Tennessee Valley Authority

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

Quarterly Report

For the quarterly period ended June 30, 2005

Tennessee Valley Authority

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For the quarterly period ended June 30, 2005

This document contains the unaudited Quarterly Report of TVA for the quarterly period ended June 30, 2005 (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 Exchange Act of 1934. Accordingly, TVA does not intend to file this Quarterly Report with the SEC. Due to legislation enacted in December 2004, beginning with its 2006 annual report, TVA will 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 Quarterly Report should be read in conjunction with the Information Statement dated November 24, 2004 (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; the impact of new accounting pronouncements and interpretations, including Financial Accounting Standards Board (“FASB”) Interpretation No. 46, “*Consolidation of Variable Interest Entities*,” which was amended by FASB Interpretation No. 46R, and Statement of Financial Accounting Standards 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 and schedule 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; changes to the Anti-Cherrypicking Provision; 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)
(in millions)

	Three months ended June 30		Nine months ended June 30	
Operating revenues	2005	2004	2005	2004
Sales of electricity				
Municipalities and cooperatives	$ 1,558	$ 1,568	$ 4,644	$ 4,699
Industries directly served	247	227	698	640
Federal agencies and other	40	30	145	97
Other revenue	36	32	67	77
Total operating revenues	1,881	1,857	5,554	5,513
Operating expenses				
Fuel and purchased power	599	561	1,674	1,509
Operating and maintenance	575	556	1,741	1,684
Depreciation, amortization, and accretion	288	279	863	831
Tax-equivalents	91	84	272	252
(Gain) loss on project cancellation (note 1)	–	(15)	–	20
Total operating expenses	1,553	1,465	4,550	4,296
Operating income	328	392	1,004	1,217
Other income, net	11	9	22	24
Unrealized (loss) gain on derivative contracts, net	(44)	30	(32)	35
Interest expense				
Interest on debt	334	347	1,011	1,040
Amortization of debt discount, issue, and reacquisition costs, net	6	6	16	19
Allowance for funds used during construction	(30)	(27)	(84)	(74)
Net interest expense	310	326	943	985
Net (loss) income	$ (15)	$ 105	$ 51	$ 291

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

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

ASSETS	June 30 2005	September 30 2004
Current assets		
Cash and cash equivalents	$ 584	$ 519
Short-term investments	14	335
Accounts receivable, net	1,005	1,034
Inventories at average cost and other		
Fuel	208	193
Other, net	323	305
Total current assets	2,134	2,386
Property, plant, and equipment		
Completed plant	35,051	34,786
Less accumulated depreciation	(14,194)	(13,424)
Net completed plant	20,857	21,362
Construction in progress	2,486	1,923
Nuclear fuel and capital leases, net	538	504
Total property, plant, and equipment	23,881	23,789
Deferred nuclear generating units	3,911	3,909
Investment funds	859	744
Deferred charges and other assets		
Loans and other long-term receivables	87	144
Reacquisition costs	267	277
Other deferred charges	1,430	974
Regulatory assets (note 1)	2,038	2,057
Total deferred charges and other assets	3,822	3,452
Total assets	$ 34,607	$ 34,280
LIABILITIES AND PROPRIETARY CAPITAL		
Current liabilities		
Accounts payable	$ 776	$ 761
Accrued liabilities	214	284
Accrued interest	286	402
Current portion of lease/leaseback obligations	35	35
Current portion of energy prepayment obligations	106	105
Short-term debt	2,581	1,924
Current maturities of long-term debt	1,621	2,000
Total current liabilities	5,619	5,511
Other liabilities		
Deferred liabilities	3,655	2,893
Asset retirement obligations	1,832	1,782
Lease/leaseback obligations	1,111	1,143
Energy prepayment obligations	1,270	1,350
Total other liabilities	7,868	7,168
Long-term debt		
Public bonds	18,980	19,326
Unamortized discount and other adjustments	(205)	11
Total long-term debt	18,775	19,337
Total liabilities	32,262	32,016
Commitments and contingencies (note 6)		
Proprietary capital		
Appropriation investment	4,788	4,803
Retained earnings of power program	1,213	1,162
Accumulated net expense of nonpower programs	(3,660)	(3,649)
Accumulated other comprehensive income (loss) (note 2)	4	(52)
Total proprietary capital	2,345	2,264
Total liabilities and proprietary capital	$ 34,607	$ 34,280

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CASH FLOWS (unaudited)
(in millions)

	Nine months ended June 30	
	2005	2004
Cash flows from operating activities		
Net income	$ 51	$ 291
Items not requiring (providing) cash		
Depreciation, amortization, and accretion	961	923
Allowance for funds used during construction	(84)	(74)
Nuclear fuel amortization	95	97
Loss on project cancellation	–	20
Other, net	192	49
Changes in current assets and liabilities		
Short-term investments, net	321	101
Accounts receivable, net	29	4
Inventories and other	(57)	(5)
Accounts payable and accrued liabilities	(69)	(125)
Accrued interest	(116)	(84)
Proceeds from energy prepayments	–	1,504
Refueling outage costs	(119)	(83)
Other	(37)	(13)
Net cash provided by operating activities	1,167	2,605
Cash flows from investing activities		
Construction expenditures	(933)	(1,153)
Proceeds from project cancellation settlement (note 1)	–	15
Allowance for funds used during construction	84	74
Nuclear fuel expenditures	(124)	(88)
Investments, net	(42)	2
Loans and other receivables		
Advances	(8)	(14)
Repayments	12	13
Proceeds from sale of loans (note 1)	55	–
Other, net	1	(2)
Net cash (used in) investing activities	(955)	(1,153)
Cash flows from financing activities		
Long-term debt		
Issues	1,630	772
Redemptions and repurchases	(2,365)	(1,169)
Short-term issues (redemptions), net	658	(1,175)
Bond premium received	–	97
Payments on combustion turbine financing	(26)	(27)
Payments on equipment financing	(6)	(29)
Proceeds from other financing sources	6	–
Financing costs, net	(18)	(2)
Payments to U.S. Treasury	(26)	(29)
Net cash (used in) financing activities	(147)	(1,562)
Net change in cash and cash equivalents	65	(110)
Cash and cash equivalents at beginning of period	519	533
Cash and cash equivalents at end of period	$ 584	$ 423

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (unaudited)
(in millions)

	Three-Month Period					
	Appropriation Investment	Retained Earnings - Power Program	Accumulated Net Expense of Nonpower Programs	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income (Loss)
Balance at April 1, 2004	$ 4,813	$ 966	$ (3,644)	$ (63)	$ 2,072	$ –
Net income (loss)	–	107	(2)	–	105	105
Return on appropriation investment	–	(5)	–	–	(5)	–
Other comprehensive income (note 2)	–	–	–	61	61	61
Return of appropriation investment	(5)	–	–	–	(5)	–
Balance at June 30, 2004	$ 4,808	$ 1,068	$ (3,646)	$ (2)	$ 2,228	$ 166
Balance at April 1, 2005	$ 4,793	$ 1,226	$ (3,655)	$ 44	$ 2,408	$ –
Net (loss)	–	(10)	(5)	–	(15)	(15)
Return on appropriation investment	–	(3)	–	–	(3)	–
Other comprehensive (loss) (note 2)	–	–	–	(40)	(40)	(40)
Return of appropriation investment	(5)	–	–	–	(5)	–
Balance at June 30, 2005	$ 4,788	$ 1,213	$ (3,660)	$ 4	$ 2,345	$ (55)

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (unaudited)
(in millions)

	Nine-Month Period					
	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)	–	299	(8)	–	291	291
Return on appropriation investment	–	(14)	–	–	(14)	–
Other comprehensive income (note 2)	–	–	–	72	72	72
Return of appropriation investment	(15)	–	–	–	(15)	–
Balance at June 30, 2004	$ 4,808	$ 1,068	$ (3,646)	$ (2)	$ 2,228	$ 363
Balance at September 30, 2004	$ 4,803	$ 1,162	$ (3,649)	$ (52)	$ 2,264	$ –
Net income (loss)	–	62	(11)	–	51	51
Return on appropriation investment	–	(11)	–	–	(11)	–
Other comprehensive income (note 2)	–	–	–	56	56	56
Return of appropriation investment	(15)	–	–	–	(15)	–
Balance at June 30, 2005	$ 4,788	$ 1,213	$ (3,660)	$ 4	$ 2,345	$ 107

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

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

1. Summary of Significant Accounting Policies

Organization
TVA is a wholly owned corporate agency and instrumentality of the United States and was established by Congress through the Tennessee Valley Authority Act of 1933, as amended, 16 U.S.C. §§ 831-831ee (2000 and Supp. II 2002) (the "TVA Act"). TVA is charged with providing navigation, flood control, agricultural and industrial development, and electric power to the Tennessee Valley 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 for either its power or its nonpower programs, 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.

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 ("GAAP") accepted in the United States of America for interim financial information. Accordingly, TVA's interim financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. Because the accompanying interim financial statements do not include all of the information and footnotes required by GAAP 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, which are contained in the 2004 Information Statement.

The amounts included in the accompanying interim financial statements are unaudited but, in the opinion of TVA 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 GAAP, 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.

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

Accounts Receivable

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

	At June 30 2005	At September 30 2004
Power receivables billed	$ 229	$ 288
Power receivables unbilled	739	713
Total power receivables	968	1,001
Other receivables	44	41
Allowance for uncollectible accounts	(7)	(8)
Net accounts receivable	$ 1,005	$ 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. TVA's regulatory assets consist of the following:

	At June 30 2005	At September 30 2004
Decommissioning costs	$ 734	$ 755
Changes in fair value of derivative contracts	61	59
Adjustment to accrue minimum pension liability		
TVA Retirement System	1,235	1,235
Supplemental executive retirement plan	8	8
Subtotal	2,038	2,057
Reacquisition costs	267	277
Deferred nuclear generating units	3,911	3,909
Total	$ 6,216	$ 6,243

Regulatory liabilities accounted for under the 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 June 30, 2005, and September 30, 2004, were $903 million and $478 million, respectively, and are included in DEFERRED LIABILITIES on the Balance Sheets.

At June 30, 2005, construction of the Bellefonte Nuclear Plant ("Bellefonte") remains in a deferred status. In July 2005, the Board approved the amortization of TVA's investment in the deferred nuclear generating units over a ten-year period beginning in 2006.

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 only 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 revised asset cost, the ARO liability as of September 30, 2004, and June 30, 2005, the fair market value of any assets legally restricted for purposes of settling the obligations, and the estimated future liability at the projected time of retirement.

