Tennessee Valley Authority

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

Quarterly Report

For the quarterly period ended December 31, 2005

Tennessee Valley Authority

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For the quarterly period ended December 31, 2005

This document contains the unaudited Quarterly Report of TVA for the quarterly period ended December 31, 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 report with the SEC. Due to legislation enacted in December 2004, beginning with its 2006 annual report, TVA will be required to file annual reports, quarterly reports, and current reports with the SEC under the Securities Exchange Act of 1934. Several portions of this Quarterly Report contain forward-looking statements, and reference is made to page 1 regarding such statements. This Quarterly Report should be read in conjunction with the 2005 Information Statement dated November 18, 2005 (as may be amended from time to time, the "2005 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.

Some examples of forward-looking statements include statements regarding strategic objectives; estimates of costs for disposing of certain asset retirement obligations; expectations about the adequacy of TVA’s nuclear decommissioning fund; estimates regarding the reduction of total financing obligations; the impact of new accounting pronouncements and interpretations, including Statement of Financial Accounting Standards No. 151, *“Inventory Costs — an amendment of ARB No. 43, Chapter 4”* and Financial Accounting Standards Board (“FASB”) Interpretation No. 47, *“Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143;”* TVA’s plans to continue using short-term debt to meet current obligations; and the anticipated cost and timetable for returning Browns Ferry Unit 1 to service. Additionally, other risks that may cause actual results to differ from the predicted results are set forth in *“Management's Discussion and Analysis” — “Risk Factors and Forward-Looking Statements.”*

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 the 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 or systems 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 materially from those contained in any forward-looking statement.

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

FINANCIAL INFORMATION

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF INCOME (unaudited)

For the three months ended December 31
(in millions)

	2005	2004
Operating revenues		
Sales of electricity		
Municipalities and cooperatives	$ 1,769	$ 1,525
Industries directly served	230	215
Federal agencies and other	26	73
Other revenue	27	21
Total operating revenues	2,052	1,834
Operating expenses		
Fuel and purchased power	745	477
Operating and maintenance	600	582
Depreciation, amortization, and accretion	388	285
Tax-equivalents	94	91
Total operating expenses	1,827	1,435
Operating income	225	399
Other income, net	7	5
Unrealized gain on derivative contracts, net	14	4
Interest expense		
Interest on debt	330	339
Amortization of debt discount, issue, and reacquisition costs, net	5	5
Allowance for funds used during construction and nuclear fuel expenditures	(36)	(26)
Net interest expense	299	318
Net (loss) income	$ (53)	$ 90

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

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

ASSETS	December 31 2005	September 30 2005
Current assets		
Cash and cash equivalents	$ 519	$ 538
Restricted cash and investments (note 1)	117	107
Accounts receivable, net	1,047	1,145
Inventories and other	589	479
Total current assets	2,272	2,269
Property, plant, and equipment		
Completed plant	35,265	35,215
Less accumulated depreciation	(14,653)	(14,407)
Net completed plant	20,612	20,808
Construction in progress	2,833	2,643
Nuclear fuel and capital leases	515	437
Total property, plant, and equipment	23,960	23,888
Investment funds	886	858
Regulatory and other long-term assets (note 1)		
Deferred nuclear generating units	3,814	3,912
Other regulatory assets	2,340	2,367
Subtotal	6,154	6,279
Other long-term assets	1,328	1,272
Total regulatory and other long-term assets	7,482	7,551
Total assets	$ 34,600	$ 34,566
LIABILITIES AND PROPRIETARY CAPITAL		
Current liabilities		
Accounts payable	$ 853	$ 860
Accrued liabilities	211	274
Accrued interest	301	380
Current portion of lease/leaseback obligations	35	35
Current portion of energy prepayment obligations	106	106
Short-term debt	2,744	2,469
Current maturities of long-term debt, net (note 3)	3,129	2,693
Total current liabilities	7,379	6,817
Other liabilities		
Deferred liabilities	2,520	2,500
Regulatory liabilities (note 1)	975	897
Asset retirement obligations	1,883	1,857
Lease/leaseback obligations	1,107	1,108
Energy prepayment obligations	1,217	1,244
Total other liabilities	7,702	7,606
Long-term debt, net (note 3)	17,172	17,751
Total liabilities	32,253	32,174
Commitments and contingencies (note 6)		
Proprietary capital		
Appropriation investment	4,778	4,783
Retained earnings	1,190	1,244
Accumulated other comprehensive income	44	27
Accumulated net expense of nonpower programs	(3,665)	(3,662)
Total proprietary capital	2,347	2,392
Total liabilities and proprietary capital	$ 34,600	$ 34,566

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

TENNESSEE VALLEY AUTHORITY
STATEMENTS OF CASH FLOWS (unaudited)

