.

Based on December 31, 2004, closing prices, the MTM value of TVA's electricity portfolio for the next 12 months is $3.8 billion. The fair value calculation determines a profit or loss for each source of fair value (e.g. load revenue) based on market prices.

Derivatives

To manage its risk exposures, TVA has entered into various derivative transactions. TVA risk management policies provide for the use of derivative financial instruments to manage financial exposures but prohibit the use of these instruments for speculative trading purposes. TVA accounts for these derivative instruments in accordance with the provisions of SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*," as amended by SFAS No. 138, "*Accounting for Certain Derivative Instruments and Certain Hedging Activities*," and SFAS No. 149, "*Amendment of Statement 133 on Derivative Instruments and Hedging Activities*."

Derivative contracts utilized by TVA include currency and interest rate swap agreements, a swaption agreement and option and futures contracts on various commodities. An interest rate swap is used to hedge TVA's exposure related to its inflation-indexed accreting principal bonds, and currency swap contracts are used as hedges for foreign currency denominated debt issues. These transactions qualify for cash flow hedge accounting treatment under SFAS No. 133. Consequently, the effective portions of gains and losses related to these types of contracts are deferred and reported in ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) with corresponding adjustments to the derivatives' book values until the contracts actually settle. The ineffective portions of the derivatives' changes in fair value are recognized immediately in the determination of earnings.

Cash Flow Hedges included in ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) on the Balance Sheets at December 31, 2004, include the following:

	Accumulated Other Comprehensive Income (Loss)	
	December 31, 2004	**September 30, 2004**
	(in millions)	
Interest rate swaps	$ (2)	$ (50)
Foreign currency swaps	16	(2)
Total	$ 14	$ (52)

Other derivative contracts include various purchased power option contracts, coal contracts, natural gas futures contracts, and a swaption agreement. Hedges entered into in conjunction with certain of these contracts qualify for fair value hedge accounting under SFAS Nos. 133 and 138 with changes in market values deferred and recognized as regulatory assets and/or liabilities in accordance with SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*." Such treatment reflects TVA's ability and intent to account for these derivative instruments on a settlement basis for rate-making purposes. The ineffective portions of the derivatives' changes in fair value are recognized immediately in the determination of earnings.

Credit Risk
TVA's credit risk has not changed materially from that reported in the 2004 Information Statement for the year ended September 30, 2004.

Emission Allowances
In October, 2004, the Board expanded the existing delegation, which allows TVA to enter into agreements for the sale, purchase and loan of SO_2 emission allowances, to include NOx emission allowances. This provides TVA the same ability to transact in the new and evolving NOx emissions allowance market as the SO_2 emissions allowance market.

Financial Hedging Pilot Program
A financial trading pilot program to reduce TVA's economic risk exposure associated with TVA's physical electricity generation, purchases, and sales was approved by the Board on September 11, 2003. The program enables TVA to trade certain futures contracts and options on futures contracts for the purpose of managing risks associated with the cost of natural gas and fuel oil for TVA's power generation operations and risks under power purchase or sale arrangements where the energy price varies based upon a fuel index. Trading of authorized futures contracts and options on futures contracts is limited solely to those transactions that hedge or otherwise limit economic risks directly associated with TVA's fuel requirements for power generation or with the aforementioned type of power purchase or sale arrangement. Transactions are limited to trading of NYMEX futures contracts and options on futures contracts related to natural gas and fuel oil. Trading is not authorized for speculative purposes. The pilot program extends through August 31, 2005. Trading under this pilot program commenced on May 26, 2004, and trades are being executed routinely. TVA monitors the program's status on a daily basis by tracking the program's financial positions and Value at Risk.

At December 31, 2004, TVA had 100 derivative contracts outstanding under this pilot program. The pilot program enabled TVA to effectively hedge the price risk associated with a portion of its natural gas and power purchases. TVA recognized losses of approximately $0.4 million, of which $0.3 million was unrealized and included all such losses in purchased power expense for the period ended December 31, 2004. The losses on the positions were less than one percent of the total natural gas expense for the period.

Financial Trading Pilot Activity
Three Months Ended December 31, 2004

	Notional Amount (in mmBtu)	**Contract Value** (in millions)
Financial positions, net, at beginning of period	–	$ –
Futures contracts		
Purchased	600,000	4.0
Sold	(50,000)	(0.3)
Net positions–long	550,000	$3.7
Options contracts		
Calls purchased	150,000	0.1
Puts sold	(300,000)	(0.1)
Net positions–(short)	(150,000)	–
Gains/(losses)		
Unrealized (losses)	–	(0.3)
Financial positions, net, at end of period	400,000	$ 3.4

CONTROLS AND PROCEDURES

TVA's management, including the Chief Financial Officer and the members of the Board, have conducted an evaluation of the effectiveness of TVA's disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based on that evaluation, the members of the Board and the Chief Financial Officer concluded that the disclosure controls and procedures are effective in providing reasonable assurance that all material information necessary and appropriate in this Quarterly Report has been accumulated and communicated to them to allow timely decisions regarding disclosure.