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

ARO Category	Revised Asset Cost	September 30 2004 Obligation	June 30 2005 Obligation	Fair Market Value of Assets	Estimated Future Liability
Nuclear Plants	$ 451	$ 1,555	$ 1,595	$ 793	$ 10,002
Coal-Fired Plants	19	225	235	N/A	1,021
Gas/Oil Turbine Plants	1	2	2	N/A	45
Total	$ 471	$ 1,782	$ 1,832	$ 793	$ 11,068

In March 2005, TVA made revisions to the amount and timing of certain cash flow estimates related to its nuclear plant AROs. The revisions in cost were based on new engineering studies performed in accordance with requirements of the Nuclear Regulatory Commission ("NRC"). The changes in estimates produced obligations that were less than the amounts originally recorded on an accreted basis. Accordingly, TVA made adjustments in the recorded amounts to properly reflect such revised balances. The adjustments resulted in an aggregate decrease of $25 million in the ARO, a $7 million reduction in the asset base, a $3 million reduction in accumulated depreciation, and a decrease of $21 million in the originally recorded regulatory asset. The result of the changes described does not impact net income for the nine month period ended June 30, 2005.

TVA's total ARO liability increased $50 million during the first nine months of 2005 due to accretion of the obligations, offset by NRC cost revisions. The nuclear accretion of $65 million was deferred and charged to a regulatory asset in accordance with SFAS No. 71. The remaining accretion expense of $10 million, related to coal-fired plants, was expensed during 2005.

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 of electricity in the prepaid block. The remainder of the price of the kilowatt-hours of electricity delivered is due upon billing.

As of June 30, 2005, TVA had entered into sales agreements for 54.5 DEU totalling $54.5 million, of which $7.25 million is for the 2004 program. Revenue recognized on a cumulative basis through June 30, 2005, totals over $13 million. Of this amount, over $4 million was recognized as revenue during 2005.

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 revenue recognized on a cumulative basis through June 30, 2005, exceeds $165 million. Of this amount, $75 million was recognized as revenue during 2005. This amount was based on the ratio of kilowatt-hours of electricity delivered to the total kilowatt-hours under contract.

TVA is reporting the June 30, 2005, and September 30, 2004, obligations of $1,376 million and $1,455 million, respectively, to deliver power under these energy prepayment programs as ENERGY PREPAYMENT OBLIGATIONS and CURRENT PORTION OF ENERGY PREPAYMENT OBLIGATIONS on the June 30, 2005, and September 30, 2004 Balance Sheets.

There have been no energy prepayment transactions during 2005.

Blended Low Enriched Uranium Program

On December 5, 2004, TVA received the first fuel assembly under the Blended Low Enriched Uranium ("BLEU") fuel program for loading into its Browns Ferry Nuclear Plant Unit 2. The unit ended its most recent refueling outage in April 2005, at which time the costs of the BLEU fuel assemblies began being amortized to nuclear fuel expense.

The BLEU fuel program is implemented, in part, through agreements with counterparties, including an interagency agreement with the Department of Energy ("DOE") to provide raw nuclear fuel materials to be processed into usable fuel for TVA nuclear reactors, and other contracts with third-party nuclear fuel processors under which the nuclear fuel processors, either by themselves or through subcontractors (collectively, "Third Party Fuel Processors"), acquire land, construct facilities, and process the raw materials from DOE into usable fuel for TVA nuclear reactors.

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

Under the terms of the interagency agreement, DOE supplies off-specification, highly enriched uranium materials to the appropriate Third Party Fuel Processors for processing into usable fuel for TVA. In exchange, DOE will participate to a degree in the savings generated by TVA's use of this blended nuclear fuel product. As of June 30, 2005, TVA projects that the DOE's share of savings generated by TVA's use of this blended nuclear fuel product could result in future payments to DOE of as much as $212 million. TVA anticipates these future payments, if such payments materialize, could begin as early as 2010. However, due to the uncertainty of the related amounts and less than probable occurrence, TVA will not currently accrue an obligation related to such future cost savings.

The Third Party Fuel Processors own the conversion and processing facilities and will retain title to all land, property, plant, and equipment used in the BLEU fuel program. There is no provision for TVA to own or otherwise take title to the facilities, materials, or equipment now or at any time in the future. However, in accordance with the requirements of EITF No. 01-08, "*Determining Whether an Arrangement Contains a Lease*," and SFAS No. 13, "*Accounting for Leases,*" TVA recognized a capital lease asset and corresponding lease obligation related to amounts paid or payable to a Third Party Fuel Processor. Accounting recognition of the capital lease asset and obligation was brought about due to a contract modification to the pre-existing fuel fabrication contract, which occurred during the second quarter of 2004.

During the quarter ended March 31, 2005, TVA recorded a capital lease asset of $60 million comprised of $23 million in pre-recharacterization contract payments (that is, payments made before the original contract was modified) and $37 million in post-recharacterization contract payments (that is, payments made after the original contract was modified) either paid or payable. Also during the quarter, TVA recorded an initial capital lease obligation of $37 million which has been reduced by $17 million in post-recharacterization principal payments leaving an unpaid capital lease obligation of $20 million at the end of June 2005. Additionally, TVA has recognized asset amortization expense of $8 million and interest expense of $2 million related to the capital lease obligation through June 30, 2005.

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 nine months ended June 30, 2005.

Reduction in Workforce

During 2004, organizations within TVA performed program and staffing reviews to identify surplus staffing. 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 June 30, 2005, there were 727 employees impacted by the combined RIF actions, including 17 during the first quarter of 2005 and ten in each of the second and third quarters of 2005. TVA has recognized total expense in the amount of $39 million for termination costs incurred through June 30, 2005, which includes $1 million for the first quarter of 2005, $1 million for the second quarter of 2005, and less than $1 million for the third 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.

Termination Costs Liability Activity

	Three months ended June 30		**Nine months ended June 30**	
	2005	**2004**	**2005**	**2004**
Termination costs liability at beginning of period	$ 8	$ 20	$ 14	$ –
Liabilities incurred	1	7	3	29
Actual costs paid	(5)	(13)	(13)	(15)
Termination costs liability at end of period	$ 4	$ 14	$ 4	$ 14

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.

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

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 ("FIN 46"), "*Consolidation of Variable Interest Entities—an interpretation of ARB No. 51*," which was later revised by FIN No. 46(R) ("FIN 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 ("ARB") 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.

In March 2005, the FASB released FASB Staff Position ("FSP") FIN 46(R)-5, "*Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities*," which is applicable to both nonpublic and public reporting enterprises. This FSP addresses transactions in which a reporting enterprise has an interest in, or other involvement with, a VIE or potential VIE that is not considered a variable interest, and the reporting enterprise's related party (a non-VIE) has a variable interest in the same entity. This FSP must be applied in accordance with the FIN 46R effective date and transition. At this time, TVA is in the process of evaluating the requirements of this interpretation and does not yet know the impact of its implementation, which may or may not be material to TVA's 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 FSP Financial Accounting Standard ("FAS") 106-2, "*Accounting and 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 determined that it does not qualify for the subsidy as outlined in the Medicare Prescription Drug, Improvement and Modernization Act of 2003. TVA continues to work directly with its health care providers to control costs and to provide affordable benefits to its retirees. TVA adopted the disclosure requirements for nonpublic entities 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.

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 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 will 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

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

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 will 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.

Conditional Asset Retirement Obligations. In March 2005, the FASB issued FIN No. 47, "*Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143*." This interpretation clarifies that the term conditional asset retirement obligation ("conditional ARO") as used in SFAS No. 143, "*Accounting for Asset Retirement Obligations*," refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for the fair value of a conditional ARO if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional ARO should be recognized when incurred. This interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an ARO. This interpretation is effective no later than the end of fiscal years ending after December 15, 2005. TVA is evaluating the potential implications of this interpretation on its AROs, which may or may not be material to its financial position or results of operations.

Accounting Changes and Error Corrections. In May 2005, the FASB issued SFAS No. 154, "*Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3*," which replaces Accounting Principles Board ("APB") Opinion No. 20, "*Accounting Changes*," and FASB Statement No. 3, "*Reporting Accounting Changes in Interim Financial Statements*." This statement applies to all voluntary changes in accounting principles and also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This statement requires, unless impracticable, retrospective application to prior periods' financial statements to reflect the changes in accounting principle. If it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this statement requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, this statement requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. This statement also requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. The statement will become effective for TVA beginning in fiscal year 2007 with early adoption permitted for accounting changes and corrections of errors made in fiscal years beginning after the date the statement is issued.

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 gains (losses) for the three months and nine months ended June 30, 2005, and 2004, are due to unrealized gains (losses) related to mark-to-market valuation adjustments for certain derivative instruments that qualify for cash flow hedge accounting treatment.

Total Other Comprehensive Income (Loss) Activity

	Three months ended June 30		Nine months ended June 30	
	2005	**2004**	**2005**	**2004**
Accumulated other comprehensive income (loss) at beginning of period	$ 44	$ (63)	$ (52)	$ (74)
Changes in fair value of interest rate swaps	(8)	(2)	(3)	2
Changes in fair value of foreign currency swaps	(32)	60	59	66
Changes in fair value of emission allowance call options	–	3	–	4
Accumulated other comprehensive income (loss) at end of period	$ 4	$ (2)	$ 4	$ (2)

NOTES TO FINANCIAL STATEMENTS (unaudited) Continued
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3. Debt Securities

TVA issues power bonds from time to time pursuant to Section 15d of the TVA Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution adopted on October 6, 1960, as amended on September 28, 1976, October 17, 1989, and March 25, 1992. 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 June 30, 2005.

Activity from October 1, 2004 to June 30, 2005

Redemptions/Maturities:	Date	Amount	Interest Rate
electronotes®	First Quarter 2005	$ 3	3.50% to 6.50%
electronotes®	Second Quarter 2005	75	3.20% to 6.13%
electronotes®	Third Quarter 2005	101	2.45% to 6.50%
2000E QUINTS	March 18, 2005	100	7.75%
1998D PARRS	June 1, 2005	86	5.95%
1995A	June 15, 2005	2,000	6.38%
Issues:			
electronotes®	Second Quarter 2005	$ 25	5.00%
electronotes®	Third Quarter 2005	105	4.13% to 5.13%
2005A	June 6, 2005	500	4.65%
2005B	June 21, 2005	1,000	4.38%

During the same period, TVA issued $16 billion in discount notes, maturing in less than one year, and redeemed $15 billion in discount notes.