For the three months ended December 31
(in millions)

	2005	2004
Cash flows from operating activities		
Net (loss) income	$ (53)	$ 90
Items not requiring (providing) cash		
Depreciation, amortization, and accretion	416	321
Allowance for funds used during construction and nuclear fuel expenditures	(36)	(26)
Nuclear fuel amortization	35	34
Other, net	30	53
Changes in current assets and liabilities		
Accounts receivable, net	98	38
Inventories and other	(111)	(19)
Accounts payable and accrued liabilities	(72)	(234)
Accrued interest	(79)	(93)
Refueling outage costs	(3)	(28)
Other	(26)	(19)
Net cash provided by operating activities	199	117
Cash flows from investing activities		
Construction expenditures	(282)	(329)
Nuclear fuel expenditures	(116)	(84)
Allowance for funds used during construction and nuclear fuel expenditures	36	26
Investments		
Short-term investments, net	–	(114)
Change in restricted cash and investments	(10)	–
Purchases	(8)	–
Loans and other receivables		
Advances	(2)	(2)
Repayments	4	5
Proceeds from sale of loans	–	55
Other, net	(1)	(2)
Net cash used in investing activities	(379)	(445)
Cash flows from financing activities		
Long-term debt		
Issues	49	–
Redemptions and repurchases	(152)	(3)
Short-term issues, net	275	65
Payments on combustion turbine financing	(1)	(3)
Proceeds from other financing activities	–	1
Financing costs, net	(1)	–
Payments to U.S. Treasury	(9)	(9)
Net cash provided by financing activities	161	51
Net change in cash and cash equivalents	(19)	(277)
Cash and cash equivalents at beginning of period	538	519
Cash and cash equivalents at end of period	$ 519	$ 242

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

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

For the three months ended December 31, 2005 and 2004
(in millions)

	Appropriation Investment	Retained Earnings - Power Program	Accumulated Net Expense of Nonpower Programs	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income (Loss)
Balance at September 30, 2004	$ 4,803	$ 1,162	$ (3,649)	$ (52)	$ 2,264	
Net income (loss)	–	93	(3)	–	90	$ 90
Return on appropriation investment	–	(4)	–	–	(4)	–
Other comprehensive income (note 2)	–	–	–	66	66	66
Return of appropriation investment	(5)	–	–	–	(5)	–
Balance at December 31, 2004	$ 4,798	$ 1,251	$ (3,652)	$ 14	$ 2,411	$ 156
Balance at September 30, 2005	$ 4,783	$ 1,244	$ (3,662)	$ 27	$ 2,392	
Net (loss)	–	(50)	(3)	–	(53)	$ (53)
Return on appropriation investment	–	(4)	–	–	(4)	–
Other comprehensive income (note 2)	–	–	–	17	17	17
Return of appropriation investment	(5)	–	–	–	(5)	–
Balance at December 31, 2005	$ 4,778	$ 1,190	$ (3,665)	$ 44	$ 2,347	$ (36)

The accompanying notes are an integral part of these condensed 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 TVA Act of 1933, as amended, 16 U.S.C. §§ 831-831ee (2000 and Supp. III 2003) (the "TVA Act"). TVA is charged with providing navigable channels on the Tennessee River system, flood damage reduction, agricultural and industrial development, and electric power to the Tennessee Valley region. TVA carries out these responsibilities in a service area that centers on Tennessee and includes parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina, and Virginia.

TVA's operations have historically been divided into two types of activities, the power program and the nonpower programs. Substantially all TVA revenues and assets are attributable to its power program. The power program has historically been separate and distinct from the nonpower programs and is required to be self-supporting from power revenues and proceeds from power program financings, such as proceeds from the issuance of debt. Although TVA no longer receives congressional appropriations, it is required to make annual payments to the U.S. Treasury in repayment of, and as a return on, the government's appropriation investment in TVA power facilities. Until 2000, most of the funding for TVA's nonpower programs was provided by congressional appropriations. These programs are now funded largely with power revenues. Certain nonpower activities are also funded with various revenues and user fees. Prior to 2004, TVA presented information separately on its power program and nonpower programs in its financial statements. Because of the change in funding explained above, beginning with the fourth quarter of 2004, TVA began presenting consolidated financial statements which include both power and nonpower activities.

Power rates are established by the TVA Board of Directors ("Board" or "TVA 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; and debt service on outstanding indebtedness. 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 (discussed in *"Management's Discussion and Analysis of Financial Condition and Results of Operations" — "TVA and Competition"* in Part II of the 2005 Information Statement).

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 generally accepted accounting principles for complete financial statements. Because the accompanying interim financial statements do not include all of the information and footnotes required by GAAP for complete financial statements, they should be read in conjunction with the audited financial statements for the year ended September 30, 2005, and the notes thereto, which are contained in the 2005 Information Statement.