During the fourth quarter of 2004, management identified a significant deficiency related to TVA's end use billing arrangements with wholesale power customers. Under these arrangements, TVA relies on the customers to calculate major components of their own power bills. Without some assurance of the adequacy of customer internal controls, TVA cannot be reasonably satisfied that internal control deficiencies within the customer control environments do not

exist. TVA is currently fully assessing the potential impacts of this deficiency and reviewing a consultant's report of TVA's end use billing arrangements in order to form a plan of action.

Also during the fourth quarter of 2004, TVA management identified a significant deficiency related to the mark-to-market valuation of coal contracts that contain volumetric optionality. Although key controls have been designed to facilitate the complete and accurate capture and processing of coal contract activities, many control activities are not standardized. As such, the reliability and effectiveness of these control processes are dependent on interpretation and execution by different coal contract administrators. In addition, certain coal contract activities are not adequately documented and have not been supported by formal training or communication of controls. In response to these control deficiencies, TVA performed a 100 percent review of coal contracts and corrected all assumptions in the valuation models to reflect the proper valuation as of December 31, 2004. This is not an optimal correction because of the manual nature and the time required to perform such reviews. TVA is implementing plans to address this internal control deficiency which include standardized guidelines and procedures, formal training, and communications of controls and proper segregation of duties.

There have been no changes in internal control over financial reporting during the period ended December 31, 2004, that have materially affected, or are reasonably likely to materially affect, TVA's internal control over financial reporting. 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 no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company can be detected. TVA's controls and procedures can only provide reasonable, not absolute, assurance that the objectives will be met.

It should be noted that the design of any system of 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.

OTHER INFORMATION

BOARD ACTIONS

As of October 1, 2004, the Board approved amendments to the 1996 delegation to enter into agreements for the sale, purchase, and loan of SO_2 allowances (the 1996 Delegation) to add nitrogen oxide allowances to the 1996 Delegation, increase the maximum authorized value of each transaction and include the authority to engage in the purchase and sale of options and the swaps of allowances.

At the October 27, 2004, Board Meeting, the Board approved a contract for nuclear fuel and fuel-related engineering services for Browns Ferry Nuclear Plant Unit 1 ("BFN1") and a supplement to an existing contract for natural uranium for BFN1. The estimated cost of the contract and the supplement is $125 million.

As of October 29, 2004, the Board approved a TVA contribution to the TVA Retirement System of $53 million, or approximately 6.2 percent of members' payroll, for 2005.

As of November 18, 2004, the Board approved the public auction of an option to purchase the Knoxville Office Complex East Tower, consisting of a building and fixtures and approximately one acre of land in Knoxville, Tennessee, and associated easements affecting the adjacent plaza area, walkways, and sidewalks.

As of November 24, 2004, the Board approved the 2004 Information Statement.

At the November 27, 2004, Board Meeting, the Board approved tax-equivalent payments for 2004 in the amount of $338 million and estimated tax-equivalent payments for 2005 in the amount of $362 million.

As of November 29, 2004, the Board approved the delegation of authority to the Chief Financial Officer, the Treasurer, or the designees of such officers, to sell promissory notes that distributors have issued to TVA under TVA's Distributor Financing Program.

As of January 4, 2005, the Board approved the sale at a public auction of the Natural Resources and Forestry buildings in Norris, Tennessee.

ADDITIONAL INFORMATION

Customers

In December 2004, TVA received notice from Paducah Power System ("PPS") to cancel its power contract with TVA effective December 21, 2009. In 2004, less than one-half of one percent of TVA's total revenues came from sales to PPS.

In January 2005, TVA received notice from the Princeton Electric Plant Board ("PEPB") terminating its power contract with TVA effective January 2010. PEPB is a municipal distributor in Princeton, Kentucky. In 2004, less than 0.1 percent of TVA's total operating revenues came from sales to PEPB.

Management

On January 25, 2005, TVA announced the appointment of Tom Kilgore as President & Chief Operating Officer to succeed Ike Zeringue, who had previously announced his intent to retire from TVA. Mr. Kilgore joins TVA from Progress Energy where he currently serves as President & Chief Executive Officer of Progress Energy Ventures, which manages Progress Energy's operations in fuel extraction (gas and coal), merchant generation, energy marketing, and coal terminal operations. He also held officer positions at Oglethorpe Power Corp. in Tucker, Georgia and Arkansas Power and Light. He holds a bachelor of science degree in mechanical engineering from the University of Alabama and a master's degree in industrial engineering from Texas A&M.