Revolving Credit Facility Agreement
On May 26, 2005, TVA and a national bank entered into a revolving credit facility agreement with an initial term of 180 days. The facility provides TVA with an unsecured revolving line of credit of up to $2.5 billion. There were no outstanding borrowings under the facility at June 30, 2005.

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, option and swaption contracts, and commodity purchase contracts.

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

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

Mark-to-Market Values of Derivative Transactions

	Asset (Liability)	
	At June 30 2005	**At September 30 2004**
Interest rate swaps:		
Inflation bond issue	$ 9	$ 2
$476 million notional	(189)	(140)
Currency swaps:		
Deutschemark (DM1.5 billion)	(37)	(62)
Sterling (GBP200 million)	17	13
Sterling (GBP250 million)	79	79
Sterling (GBP150 million)	24	32
Swaptions:		
$1 billion notional	(367)	(225)
$28 million notional	(5)	–
$14 million notional	(2)	–
Emission allowance call options	–	6
Coal contracts	903	478
Purchase power contracts	(61)	(59)

5. Benefit Plans

TVA sponsors a noncontributory defined benefit pension plan for substantially all of its 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 for the Three Months Ended June 30		Other Benefits for the Three Months Ended June 30		Pension Benefits for the Nine Months Ended June 30		Other Benefits for the Nine Months Ended June 30	
	2005	2004	2005	2004	2005	2004	2005	2004
Service Cost	$ 26	$ 28	$ 1	$ 1	$ 88	$ 84	$ 4	$ 4
Interest Cost	103	102	6	5	322	305	19	14
Expected return on plan assets	(114)	(116)	–	–	(343)	(348)	–	–
Amortization of prior service costs	9	9	1	1	27	27	4	4
Amortization of losses	24	22	3	–	89	66	8	–
Cost of special events	–	–	–	2	–	–	–	5
Net periodic benefit	$ 48	$ 45	$ 11	$ 9	$ 183	$ 134	$ 35	$ 27

TVA's Board approved $53 million in pension contributions for 2005. During the nine months ended June 30, 2005, TVA has made approximately $27 million in contributions and plans to contribute another $26 million by the end of the year. 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 $12 million during the nine months ended June 30, 2005, to fund other benefit costs.

During 2005, TVA implemented two changes in its pension plan with effective dates beginning in January and May 2005. The plan changes adopted by the TVA Board and the TVA Retirement System Board focused on the rates of accretion and future contributions granted by the Board on members' certain annuity account balances. The approved plan changes determined (1) that future rates of return will no longer be guaranteed at a specific level but rather will decrease by a graduated amount per year until an agreed lower level of return is reached and (2) members previously ineligible to participate in such annuity accounts are now eligible to establish these type accounts.

As a result of these pension plan changes, TVA revised its actuarial estimate of 2005 pension expense and prospectively recorded the entire change, as a reduction in year-to-date pension expense, during the third quarter of 2005.

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TVA recorded the cumulative effects of the plan changes by adjusting the third quarter pension expense downwardly by $20 million. TVA effected the change in expense by revising the amounts previously recorded at $68 million per quarter to an amount equal to $61 million per quarter. Thus, TVA's year-to-date pension expense was decreased from $203 million to $183 million at the end of the third quarter of 2005. Pension expense is expected to be recorded at the $61 million amount for the last quarter of the year and is expected to result in total expense of $244 million for the year.

6. Commitments and Contingencies

The estimated future commitments for TVA as of June 30, 2005, are as follows:

	2005*	2006	2007	2008	2009	Thereafter	Total
Debt	$ 2,581	$ 2,621	$ 968	$ 91	$ 2,031	$ 14,890	$ 23,182
Interest on debt	209	1,226	1,034	1,009	953	13,170	17,601
Leases	21	83	80	70	65	104	423
Lease/leasebacks	22	84	85	89	84	1,300	1,664
Power purchase obligations	46	176	159	133	137	3,677	4,328
Other obligations	180	419	197	211	56	61	1,124
Fuel purchase obligations	412	540	315	267	186	505	2,225
Pension contribution	26	75	–	–	–	–	101
Total	$ 3,497	$ 5,224	$ 2,838	$ 1,870	$ 3,512	$ 33,707	$ 50,648

* Period July 1 – September 30, 2005

During the quarter ended March 31, 2005, TVA recorded a capital lease asset of $60 million comprised of $23 million in pre-recharacterization contract payments and $37 million in post-recharacterization contract payments either paid or payable. Also during the quarter, TVA recorded an initial capital lease obligation of $37 million which has been been reduced by $17 million in post-recharacterization principal payments leaving an unpaid capital lease obligation of $20 million at June 30, 2005. See note 1–*Blended Low Enriched Uranium Program*.

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
Energy prepayment obligations	$ 26	$ 106	$ 106	$ 106	$ 105	$ 927	$ 1,376

* Period July 1 – September 30, 2005

7. Legal Proceedings

The National Parks Conservation Association ("NPCA") and the Sierra Club filed cases in two federal district courts in 2001 alleging that TVA modified its Bull Run Fossil Plant ("Bull Run") and Colbert Fossil Plant Unit 5 ("Colbert Unit 5") without complying with the new source review ("NSR") requirements of the Clean Air Act ("CAA"). In March 2005, the district court granted TVA's motion to dismiss the lawsuit in the Bull Run case, and the plaintiffs have moved for reconsideration of the decision. The court denied plaintiffs' motion for reconsideration. Since the denial of the motion, the plaintiffs have appealed the case to the Sixth Circuit. In the Colbert Unit 5 case, the parties have filed motions for summary judgment, with briefing on all motions expected to be completed in September 2005. In similar lawsuits filed by EPA and others against other utility companies, the rulings by the respective courts differ widely.

The Alabama Environmental Council and the Sierra Club filed a lawsuit in federal district court in Florence, Alabama, alleging that TVA violated 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 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 appealed the district court's decision to the Court of Appeals for the Eleventh Circuit (the "Eleventh

NOTES TO FINANCIAL STATEMENTS (unaudited) Continued
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Circuit"). Oral argument was held on August 17, 2005, and all parties are waiting on the Eleventh Circuit's decision.

On July 25, 2003, TVA received a notice of intent to sue from Our Children's Earth Foundation ("OCE"). OCE contends 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 without installing additional pollution control equipment. OCE also contends 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 specify a monetary amount of TVA's claimed liability. 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 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 Unit 5 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 four years ago in federal court in Knoxville, Tennessee. TVA ultimately prevailed in that lawsuit. The Sierra Club has not yet filed suit.

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 sought, among other things, compensatory damages in excess of $45 million, plus interest. TVA and Bowater settled the lawsuit by entering into revised and extended power supply arrangements at the two plants. The settlement agreement does not require TVA to pay Bowater for the damages sought. On March 8, 2005, the court dismissed this case with prejudice.

On August 31, 1999, Birmingham Steel Corporation filed a lawsuit in federal court in 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 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 Manville Corporation to represent the class. The district court has set a September 2005 deadline for filing motions for summary judgment.

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. Oral argument was held on the motions on August 12, 2005, and the parties are waiting on the judge's decision on the motions.

On November 10, 2004, North Carolina sent the EPA a Notice of Intent to Sue TVA for violations of the CAA (the "Notice"), which allows North Carolina to 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 CAA (among other state

NOTES TO FINANCIAL STATEMENTS (unaudited) Continued
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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. Although the 60-day period has expired, North Carolina has not yet filed suit.

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 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. The plaintiffs have moved for reconsideration of the dismissal, and the court has not ruled on that motion. Since the denial of the motion, the plaintiffs have appealed the case to the Sixth Circuit.

Pursuant to the Nuclear Waste Policy Act of 1982, TVA (and all other domestic nuclear utilities) entered into a contract with DOE for the disposal of spent nuclear fuel ("SNF"). Payments to DOE are based upon TVA's nuclear generation and charged to nuclear fuel expense. Although the contracts called for DOE to begin accepting SNF from the utilities by January 31, 1998, DOE has announced that it will not begin picking up spent nuclear fuel from any domestic nuclear utility until 2010 at the earliest. TVA, like other utilities, stores SNF in pools of borated water at its nuclear sites. Although TVA would have had sufficient space to continue to store spent nuclear fuel in those storage pools at its Sequoyah and Browns Ferry Nuclear Plants indefinitely had DOE begun accepting spent nuclear fuel, DOE's failure to do so required TVA to construct dry cask storage facilities at its Browns Ferry and Sequoyah Nuclear Plants and to purchase special storage containers for the SNF. (Watts Bar Nuclear Plant currently has sufficient storage capacity in its spent fuel pool to last until 2018.) Both Sequoyah's and Browns Ferry's dry cask storage facilities are fully operational. To recover the cost of providing long-term, on-site storage for SNF, TVA filed a breach of contract suit against the United States in the Court of Federal Claims in 2001. The evidentiary portion of the case was completed in Washington D.C. in July 2005. Closing arguments are currently scheduled for October 2005.

8. Stewardship Responsibilities

During the first nine months 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 $61 million and $57 million on essential stewardship activities during each of the first nine months of 2005 and 2004, respectively, and recognized depreciation expense on nonpower assets of $8 million in each nine month period.

NOTES TO FINANCIAL STATEMENTS (unaudited) Continued
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9. Subsequent Events

Debt Securities
In July 2005, TVA issued $7 million of electronotes® with an interest rate of 4.50 percent which mature in 2015 and are callable in 2007.

In August 2005, TVA issued $10 million of electronotes® with an interest rate of 5.00 percent which mature in 2020 and are callable in 2008.

Sale of Buildings
Knoxville Office Building
In November 2004, TVA entered into an option agreement for the purchase the East Tower of the Knoxville Office Complex. Under the original terms of the agreement, the potential purchasers had until February 22, 2005, to exercise the option. The original option was extended until July 23, 2005, and has now been extended until September 23, 2005, after which time the option, unless extended, will expire.

Aquatic Biology Lab
On July 7, 2005, TVA conducted a public action for the Aquatic Biology Lab in Anderson County, Tennessee. The winning bidder purchased the property for $276,000. There was no gain or loss recognized on the sale of the building.

Customer Termination Notice
In August 2005, TVA received notice from the Hopkinsville Electric System giving its intent to terminate its power contract with TVA at the end of the five-year notice period (2010) required by its contract terms.

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

Dollars in million except where noted

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.