The amounts included in the accompanying interim financial statements are unaudited but, in the opinion of TVA management, reflect all adjustments, which consist solely of normal recurring 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.

Fiscal Year
TVA's fiscal year ends September 30. Unless otherwise indicated, years (2006, 2005, etc.) refer to TVA's fiscal years.

Reclassifications
Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation. Cash flows associated with the net activity of short-term investments were reclassified from cash used in operating activities

to cash used by investing activities. The reclassification improved operating cash flows by $114 million and conversely was an additional use of cash in investing activities on the 2005 Statement of Cash Flows. A reclassification was made to the 2005 cash flows associated with loans and other receivables as advances of $2 million represented amounts advanced by TVA or a use of cash and repayments of $5 million represented amounts received by TVA or a source of cash. These reclassifications had no effect on previously reported results of operations and net cash flows.

Restricted Cash and Investments

As of December 31, 2005, TVA had $117 million in restricted cash and investments on its balance sheet as a result of collateral posted with TVA by a swap counterparty in accordance with certain credit terms included in the swap contract. Due to the uncertainty of the timing of the return of these funds to the counterparty, the funds are reported in RESTRICTED CASH AND INVESTMENTS and the corresponding liability is reported in ACCOUNTS PAYABLE on the December 31, 2005 Balance Sheet.

Accounts Receivables

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

	Accounts Receivable	
	At December 31 2005	At September 30 2005
Power receivables billed	$ 259	$ 323
Power receivables unbilled	753	787
Total power receivables	1,012	1,110
Other receivables	42	42
Allowance for uncollectible accounts	(7)	(7)
Net accounts receivable	$ 1,047	$ 1,145

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 DEFERRED NUCLEAR GENERATING UNITS and OTHER REGULATORY ASSETS on the Balance Sheets. Components of OTHER REGULATORY ASSETS include certain charges related to the closure and removal from service of nuclear generating units, reacquisition costs of debt instruments, deferred outage costs, unrealized losses related to mark-to-market valuations of purchase power contracts, deferred capital lease asset costs and an adjustment to accrue the minimum pension liability. TVA's regulatory assets consist of the following:

	Regulatory Assets	
	At December 31 2005	At September 30 2005
Regulatory Assets:		
Adjustment to accrue minimum pension liability	$ 1,158	$ 1,158
Nuclear decommissioning costs	721	716
Reacquisition costs	261	264
Deferred outage costs	83	103
Capital leases	83	84
Unrealized losses related to mark-to-market valuation of a purchase power contracts	34	42
Total other regulatory assets	2,340	2,367
Deferred nuclear generating units	3,814	3,912
Total regulatory assets	$ 6,154	$ 6,279

Regulatory liabilities accounted for under provisions of SFAS No. 71 consist of mark-to-market valuation gains on certain derivative contracts and capital leases. The balances of TVA's regulatory liabilities at December 31, 2005, and September 30, 2005, were $975 million and $897 million, respectively, and are included in REGULATORY LIABILITIES on the Balance Sheets.

Regulatory Liabilities

	At December 31 2005	At September 30 2005
Regulatory Liabilities:		
Unrealized gain on coal purchase contracts	$ 873	$ 791
Capital lease liability	102	106
Total regulatory liabilities	$ 975	$ 897

Asset Retirement Obligations

In accordance with the provisions of SFAS No. 143, "*Accounting for Asset Retirement Obligations*," TVA recognizes legal obligations associated with the future retirement of certain tangible long-lived assets. TVA records estimates of such disposal costs at the time the legal obligation arises or costs are actually incurred.

During the first three months of 2005, TVA's total Asset Retirement Obligations ("ARO") liability increased $25 million due to accretion expense. The nuclear accretion expense of $22 million was deferred and charged to a regulatory asset in accordance with SFAS No. 71. The remaining accretion expense of $3 million, related to coal-fired and gas/oil plants, was expensed during 2005. During the first three months of 2006, TVA's total ARO liability increased $26 million due to accretion expense. The nuclear accretion expense of $23 million was deferred and charged to a regulatory asset in accordance with SFAS No. 71. The remaining accretion expense of $3 million, related to coal-fired and gas/oil plants, was expensed during 2006.