Effective March 3, 2005, Tom Kilgore will report directly to the TVA Board and serve on TVA's Management Committee with responsibility for overall management of TVA's power production, transmission, power trading and resource-management programs.

Operations

Browns Ferry Unit 1

In May 2002, the TVA Board initiated activities for the return of Browns Ferry Unit 1 to service in order to meet long-term energy needs in the Tennessee Valley. It is anticipated the Browns Ferry Unit 1 recovery project will add approximately 1,280 megawatts of generation at a cost of approximately $1.8 billion. Unit 1 is expected to return to service in 2007, and the additional generating capacity is expected to lower the average cost of power and provide additional cash flow. As of December 31, 2004, TVA had incurred approximately $979 million of costs (including AFUDC of $56 million) on the Browns Ferry Unit 1 restart project, the planned amount for this period. The restart project was about 54 percent complete at that date and on schedule for completion.

Transmission Agreements

TVA has taken steps to become a “market participant” with the Midwest Independent Transmission System Operator, Inc. (“MISO”). Since the MISO markets are not scheduled to open until April 1, 2005, TVA has not yet purchased any power from MISO, but TVA continues to make sales to individual legally permissible MISO members such as Cinergy and LG&E Energy and continues to make purchases from these and other MISO members. In a separate arrangement, TVA began acting as an “other supplier” for PJM Interconnection, L.L.C. (“PJM”) in the summer of 2004. As an “other supplier,” TVA can continue its trading relationship with AEP and make power purchases from PJM itself. TVA is routinely executing transactions under the PJM arrangement and has demonstrated that TVA has the capability to participate in the market in good faith. Although definitive agreements for the MISO and PJM arrangements have not yet been finalized, TVA is financially responsible for all of its market activity and obligations under these arrangements.

Other

In February 2005, the Office of Management and Budget (“OMB”) issued its fiscal year 2006 budget plan. The plan includes recommendations to (1) require TVA to register its debt securities with the Securities and Exchange Commission, (2) grant the Federal Energy Regulatory Commission jurisdiction over TVA’s transmission system, (3) count long-term liabilities that are similar to traditional debt, such as equipment lease/leasebacks and long-term power prepayment agreements, toward TVA’s $30 billion statutory debt limit, and (4) use the Congressional appropriations process to direct TVA power revenues to fund the Office of Inspector General (OIG). It will now be up to Congress to act on these proposals or not take these recommendations any further..

CERTIFICATIONS OF THE MEMBERS OF THE TVA BOARD OF DIRECTORS

Glenn L. McCullough, Jr., Skila Harris, and Bill Baxter individually certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report (“Report”) for the quarterly period ended December 31, 2004;

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 periods 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 Tennessee Valley Authority as of, and for, the periods presented in this Report;

4. The other certifiers and I are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and 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 Tennessee Valley Authority is made known to us by others particularly during the period in which this Report is being prepared;

b) evaluated the effectiveness of the Tennessee Valley Authority’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

c) disclosed in this Report any change in internal control over financial reporting that occurred during the quarter ended December 31, 2004, that has materially affected, or is reasonably likely to materially affect, the Tennessee Valley Authority’s internal control over financial reporting; and

5. The other certifiers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Tennessee Valley Authority’s auditors and the Inspector General of the Tennessee Valley Authority:

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 Tennessee Valley Authority’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 Tennessee Valley Authority’s internal control over financial reporting.

Date: February 8, 2005

Glenn L. McCullough, Jr.
Chairman

Skila Harris
Director

Bill Baxter
Director

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, Michael E. Rescoe, certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report ("Report") for the quarterly period ended December 31, 2004;

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 periods 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 Tennessee Valley Authority as of, and for, the periods presented in this Report;

4. The other certifiers and I are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and 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 Tennessee Valley Authority is made known to us by others particularly during the period in which this Report is being prepared;

b) evaluated the effectiveness of the Tennessee Valley Authority'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

c) disclosed in this Report any change in internal control over financial reporting that occurred during the quarter ended December 31, 2004, that has materially affected, or is reasonably likely to materially affect, the Tennessee Valley Authority's internal control over financial reporting; and

5. The other certifiers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Tennessee Valley Authority's auditors and the Inspector General of the Tennessee Valley Authority:

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 Tennessee Valley Authority'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 Tennessee Valley Authority's internal control over financial reporting.

Date: February 8, 2005

Michael E. Rescoe
Chief Financial Officer
and Executive Vice President of Financial Services

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E-mail Alert
E-mail alerts are messages that are delivered to a subscriber's e-mail address whenever certain new information is posted to TVA's Investor Resources web pages. To subscribe to e-mail alerts, visit TVA's web site at: www.tva.com/finance

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