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;
- Reducing 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; and
- 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 a more 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.

Results of Operations

Net loss for the third quarter of 2005 was $15 million compared to net income of $105 million for the same period of 2004. Significant items contributing to the $120 million change in net income for the three months ended June 30, 2005, as compared to June 30, 2004, include decreased operating income of $64 million and increased unrealized net losses on derivative contracts of $74 million, partially offset by lower net interest expense of $16 million.

Net income through the first three quarters of 2005 was $51 million compared to $291 million for the same period of 2004. Significant items contributing to the $240 million decrease in net income for the nine months ended June 30, 2005, as compared to June 30, 2004, include increased total operating expenses of $254 million and increased unrealized net losses on derivative contracts of $67 million, partially offset by increased total operating revenues of $41 million and lower net interest expense of $42 million.

Operating Revenues

A detailed table of operating revenue for the three and nine month periods ended June 30, 2005, and 2004 is as follows:

	Three months ended June 30			Nine months ended June 30		
	2005	2004	Percent Change	2005	2004	Percent Change
Operating revenues						
Sales of electricity						
Municipalities and cooperatives	$ 1,558	$ 1,568	(0.6%)	$ 4,644	$ 4,699	(1.2%)
Industries directly served	247	227	8.8%	698	640	9.1%
Federal agencies and other	40	30	33.3%	145	97	49.5%
Other revenue	36	32	12.5%	67	77	(13.0%)
Total operating revenues	$ 1,881	$ 1,857	1.3%	$ 5,554	$ 5,513	0.7%

Significant items contributing to the $24 million increase in operating revenues for the three months ended June 30, 2005, as compared to June 30, 2004, include:

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued
Dollars in millions except where noted

- A $20 million increase in revenues from industries directly served primarily due to increased rates with slight increased power demand reflecting favorable economic conditions; and
- A $10 million increase in revenues from off-system sales (included in FEDERAL AGENCIES AND OTHER) due to increased generation available for sale as a result of favorable market conditions.

Favorable market conditions relate to electricity demands both inside and outside the TVA service area in addition to advantageous market rates.

These items were partially offset by a $10 million decrease in revenues from municipalities and cooperatives primarily due to lower volume as a result of milder weather.

Significant items contributing to the $41 million increase in operating revenues for the nine months ended June 30, 2005, as compared to June 30, 2004, include:

- A $58 million increase in revenues from industries directly served, primarily due to increased rates and increased power demand reflecting favorable economic conditions; and
- A $46 million increase in revenues from off-system sales (included in FEDERAL AGENCIES AND OTHER) due to increased generation available for sale and favorable market conditions.

These items were partially offset by:

- A $55 million decrease in revenues from municipalities and cooperatives due to lower average rates related to a shift in product and customer mix, lower rates for variable priced products, and lower volume as a result of milder weather; and
- A $10 million decrease in other revenue due to a reduction in nonutility services and wheeling activity.

A detailed table of electricity sales for the three and nine month periods ended June 30, 2005, and 2004 is as follows:

	Three months ended June 30			Nine months ended June 30		
	2005	**2004**	**Percent Change**	**2005**	**2004**	**Percent Change**
	(millions of kWh)			(millions of kWh)		
Sales of electricity						
Municipalities and cooperatives	32,129	32,509	(1.2%)	96,265	96,501	(0.2%)
Industries directly served	7,676	7,539	1.8%	24,291	23,195	4.7%
Federal agencies and other	870	673	29.3%	3,336	2,371	40.7%
Total sales	40,675	40,721	(0.1%)	123,892	122,067	1.5%

Significant items contributing to the 46 million kilowatt-hour decrease in electricity sales for the three months ended June 30, 2005, as compared to June 30, 2004, include a 380 million kilowatt-hour, or one percent, decrease in sales to municipalities and cooperatives primarily due to lower volume as a result of milder weather.

The decrease was partially offset by:

- A 137 million kilowatt-hour, or two percent, increase in sales to industries directly served due to slight increases in volume; and
- A 197 million kilowatt-hour, or 29 percent, increase in sales to federal agencies and other primarily due to an increase in off-system sales as a result of increased generation available for sale due to favorable market conditions.

Significant items contributing to the 1,825 million kilowatt-hour increase in electricity sales for the nine months ended June 30, 2005, as compared to June 30, 2004, include:

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- A 1,096 million kilowatt-hour, or five percent, increase in sales to industries directly served due in large part to increased power demand reflecting favorable economic conditions; and
- A 965 million kilowatt-hour, or 41 percent, increase in off-system electricity sales (included in FEDERAL AGENCIES AND OTHER) due to increased generation available for sale and favorable market conditions.

These items were partially offset by a 236 million kilowatt-hour, or less than one percent, decrease in sales to municipalities and cooperatives primarily due to lower volume as a result of milder weather.

Sales to municipalities and cooperatives are more sensitive to weather than the other categories of sales since they service the more volatile residential markets. A measure of this volatility is the "weather degree day" which is a unit of measure used to express the extent to which temperatures vary from a specific reference temperature during a given period. TVA uses 65 degrees Fahrenheit as its standard. During the three month periods ended June 30, 2005, and 2004, there were 98, or 15 percent, fewer degree cooling days in 2005. During the nine month periods ended June 30, 2005, and 2004, there were 52, or nearly seven percent, fewer degree cooling days and 290, or nearly nine percent, fewer degree heating days in 2005.

Operating Expenses

A detailed table of operating expenses for the three and nine month periods ended June 30, 2005, and 2004 is as follows:

	Three months ended June 30			Nine months ended June 30		
	2005	**2004**	**Percent Change**	**2005**	**2004**	**Percent Change**
Operating expenses						
Fuel and purchased power	$ 599	$ 561	6.8%	$ 1,674	$ 1,509	10.9%
Operating and maintenance	575	556	3.4%	1,741	1,684	3.4%
Depreciation, amortization, and accretion	288	279	3.2%	863	831	3.9%
Tax-equivalents	91	84	8.3%	272	252	7.9%
(Gain) loss on project cancellation	–	(15)	100.0%	–	20	(100.0%)
Total operating expenses	$ 1,553	$ 1,465	6.0%	$ 4,550	$ 4,296	5.9%

Significant items contributing to the $88 million increase in total operating expenses for the three months ended June 30, 2005, as compared to June 30, 2004, include:

- A $56 million increase in fuel expense attributable primarily to higher coal prices;
- A $10 million increase in pension and post retirement expense due primarily to increased interest cost coupled with an increased amortization of actuarial loss (see note 5);
- A $10 million charge to operating and maintenance ("O&M") for the accrual of expected performance awards;
- A $7 million increase in depreciation expense attributable to capital projects placed in service;
- A $16 million charge to O&M related to the write-down of certain assets for new technology that had not been proven effective; and
- A $15 million recovery of project costs related to the Regenesys project (see note 1—*Project Cancellation*) not present in 2005.

These items were partially offset by a $5 million reduction in severance expense due to recognition of termination benefit costs in the prior period and a $17 million decrease in purchased power expense which can be attributed to a lower volume of power purchases due to increased hydro production.

Significant items contributing to the $254 million increase in total operating expenses for the nine months ended June 30, 2005, as compared to June 30, 2004, include:

- A $143 million increase in fuel expense attributable to higher coal prices and increased generation at coal fired plants;

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- A $22 million increase in purchased power expense which can be attributable primarily to higher market prices for off-system power;
- A $58 million increase in pension and post retirement expense due primarily to increased interest cost coupled with increased amortization of actuarial loss (see note 5);
- A $28 million charge to O&M for the year-to-date accrual for expected performance awards;
- A $23 million increase in depreciation expense attributable to capital projects placed in service;
- An $8 million increase in amortization expense related to the amortization of the capital lease recognized for the Blended Low Enriched Uranium Program (see note 1—*Blended Low Enriched Uranium Program*); and
- A $16 million charge to O&M related to the write-down of certain assets related to new technology that had not been proven effective (see *Other—Cancellation of Certain Clean Air Projects* below).

These items were partially offset by a one-time loss of $20 million recognized in 2004 due to the cancellation of the Regenesys project (see note 1—*Project Cancellation*) and a $26 million reduction in severance expense due to recognition of termination benefit costs in the prior period.

Other Income, Net

Net other income was $2 million higher for the three months ended June 30, 2005, as compared to the same period in 2004 due to an increase in non-electric business activity.

Items contributing to the $2 million decrease in net other income for the nine months ended June 30, 2005, as compared to the same period in 2004, include a $2 million loss on the sale of distributor loan program receivables (see note 1—*Sale of Loans*) and a decrease in non-electric business activity.

Unrealized Loss on Derivative Contracts, Net

Significant items contributing to the $44 million unrealized net loss on derivative contracts for the three months ended June 30, 2005, include: a $113 million loss recognized on the mark-to-market valuation of three swaption contracts and a $55 million loss recognized on the mark-to-market valuation of an interest rate swap, partially offset by a $124 million unrealized gain related to the mark-to-market valuation adjustment of an embedded call option.

Significant items contributing to the $32 million unrealized net loss on derivative contracts for the nine months ended June 30, 2005, include:

- A $50 million unrealized net loss related to the mark-to market valuation adjustment of an interest rate swap contract;
- A $6 million unrealized net loss related to the mark-to-market valuation of SO_2 emissions allowance call options; and
- A $143 million unrealized net loss related to the mark-to-market valuation of three swaption contracts.

These items were partially offset by a $167 million unrealized net gain related to the mark-to-market valuation adjustment of an embedded call option contract.

Interest Expense

A detailed table of interest expense for the three and nine month periods ended June 30, 2005, and 2004 is as follows:

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	Three months ended June 30			NIne months ended June 30		
	2005	**2004**	**Percent Change**	**2005**	**2004**	**Percent Change**
Interest expense						
Interest on debt	$ 334	$ 347	(3.7%)	$ 1,011	$ 1,040	(2.8%)
Amortization of debt discount, issue, and reacquisition costs, net	6	6	0.0%	16	19	(15.8%)
Allowance for funds used during construction	(30)	(27)	11.1%	(84)	(74)	13.5%
Net interest expense	$ 310	$ 326	(4.9%)	$ 943	$ 985	(4.3%)

Significant items contributing to the $16 million decrease in interest expense for the three months ended June 30, 2005, as compared to June 30, 2004, include:

- A reduction of approximately $1,844 million in the average balance of long-term debt outstanding; and
- A $3 million increase in Allowance for Funds Used During Construction ("AFUDC") due to a higher level of construction work-in-progress in 2005.

These items were partially offset by:

- An increase in the average long-term interest rate on TVA's outstanding long-term debt from 6.18 percent to 6.27 percent; and
- An increase of approximately $1,205 million in the average balance of short-term debt outstanding coupled with an increase in average short-term interest rates from 1.37 percent to 2.89 percent.

Significant items contributing to the $42 million decrease in interest expense for the nine months ended June 30, 2005, as compared to the same period in 2004, include:

- A reduction of approximately $1,636 million in the average balance of long-term debt outstanding; and
- A $10 million increase in AFUDC due to a higher level of construction work-in-progress in 2005.

These items were partially offset by an increase of approximately $774 million in the average balance of short-term debt outstanding coupled with an increase in average short-term interest rates from 1.00 percent to 2.41 percent.

Material Changes in Liquidity and Capital Resources

Comparative Cash Flow Analysis

Net cash provided by operating activities decreased $1,438 million, from $2,605 million to $1,167 million for the nine month period ending June 30, 2004, and 2005, respectively. This decrease resulted from:

- Proceeds of $1.5 billion received in 2004 for energy prepayments not present in the current year; and
- An increase in cash paid for fuel and purchased power of $167 million due to higher coal prices, increased generation at coal-fired plants, and higher market prices for purchased power.

Net cash provided by working capital components changed $217 million, from net cash used of $109 million for the nine month period ending June 30, 2004, to net cash provided of $108 million for the same period in the current year. This change resulted from:

- A larger liquidation of short-term investments of $220 million;
- A larger decrease in accounts receivable of $25 million; and
- A smaller decrease in accounts payable and accrued liabilities of $56 million.

These items were partially offset by:

- A larger decrease in accrued interest of $32 million due to a lower level of long-term debt outstanding; and
- A larger increase in inventories and other assets of $52 million primarily due to the purchase of emission allowances and an increase in certain contract prepayments related to software, leases, and the Browns Ferry Unit 1 restart project.

The smaller decrease in accounts payable and accrued liabilities of $56 million is due primarily to:

- A counterparty that posted collateral with TVA under the provisions of a swap agreement (the balance of collateral held by TVA at June 30, 2005, was $79 million, and was recorded in accounts payable); and
- An accrual of $28 million for expected performance awards.

These items were partially offset by:

- A $26 million reduction in termination benefits; and
- Certain payments for rebate accruals of $19 million.

Cash used in investing activities decreased $198 million, from $1,153 million to $955 million for the nine month periods ending June 30, 2004, and 2005, respectively, primarily due to:

- A decrease in expenditures for capital projects of $220 million, primarily due to decreases in clean air expenditures of $210 million, partially 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—*Sale of Loans*).

These items were partially offset by:

- An increase in the enrichment and fabrication of nuclear fuel of $36 million as four nuclear plants completed refueling outages for the nine months ended June 30, 2005; and
- Purchases of investments of $43 million.

Net cash used in financing activities decreased $1,415 million, from $1,562 million to $147 million for the nine months ended June 30, 2004, and 2005, respectively. The change is related primarily to:

- Net short-term debt issues of $658 million for the nine months ended June 30, 2005, compared to net short-term debt redemptions of $1,175 million for the same period in 2004; and
- An increase of $858 million in long-term debt issues in the first nine months of 2005.

These items were partially offset by:

- An increase of $1,196 million in redemptions of long-term debt; and
- Bond reopening proceeds of $97 million in the first nine months in 2004.

The increase in short-term debt redemptions in 2004 was due primarily to $1,500 million in proceeds received from energy prepayments in the first quarter of that year.

<u>Working Capital</u>
At June 30, 2005, TVA had negative working capital of $3,485 million, largely attributable to current maturities of long-term debt of $1,621 million and short-term indebtedness of $2,581 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 cash provided by operations and proceeds from the sale of bonds and short-term notes to meet current obligations. TVA plans to continue to use such financing instruments as long as short-term interest rates remain favorable.

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In the event that the market for such securities becomes disrupted as a result of overall market conditions or an event specific to TVA, TVA could experience financial distress depending on the timing of such event. Accordingly, during the third quarter of 2005 the Board authorized TVA to enter into one or more credit facilities which would give TVA the right, but not the obligation, to borrow money in accordance with the terms of such credit facilities in an amount not to exceed $5 billion outstanding at any time. In addition, the Board authorized officers and their designees to borrow up to $1 billion under such credit facilities without additional approval from the Board. The credit facilities would be used primarily as insurance against the loss of primary funding markets. For a description of the current credit facility, see *Financing Activities—Revolving Credit Facility Agreement* below.

	June 30 2005	September 30 2004
Current assets	$ 2,134	$ 2,386
Current liabilities	(5,619)	(5,511)
Working capital	$ (3,485)	$ (3,125)
Discount notes <90 days	$ 2,581	$ 1,924
Current maturities of long-term debt	1,621	2,000
Total short-term debt	$ 4,202	$ 3,924

Financing Activities

Capital Resources. From October 1, 2004, to June 30, 2005, TVA redeemed at par $179 million of electronotes® carrying an average interest rate of 6.20 percent, the 2000 Series E QUINTS with $100 million par amount and an interest rate of 7.75 percent, and the 1995 Series A Global Power Bonds with $2 billion par amount and an interest rate of 6.38 percent. In addition, on June 1, 2005, the interest rate on the TVA 1998 Series D Putable Automatic Rate Reset Securities ("PARRS") reset from 5.95 percent to 5.49 percent. The rate may be reset again under certain circumstances on June 1, 2006, and annually thereafter, until maturity. In conjunction with the reset, $86 million of the $552 million of 1998 Series D PARRS outstanding was redeemed by bondholders. The remaining bonds mature on June 1, 2028.

TVA issued $1,605 million of debt during the quarter ended June 30, 2005, including $105 million par amount of electronotes® with maturity dates ranging from 2010 to 2025 and an average interest rate of 4.67 percent, Global Power Bonds 2005 Series A maturing on June 15, 2035, with a par amount of $500 million and an interest rate of 4.65 percent, and Global Power Bonds 2005 Series B maturing on June 15, 2015, with a par amount of $1 billion and an interest rate of 4.38 percent. See note 3.

In April 2005, TVA monetized the call provisions of two electronotes® issues ($42 million total par value) by entering into swaption agreements with a third party in exchange for $5 million. The swaptions are recorded in OTHER LIABILITIES on the balance sheet and are marked to market, with changes in the market value recognized currently in earnings. See note 6 in the 2004 Information Statement.

Revolving Credit Facility Agreement. On May 26, 2005, TVA and a national bank entered into a revolving credit facility agreement with an initial term of 180 days. The facility provides TVA with an unsecured revolving line of credit of up to $2.5 billion. There were no outstanding borrowings under the facility at June 30, 2005.

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 nine months ended June 30, 2005.

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 of electricity in the prepaid block. The remainder of the price of the kilowatt-hours of electricity delivered is due upon billing.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued
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As of June 30, 2005, TVA had entered into sales agreements for 54.5 DEU totalling $54.5 million of which $7.25 million is for the 2004 program. Total revenue recognized on a cumulative basis through June 30, 2005, exceeds $13 million. Of this amount, over $4 million was recognized as revenue during 2005.

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 is 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 revenue recognized on a cumulative basis through June 30, 2005, exceeds $165 million. Of this amount, $75 million was recognized as revenue during 2005. This amount was based on the ratio of kilowatt-hours of electricity delivered to the total kilowatt-hours under contract.

TVA is reporting the June 30, 2005, and September 30, 2004, obligations of $1,376 million and $1,455 million, respectively, to deliver power under these energy prepayment programs as ENERGY PREPAYMENT OBLIGATIONS and CURRENT PORTION OF ENERGY PREPAYMENT OBLIGATIONS on the June 30, 2005 and September 30, 2004 Balance Sheets.

There have been no energy prepayment transactions during 2005.

Cash Requirements and Contractual Obligations. The estimated future cash requirements and contractual obligations for TVA as of June 30, 2005, are as follows:

	2005*	2006	2007	2008	2009	Thereafter	Total
Debt	$ 2,581	$ 2,621	$ 968	$ 91	$ 2,031	$ 14,890	$ 23,182
Interest on debt	209	1,226	1,034	1,009	953	13,170	17,601
Leases	21	83	80	70	65	104	423
Lease/leasebacks	22	84	85	89	84	1,300	1,664
Power purchase obligations	46	176	159	133	137	3,677	4,328
Other obligations	180	419	197	211	56	61	1,124
Fuel purchase obligations	412	540	315	267	186	505	2,225
Pension contribution	26	75	–	–	–	–	101
Total	$ 3,497	$ 5,224	$ 2,838	$ 1,870	$ 3,512	$ 33,707	$ 50,648

* Period July 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
Energy prepayment obligations	$ 26	$ 106	$ 106	$ 106	$ 105	$ 927	$ 1,376

* Period July 1 – September 30, 2005

As of June 30, 2005, TVA's decommissioning trust funds totaled approximately $793 million, which is less than the present value of the estimated future decommissioning costs calculated in accordance with the Nuclear Regulatory Commission ("NRC") requirements. In March 2005, TVA submitted its biennial letter to the NRC outlining the funding status of the TVA Nuclear Decommissioning Trust as compared with its liabilities. In addition, on October 30, 2003, TVA sent a letter to the NRC establishing a method to provide funding assurance on an ongoing basis. This method essentially establishes a projection of necessary funds at the end of each calendar year based upon current decommissioning cost estimates and assumptions regarding escalation and rate of earnings. Each year TVA reviews the performance of the trust fund. If funds at the end of the calendar year are below an established threshold of 95 percent of projected value, TVA will make contributions to the trust fund or provide other methods of funding assurance to ensure adequate funding. At the end of 2004, the total trust fund balance provided sufficient funding assurance to meet the updated threshold levels calculated in accordance with the October 30, 2003 letter.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued
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Impact of New Accounting Pronouncements and Interpretations

Variable Interest Entities
In January 2003, the FASB published FASB Interpretation No. 46, "*Consolidation of Variable Interest Entities—an interpretation of ARB No. 51*," which was later revised by FASB Interpretation ("FIN") No. 46(R) ("FIN 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 ("ARB") 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.

In March 2005, the FASB released FASB Staff Position ("FSP") FIN 46(R)-5, "*Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities*," which is applicable to both nonpublic and public reporting enterprises. This FSP addresses transactions in which a reporting enterprise has an interest in, or other involvement with, a VIE or potential VIE that is not considered a variable interest, and the reporting enterprise's related party (a non-VIE) has a variable interest in the same entity. This FSP must be applied in accordance with the FIN 46 effective date and transition. At this time, TVA is in the process of evaluating the requirements of this interpretation and does not yet know the impact of its implementation, which may or may not be material to TVA's 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 FSP Financial Accounting Standard ("FAS") 106-2, "*Accounting and 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 determined that it does not qualify for the subsidy as outlined in the Medicare Prescription Drug Improvement and Modernization Act of 2003. TVA continues to work directly with its health care providers to control costs and to provide affordable benefits to its retirees. TVA adopted the disclosure requirements for nonpublic entities 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.

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 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 will 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 will 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.

Conditional Asset Retirement Obligations
In March 2005, the FASB issued FIN No. 47, "*Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143*." This interpretation clarifies that the term conditional asset retirement obligation ("conditional ARO") as used in SFAS No. 143, "*Accounting for Asset Retirement Obligations*," refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for the fair value of a conditional ARO if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional ARO should be recognized when incurred. This interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an ARO. This interpretation is effective no later than the end of fiscal years ending after December 15, 2005. TVA is evaluating the potential implications of this interpretation on its AROs, which may or may not be material to its financial position or results of operations.

Accounting Changes and Error Corrections
In May 2005, the FASB issued SFAS No. 154, "*Accounting Changes and Error Corrections--a replacement of APB Opinion No. 20 and FASB Statement No. 3*," which replaces Accounting Principles Board ("APB") Opinion No. 20, "*Accounting Changes*," and FASB Statement No. 3, "*Reporting Accounting Changes in Interim Financial Statements*." This statement applies to all voluntary changes in accounting principle and also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This statement requires, unless impracticable, retrospective application to prior periods' financial statements of changes in accounting principle. If it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this statement requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, this statement requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. This statement also requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. The statement will become effective for TVA beginning in fiscal year 2007 with early adoption permitted for accounting changes and corrections of errors made in fiscal years beginning after the date the statement is issued.

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 TVA's service territory, averaging of effects over different times of the year as TVA has peaks during both summer and winter (double-peaking utility), and the existence of only nominal changes in hydroelectric availability during high-value periods.

Operational Risk
The financial risks associated with the operation of the system are modest over periods of one year or more. However, the increasing need for coordination with surrounding regional transmission organizations introduces new costs that are difficult to quantify at this point.

Annual financial targets can be noticeably influenced by the unforeseen interruption of key generating facilities during peak seasons. The likelihood of such interruptions increases with an aging generation fleet.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued
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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 essentially confines TVA to this defined service territory, the 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. However, Senators from Kentucky have questioned the appropriateness of applying the Anti-Cherrypicking Provision to a distributor whose notice of termination of its TVA power contract has become effective. In addition, due to the uncertainties in rulings related to the nation's transmission systems, TVA's financial exposure to customer losses may increase in the future. See *Additional Information—Transmission System*.

Termination Notices
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, eight distributors including PEPB have given notice that terminates their power contracts with TVA, but, as discussed below, two of these notices have since been withdrawn and deemed to be of no force and effect. Five of the six distributors whose notices are still in effect are located in Kentucky, where neighboring power suppliers enjoy significant competitive advantages. These five distributors are PEPB, Warren Rural Electric Cooperative Corporation, Monticello Electric Plant Board, Glasgow Electric Plant Board, and Paducah Power System. The sixth distributor, Duck River Electric Membership Corporation, is located in Tennessee.

Two other distributors gave TVA notice terminating their power contracts—Meriwether Lewis Electric Cooperative ("MLEC") and Bowling Green Municipal Utilities ("BGMU"). In 2004, the MLEC notice was withdrawn and deemed to be of no force and effect by the mutual agreement of MLEC and TVA. In March 2005, the BGMU notice was also withdrawn and deemed to be of no force and effect by the mutual agreement of BGMU and TVA. With its notice of contract cancellation withdrawn, BGMU will receive full TVA support and services under the five-year rolling contract that was in effect before notice to terminate the contract was submitted in October 2002. In 2004, BGMU purchased $43 million in electricity from TVA, which accounted for 0.6 percent of TVA's operating revenues.

The table below lists the distributors (other than MLEC and BGMU) 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued
Dollars in millions except where noted

Distributor	Date of Termination of Power Contract	Sales to Distributor in 2004	Percentage of Operating Revenues in 2004
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		$ 220	3.0%

Long-Term Contracts
A number of TVA distributors, including some with large 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. Representatives of TVA and distributors have been meeting to discuss various potential long-term contract structures that could provide more certainty to both TVA and distributors. While these discussions have not yet resulted in any agreed upon structure, TVA and the distributors plan to continue with the process.

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

TVA continues to examine cost-effective ways to further reduce emissions in light of evolving emission reduction requirements, coal markets, and emissions reduction technologies. These efforts have led TVA to consider making some changes to its clean air compliance strategy including accelerating switches to lower sulfur coals at some plants, and incorporating the selective non-catalytic reduction ("SNCR") technology into TVA's current nitrogen oxide ("NOx") emission reduction strategy. As TVA moves forward to comply with increasingly stringent NOx and sulfur dioxide ("SO_2") emission reduction requirements, TVA is also considering use of minimal amounts of purchased emission allowances.

In March 2005, the Environmental Protection Agency finalized two major rules for electric utilities, the Clean Air Interstate Rule ("CAIR"), and a rule dealing with mercury. Together these rules place cap and trade requirements on utility emissions of SO_2, NOx, and mercury, tracking closely the Administration's Clear Skies legislation. Under these cap and trade programs, emissions of pollutants are capped, and each state is authorized to distribute a specific number of emission allowances to sources within the state. Affected sources must limit their emissions to the allowances they hold at the end of reporting periods, but allowances can be transferred among sources throughout the affected region.

The mercury rule is expected to be challenged in court by several states alleging that it does not do enough to control mercury emissions from fossil-fired plants, and it is possible that CAIR will also be challenged in court. Accordingly, it may be several years before the full impact of the rules on TVA will be known. It is certain, however, that the rules will significantly increase TVA's air compliance costs, possibly adding in excess of $4 billion to currently planned expenditures and commitments over the next ten to 15 years.

When fully implemented, the rules are expected to reduce emissions of SO_2 and NOx by over 70 percent and over 60 percent, respectively, from 2003 levels in 28 eastern states and the District of Columbia and to reduce utility emissions of mercury by approximately 70 percent.

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; 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 and schedule 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; changes to the Anti-Cherrypicking Provision; 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 August 8, 2005, President Bush signed the wide-ranging energy bill passed by Congress. Provisions in the bill relevant to TVA include:

- TVA would be subject to Federal Energy Regulatory Commission ("FERC") review of transmission rates and terms and conditions of service to ensure comparability of treatment of its and others regarding the same transmission service. The bill provides that TVA distributors will be afforded native load protection preference regarding firm transmission rights on the TVA transmission system, but in a way that (i) will not affect the requirements of the Anti-Cherrypicking Provision and (ii) will not itself provide a new basis for any FERC order that would be contrary to the purposes of the Anti-Cherrypicking Provision. (Native load refers to the customers on whose behalf a company, by statute, franchise, regulatory requirement, or contract, has undertaken an obligation to serve.)

- FERC's authority to order refunds of excessive prices on short-term sales (transactions lasting 31 days or less) in market manipulation and price gouging situations would be expanded to include authority over TVA.

- TVA would be subject to new prohibitions on (i) using manipulative or deceptive devices or contrivances in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to jurisdiction and (ii) willfully and knowingly reporting false information on the price of electricity sold at wholesale or the availability of transmission capacity to a federal agency with intent to fraudulently affect the data being compiled by the agency. These entities would also be made subject to FERC's investigative and enforcement authority in these two areas. This provision does not provide a private right of action for persons or companies.

- FERC would be authorized to issue regulations requiring the reporting, on a timely basis, of information about the availability and prices of wholesale electric energy and transmission service by all market participants.

- Three new standards would be added to the Public Utility Regulatory Policies Act ("PURPA"), requiring TVA to consider its suitability for application to distributors and itself. The new standards to be considered include (i) net metering, (ii) smart metering, and (iii) interconnection.

- TVA is authorized to participate in regional transmission organizations ("RTOs"), but only under contractual relationships that (i) do not impair the requirements of federal laws and contracts, (ii) set performance standards to assure that the federal transmission assets in question are managed in ways consistent with federal laws and contracts, and (iii) enable withdrawal from the RTO if those performance standards are not met.

In short, the impacts of this energy bill on TVA will primarily be in regulatory process and administrative cost. TVA has not joined a RTO but currently has a Joint Reliability Coordination Agreement with the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") and PJM Interconnection that provides for cooperation in the management and operation of the electric transmission grid over a major portion of the eastern United States for the coordination of planning and congestion management to ensure reliability and market liquidity in the Eastern Interconnection.

In July 2005, Senator Jim Bunning (R-KY) and Senator Mitch McConnell (R-KY) introduced S.1499, a bill that would effectively remove any area within Kentucky from coverage by the Anti-Cherrypicking Provision. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" — "*Risk of Loss of Customers*" in the 2004 Information Statement for further discussion of the Anti-Cherrypicking Provision. If the bill were to become law, FERC could require TVA to wheel power from a supplier other than TVA for use inside that portion of the fence that is within Kentucky. The bill was referred to the Senate Energy and Natural Resources Committee.

Other

<u>Blended Low Enriched Uranium Program</u>
On December 5, 2004, TVA received the first fuel assembly under the Blended Low Enriched Uranium ("BLEU") fuel program for loading into its Browns Ferry Nuclear Plant Unit 2. The unit ended its most recent refueling outage in April 2005, at which time the costs of the BLEU fuel assemblies began being amortized to nuclear fuel expense.

The BLEU fuel program is implemented, in part, through agreements with counterparties, including an interagency agreement with the Department of Energy ("DOE") to provide raw nuclear fuel materials to be processed into usable fuel for TVA nuclear reactors, and other contracts with third-party nuclear fuel processors under which the nuclear fuel processors, either by themselves or through subcontractors (collectively "Third Party Fuel Processors"), acquire land, construct facilities, and process the raw materials from DOE into usable fuel for TVA nuclear reactors.

Under the terms of the interagency agreement, DOE supplies off-specification, highly enriched uranium materials to the appropriate Third Party Fuel Processors for processing into usable fuel for TVA. In exchange, DOE will participate to a degree in the savings generated by TVA's use of this blended nuclear fuel product. As of June 30, 2005, TVA projects that the DOE's share of savings generated by TVA's use of this blended nuclear fuel product could result in future payments to DOE of as much as $212 million. TVA anticipates these future payments, if such payments materialize, could begin as early as 2010. However, due to the uncertainty of the related amounts and less than probable occurrence, TVA will not currently accrue an obligation related to such future cost savings.

The Third Party Fuel Processors own the conversion and processing facilities and will retain title to all land, property, plant, and equipment used in the BLEU fuel program. There is no provision for TVA to own or otherwise take title to the facilities, materials, or equipment now or at any time in the future. However, in accordance with the requirements of EITF No. 01-08, "*Determining Whether an Arrangement Contains a Lease*," and SFAS No. 13, "*Accounting for Leases*," TVA recognized a capital lease asset and corresponding lease obligation related to amounts paid or payable to a Third Party Fuel Processor. Accounting recognition of the capital lease asset and obligation was brought about due to a contract modification to the pre-existing fuel fabrication contract, which occurred during the second quarter of 2004.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued
Dollars in millions except where noted

During the quarter ended March 31, 2005, TVA recorded a capital lease asset of $60 million comprised of $23 million in pre-recharacterization contract payments and $37 million in post-recharacterization contract payments either paid or payable. Also during the second quarter, TVA recorded an initial capital lease obligation of $37 million which has been reduced by $17 million in post-recharacterization principal payments leaving an unpaid capital lease obligation of $20 million at the end of June 2005. Additionally, TVA has recognized asset amortization expense of $8 million and interest expense of $2 million related to the capital lease obligation through June 30, 2005.

Guarantee

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. On May 12, 2005, the letter of credit was reduced to $300,000 and will expire on September 30, 2005. As of June 30, 2005, TVA's liability associated with this project was less than $150,000. The project is scheduled to be completed during the fourth quarter of 2005, and TVA does not expect the letter of credit to be drawn upon.

Financial Trading Program

As uncertainties in the electric power and power plant fuel markets increase, financial derivatives (e.g., futures, options on futures, swaps, and options on swaps) are playing an ever-increasing role. Accordingly, purchasers and suppliers of electric power or power plant fuel are hedging the economic risks associated with the generation, purchase, and sale of electricity and the purchase and sale of power plant fuel. In light of these trends, the Board established a Financial Trading Pilot Program (the "Pilot Program") (see *Quantitative and Qualitative Disclosures about Market Risk–Financial Trading Program*) in 2003 to help manage TVA's economic risk exposure. Under this Pilot Program, TVA is authorized to use futures and options on futures to hedge economic risks directly associated with the cost of natural gas and fuel oil for TVA's power generation operations and risk under power purchase or sale arrangements where the energy price varies based upon a fuel index. The Pilot Program is scheduled to end on August 31, 2005. However, on May 17, 2005, the Board established a permanent Financial Trading Program (the "Program") that allows TVA to (1) continue to hedge the risks authorized under the Pilot Program, (2) broaden the type of risks that TVA can hedge to include economic risks directly associated with both the cost of natural gas for tolling agreements and the purchase or sale arrangements where the energy price is based at least in part upon a fuel price index or proxy, and (3) hedge risks more effectively by using swaps and options on swaps in addition to futures and options on futures. Trading is not authorized for speculative purposes.

Transactions under the Program are entered into to hedge, or lock in, desired fuel supply costs, electric power supply costs, or sales margins. Under the proper hedging strategy, net losses experienced by TVA in the physical markets can be offset by net gains in the financial trading markets, and vice versa. Because of the uncertainties resulting from unanticipated changes in TVA's physical asset portfolio, the financial portfolio can become imbalanced from time to time resulting in inadvertent financial risk exposure that does not hedge a physical asset risk. The total financial risk exposure under the Program will be monitored on a daily basis to ensure that it does not exceed the maximum established under the parameters established for the Program.

Cancellation of Certain Clean Air Projects

During the third quarter of 2005, TVA performed an assessment of certain capital projects related to its clean air program. Because some of the technology has not operated as planned TVA has determined it is appropriate to write-off the project-to-date costs of $16 million and charged them to expense. TVA will continue its efforts to achieve clean air emission reductions through installation of emission control equipment and technologies.

Revision of Pension Expense

During 2005, TVA implemented two changes in its pension plan which were effective beginning in January and May 2005. The plan changes adopted by the TVA Board and the TVA Retirement System Board focused on the rates of accretion and future contributions granted by the Board on members' certain annuity account balances. The approved plan changes determined (1) that future rates of return will no longer be guaranteed at a specific level but rather will decrease by a graduated amount per year until an agreed lower level of return is reached and (2) members previously ineligible to participate in such annuity accounts are now eligible to establish these type accounts.

As a result of these pension plan changes, TVA revised its actuarial estimate of 2005 pension expense and prospectively recorded the entire change, as a reduction in year-to-date pension expense, during the third quarter of 2005. TVA recorded the cumulative effects of the plan changes by adjusting the third quarter pension expense downward by

$20 million. TVA effected the change in expense by revising the amounts previously recorded at $68 million per quarter to an amount equal to $61 million per quarter. Thus, TVA's year-to-date pension expense was decreased from $203 million to $183 million at the end of the third quarter of 2005. Pension expense is expected to be recorded at the $61 million amount for the last quarter of the year and is expected to result in total expense of $244 million for the year.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Dollars in millions except where noted

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 under certain contractual arrangements. Accordingly, TVA has established controls to mitigate exposure to these various risks.

Mark-to-Market Valuation

TVA monitors the mark-to-market ("MTM") value, or fair value, of energy assets for the upcoming year. MTM analysis values assets at the price a willing third party would pay for a particular asset. The MTM calculation determines a profit or loss for each asset based on market prices. 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. When available, quoted market prices are used to value an energy asset. However, market values for energy assets may not be readily available because the duration of the contracts exceeds the liquid activity in a particular market. If no active trading market exists, the fair value of the energy asset is based on pricing models of assets with similar terms and risks. As of June 30, 2005, the MTM value of TVA's electricity portfolio for the next 12 months is $3.6 billion.

Derivatives

TVA has entered into various derivative transactions to manage its risk exposures. 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—an amendment of FASB Statement No. 133*," 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, swaption agreements, and option and futures contracts for 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 swap transactions qualify for cash flow hedge accounting treatment under SFAS No. 133. Consequently, the effective portions of gains and losses related to these derivative 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 June 30, 2005, and September 30, 2004, include the following:

	Accumulated Other Comprehensive Income (Loss)	
	June 30, 2005	September 30, 2004
Interest rate swap	$ (5)	$ (2)
Foreign currency swaps	9	(50)
Total	$ 4	$ (52)

Other derivative contracts include various purchased power option contracts, coal contracts, natural gas futures contracts, swaption agreements, and an interest rate swap. Certain of these contracts qualify and are accounted for as fair value hedges 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 values 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. However, as a result of certain credit terms included in a swap contract, one swap counterparty has posted collateral with TVA. The balance of collateral held by TVA at June 30, 2005, was $79 million, which is recorded in CASH and SHORT-TERM INVESTMENTS. The offsetting liability is recorded in ACCOUNTS PAYABLE.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK – Continued
Dollars in millions except where noted

Emission Allowances

In October 2004, the Board expanded the existing delegation that 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 Trading 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 ("Pilot Program"). Under this Pilot Program, TVA is authorized to use futures and options on futures to hedge economic risks directly 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. On May 17, 2005, the Board established a permanent financial trading program ("Program" and, together with the Pilot Program, "Programs") that allows TVA to: (1) continue to hedge the risks authorized under the Pilot Program; (2) broaden the type of risks that TVA can hedge to include economic risks directly associated with both the cost of natural gas for tolling agreements and the purchase or sale arrangements where the energy price is based at least in part upon a fuel price index or proxy; and (3) hedge risks more effectively by using swaps and options on swaps in addition to futures and options on futures. Trading is not authorized for speculative purposes under these Programs.

At June 30, 2005, TVA had 251 derivative positions outstanding under the Programs. The Programs have enabled TVA to effectively hedge the price risk associated with a portion of its natural gas and power purchases. TVA recognized unrealized gains of approximately $0.8 million which were included as a reduction of purchased power expense for the period ended June 30, 2005. The same period also produced realized gains of about $0.4 million which were included as a reduction to purchased power expense. The gains on the positions were less than one percent of the total natural gas expense for the period.

Financial Trading Program Activity

	Three months ended June 30, 2005		Nine months ended June 30, 2005	
	Notional Amount (in mmBtu)	Contract Value	Notional Amount (in mmBtu)	Contract Value
Futures contracts				
Financial positions at beginning of period, net	380,000	$ 2.4	–	$ –
Purchased	2,460,000	16.4	3,230,000	21.4
Sold	(720,000)	(4.8)	(1,110,000)	(7.4)
Net positions–long	2,120,000	14.0	2,120,000	14.0
Options contracts				
Financial positions at beginning of period, net	510,000	–	–	–
Calls purchased	270,000	0.1	520,000	0.3
Puts sold	300,000	(0.1)	800,000	(0.3)
Positions closed or expired	(690,000)	–	(930,000)	–
Net positions–long	390,000	–	390,000	–
Holding gains (losses)				
Unrealized gain at beginning of period, net	–	0.9	–	–
Unrealized (loss) gain for the period	–	(0.1)	–	0.8
Unrealized gains at end of period, net	–	0.8	–	0.8
Financial positions at end of period, net	2,510,000	$ 14.8	2,510,000	$ 14.8

CONTROLS AND PROCEDURES

TVA maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its financial statements is recorded, processed, summarized, authorized and reported on a timely basis, and that such information is accumulated and communicated to TVA management, including members of the Board, the Disclosure Control Committee, and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

An evaluation has been performed under the supervision of TVA management, including the members of the Board, members of the Disclosure Control Committee (including the Chief Financial Officer and the Controller) of the effectiveness of TVA's disclosure controls and procedures as of June 30, 2005. Based on that evaluation, the members of the Board, members of the Disclosure Control Committee (including the Chief Financial Officer and the Controller) concluded that, as a result of two additional internal control deficiencies (described below), TVA's disclosure controls and procedures were not effective as of June 30, 2005. However, to assess the financial statement impact of these internal control deficiencies, TVA performed additional analyses and other post-closing procedures. As a result of these additional activities, the members of the Board, the Disclosure Control Committee (including the Chief Financial Officer and the Controller) have determined that there is sufficient assurance that the financial statements included in this Quarterly Report fairly present, in all material respects, TVA's financial condition, results of operations and cash flows as of, and for, the periods presented. However, these identified internal control deficiencies, if not remediated, could individually or in the aggregate result in a future determination of a material weakness.

Note: The Public Company Accounting Oversight Board ("PCAOB") has defined significant deficiency as "a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected." Further, the PCAOB has defined material weakness as "a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected."

First, general computer controls are policies and procedures that relate to many applications and support the effective functioning of application controls by helping ensure the continued operation of information systems. As of June 30, 2005, an internal control deficiency was identified related to TVA's general computer controls as follows:

- Program development and program changes including (1) documentation of change authorization and (2) restricting programmer access to the production environment, and
- Unrestricted access to programs and data including (1) user administration, (2) application and system security configurations, and (3) periodic user access validation.

Management has not completed its assessment of the magnitude of this internal control deficiency which is at least considered a significant deficiency and could ultimately be considered a material weakness. Accordingly, TVA is taking corrective actions to address this internal control deficiency going forward by implementing tighter controls over data and program changes, stricter logging and monitoring processes of data and program changes, and additional documentation and security procedures.

Second, also as of June 30, 2005, TVA identified an internal control deficiency related to the design of controls over the conduct of physical observations of materials and supplies inventory. The design and operation of the current inventory cycle count controls may not completely ensure that inventory on-hand is accurately counted and recorded. Management has not completed its assessment of the magnitude of this internal control deficiency which is at least considered a significant deficiency and could ultimately be considered a material weakness. Accordingly, TVA is taking corrective actions to address this internal control deficiency going forward by improving controls over cycle counts, performing independent reviews and audits of periodic cycle counts, and segregating the cycle count duties between the personnel performing the counts and those recording and clearing differences.

Previously, 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 has developed and communicated a plan to obtain annual Statement on Auditing Standards ("SAS") 70 internal control reports on 12 specific control objectives from customers and their third party billing processors. The first SAS 70 reports will be due to TVA on August 31, 2006.

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 were not standardized. To improve controls in this area, personnel have performed independent reviews of all new contracts and supplements and changes made to the valuation model during the quarter ended June 30, 2005. TVA has also implemented standard control procedures to address this internal control deficiency which include independent reviews of the input of contract terms into the valuation model and proper segregation of duties.

Except for the efforts taken and currently underway as described above, no changes occurred during the quarter ended June 30, 2005, in our internal control over financial reporting 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 March 31, 2005, the Board approved a delegation of authority to the Vice President, Corporate Finance and Risk Management, or the designee(s) thereof, to purchase, renew, and take other such ancillary actions as may be necessary or desirable in connection with non-nuclear property insurance, including, but not limited to, selecting policies (subject to the approval of the General Counsel) and deductibles, and negotiating terms and conditions.

As of April 12, 2005, the Board approved delegation of authority to the President and Chief Operating Officer, or a designee, to approve and implement revisions to TVA's Dispersed Power Production Guidelines for TVA and Distributors of TVA Power.

As of April 18, 2005, the Board approved (i) delegations of authority to the President and Chief Operating Officer, or a designee, to approve the practices of submitting “virtual supply offers” and “virtual demand bids” in the Midwest ISO's day-ahead energy market and of holding, buying, or selling Financial Transmission Rights in the Midwest ISO and PJM Interconnection's day-ahead energy markets; and (ii) a delegation of authority to the Chief Financial Officer, or a designee, to establish such internal monitoring, oversight, and approval processes as are necessary to reasonably assure that the aforementioned practices operate within the parameters approved by the Board.

As of April 25, 2005, the Board approved delegations of authority to the Vice President, Corporate Finance and Risk Management, and designees thereof, to purchase, renew, and take other such ancillary actions as may be necessary or desirable in connection with directors and officers insurance, including, but not limited to, selecting policies (acceptable in form to the General Counsel) and deductibles, and negotiating terms and conditions.

As of April 27, 2005, the Board authorized financial arrangements associated with call provisions (options) which TVA has on approximately $42 million of previously issued Tennessee Valley Authority Power Bonds and delegated to the Chief Financial Officer and Executive Vice President, Financial Services, and the Senior Vice President, Treasurer/Investor Relations authority to enter into these arrangements.

As of May 9, 2005, the Board delegated to the Chief Financial Officer and Executive Vice President, Financial Services, the Senior Vice President, Treasurer/Investor Relations, and the designees of either such officer authority, (i) to enter into a credit facility or credit facilities with one or more financial institutions in total amount not to exceed $5 billion at any time, and (ii) to borrow from time to time under such facility(ies) amounts not to exceed $1 billion outstanding at any time without additional Board approval.

As of May 17, 2005, the Board approved the establishment of a financial trading program that would expand and fully implement the financial trading pilot program.

As of June 6, 2005, the Board approved the issuance, sale and delivery of up to $1 billion in power bonds to refinance existing debt.

As of June 6, 2005, the Board delegated to the Executive Vice President and General Counsel responsibility for reviewing and approving the Financial Disclosure Report filed by TVA's Designated Agency Ethics Official.

As of June 14, 2005, the Board delegated authority to certain executive officers to take certain actions related to procurement, financing, personnel, and compensation matters for the interim period commencing on June 20, and ending on the earlier of December 31, 2005, or the date upon which the Board decides to address the matters otherwise. The action enhances TVA's ability to act quickly and efficiently during the transition in governance per the Consolidated Appropriations Act, 2005.

As of June 15, 2005, the Board approved the issuance, sale and delivery of up to $1 billion in power bonds to refinance existing debt.

As of July 7, 2005, the Board approved a plan of amortization of TVA's $3.91 billion investment in deferred nuclear generating unit costs over ten years at a rate of approximately $391 million a year starting with the fiscal year that begins October 1, 2005, which amount is subject to acceleration or deceleration in any given year under the provisions of TVA's amortization adjustment accounting policy.

On July 22, 2005, the Board approved a 7.5 percent increase in firm wholesale electric rates. The rate increase will be effective October 1, 2005.

On July 22, 2005, the Board approved an $8.7 billion capital and operating budget for 2006.

ADDITIONAL INFORMATION

Management

On June 16, 2005, President Bush named Director Bill Baxter chairman of the TVA Board. Director Baxter will serve as chairman until the new restructured nine-member board is in place and has selected its chairman. President Bush appointed Director Baxter to the Board in November 2001.

On July 12, 2005, TVA President & Chief Operating Officer Tom Kilgore was elected to a three-year term on the Nuclear Energy Institute's ("NEI") Executive Committee. The NEI is a trade association that helps develop national and global policy for the nuclear-energy industry.

Operations

<u>Browns Ferry Unit 1</u>

In May 2002, the 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 an expected cost of approximately $1.8 billion (excluding AFUDC). Unit 1 is scheduled to return to service in 2007, and the additional generating capacity is expected to lower TVA's average cost of power and provide additional cash flow. Through June 30, 2005, TVA had incurred approximately $1.2 billion of costs (including AFUDC of $85 million) on the Browns Ferry Unit 1 restart project, the planned amount for this period. The restart project was about 65 percent complete as of that date and on schedule for completion.

<u>Peak Demand</u>

On July 26, 2005, TVA met the highest demand for electricity ever recorded in its seven-state service area without a single sustained interruption of power to its customers. The system met a peak demand of 31,935 megawatts. The peak followed several days of hot weather and heavy power demand in the TVA region. TVA's power system had met more than 29,000 megawatts of demand for seven consecutive days, which is a record for TVA. Power demand for the July 23-24 weekend was more than seven percent higher than any weekend demand ever on the TVA system. Nearly all of TVA's generating units were operating or available to help meet the record power demand.

<u>2006 Budget</u>

On July 22, 2005, the Board approved an $8.7 billion capital and operating budget for 2006. The budget projects a 16 percent increase in fuel and purchased-power costs compared to 2005. The budget includes $340 million to reduce TVA's total financing obligations and provides $1.6 billion in capital investments including additional clean-air improvements, the restart of Browns Ferry Unit 1, and other capital projects.

<u>Bellefonte</u>

The Board action to amortize the $3.91 billion deferred nuclear generating unit costs will not limit TVA's ability to use the Bellefonte site in the future. The site is still one of the six potential sites under consideration as a future site for a new advanced-technology nuclear reactor by NuStart Energy Development LLC ("NuStart"), a consortium of nine utilities and two reactor suppliers, of which TVA is a member. NuStart is expected to narrow the list to the final two sites later in 2005. In addition, TVA is currently leading a team conducting a cost and schedule study on building an Advanced Boiling Water Reactor ("ABWR") at the Bellefonte site. Other members of the team involved in this study, which is being performed under the DOE's Nuclear Power 2010 program, include Toshiba Corp., General Electric Corp., Bechtel Corp., USEC, and Global Nuclear Fuels—Americas. The ABWR has been design-certified in the United States by the Nuclear Regulatory Commission. The study will verify the costs of building a new ABWR plant, which could provide another option for utilities interested in preserving the nuclear energy option for the future. Neither NuStart nor TVA have made a decision to build an advanced nuclear reactor at this time.

<u>Transmission System Interconnection</u>

On October 1, 2004, East Kentucky Power Cooperative ("EKPC") filed an application with the Federal Energy Regulatory Commission ("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 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. On April 13, 2005, FERC issued a proposed order granting EKPC's application. The parties tried without success to resolve their differences.

On August 3, 2005, FERC issued an order for TVA to interconnect with EKPC and to provide EKPC with coordination services necessary to deliver energy to WRECC. The order recognized that TVA is entitled to be compensated for the use of the TVA system caused by the interconnections and asked TVA to file a new agreement within 30 days, covering the terms, conditions and rates TVA believes it should receive for this use. TVA is currently assessing this order. Since the order requires both TVA and EKPC to submit additional filings, it does not represent a final order. After FERC issues a final order, TVA can request a rehearing and ultimately appeal to the Court of Appeals.

CERTIFICATIONS OF THE MEMBERS OF THE TVA BOARD OF DIRECTORS

Skila Harris and Bill Baxter individually certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report ("Report") for the quarterly period ended June 30, 2005;

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 the end 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 June 30, 2005, 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: August 23, 2005

Bill Baxter
Chairman

Skila Harris
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 June 30, 2005;

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 the end 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 June 30, 2005, 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: August 23, 2005

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

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