During the first quarter of 2005, there was a change in the estimated closure date related to the Bellefonte diesel generators. The original estimate assumed plant closure in 2029 and a six-year waiting period before closure work would begin in 2035. The new estimate assumes that closure work will begin at the date the plant ceases to operate in 2029. This change in estimate resulted in a decrease in the total future liability of nearly $1 million and an increase in the current net present value of the ARO asset and liability of less than $0.1 million. Additionally, TVA is evaluating the potential implications of Financial Accounting Standards Board ("FASB") Interpretation No. 47 ("FIN No. 47"), *"Accounting for Conditional Asset Retirement Obligations–an Interpretation of SFAS No. 143"* issued in March 2005. See *"Impact of New Accounting Pronouncements and Interpretations."*

Reconciliation of Asset Retirement Obligation Liability

	Three Months Ended December 31 2005	2004
Balance at beginning of period	$ 1,857	$ 1,782
Liabilities settled	–	–
Accretion expense	26	25
Revisions in estimated cash flows	–	–
Balance at end of period	$ 1,883	$ 1,807

Energy Prepayment Obligations

As of December 31, 2005, TVA had entered into sales agreements for 54.5 Discounted Energy Units totalling $54.5 million. There have been no energy prepayment transactions during 2005 and 2006. Total credits applied to power billings on a cumulative basis during the life of the program through December 31, 2005, exceed $16 million. Of this amount, over $1 million was recognized as revenue for the quarterly periods ended December 31, 2005 and 2004.

In November 2003, TVA, Memphis Light, Gas and Water Division ("MLGW"), and the City of Memphis entered into an arrangement whereby MLGW prepaid a portion of its power requirements for 15 years for a fixed amount of kilowatt-hours. The prepayment is being applied to MLGW's monthly power bill on a straight-line basis over the same 15-year period. The amount of the prepayment was $1.5 billion. Total credits applied to power billings on a cumulative basis during the life of the program through December 31, 2005, exceed $215 million. Of this amount, $25 million was recognized as revenue for the quarterly periods ended December 31, 2005, and 2004. These amounts were based on the ratio of kilowatt-hours of electricity delivered to the total kilowatt-hours under contract.

At December 31, 2005, and September 30, 2005, obligations under these new programs were $1,323 million and $1,350 million, respectively. The amounts are included in Energy Prepayment Obligations and Current Portion of Energy Prepayment Obligations on the December 31, 2005, and September 30, 2005, Balance Sheets.

Reduction in Workforce

During 2004, organizations within TVA performed program and staffing reviews to identify surplus staffing situations. For the areas identified as having surplus staffing, TVA provided the opportunity for certain qualifying employees to apply for voluntary resignations beginning in February 2004. In conjunction with the voluntary reduction process, TVA also instituted an involuntary reduction in force ("RIF") for certain employees. As of December 31, 2005, there were 744 employees impacted by the combined RIF actions, including five during the first quarter of 2006. TVA has recognized total expense in the amount of $41 million for termination costs incurred through December 31, 2005, of which $1 million is for the first quarter of 2006. Payout of benefits occurs as employees retire from TVA, and substantially all affected employees had retired by the end of 2005. No further reductions are planned for 2006.

Termination Costs Liability Activity

	Three Months Ended December 31	
	2005	2004
Termination costs liability at beginning of period	$ 4	$ 14
Liability incurred	1	1
Actual costs paid	(2)	(5)
Termination costs liability at end of period	$ 3	$ 10

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*," which was revised by FASB Interpretation No. 46R ("46R") in December 2003. FIN 46(R) establishes consolidation criteria for entities for which "control" is not easily discernable under Accounting Research Bulletin ("ARB") 51, *"Consolidated Financial Statements,"* which is based on the premise that holders of the equity of an entity control the entity by virtue of voting rights. FIN 46(R) provides guidance for identifying the party with a controlling financial interest resulting from arrangements or financial interests rather than from voting interests. FIN 46(R) defines the term "variable interest entity" ("VIE") and is based on the premise that if a business enterprise absorbs a majority of the VIE's expected losses and/or receives a majority of its expected residual returns (measures of risk and reward), that enterprise (the primary beneficiary) is deemed to have a controlling financial interest in the VIE. An enterprise that bears the majority of the economic risk is considered to have a controlling financial interest in a VIE, even if it has no decision making (voting) authority or equity interest. TVA adopted FIN 46 and FIN 46(R) effective October 1, 2005, for VIEs created before December 31, 2003, and immediately for VIEs created after December 31, 2003.

In February 1997, TVA entered a purchase power agreement with Choctaw Generation, Inc. (subsequently assigned to Choctaw Generation Limited Partnership) to purchase all the power generated from its facility located in Choctaw County, Mississippi. The facility had a committed capacity of 440 megawatts and the term of the agreement was 30 years. Under the accounting guidance provided by FIN 46(R), TVA may be deemed to be the primary beneficiary under the contract; however, TVA does not have access to the financial records of Choctaw Generation Limited Partnership. As a result, TVA was unable to determine whether FIN 46(R) would require TVA to consolidate Choctaw Generation Limited Partnerships' balance sheet, results of operations and cash flows for the quarter ended December 31, 2005. Power purchases for the first quarter of 2006 under the agreement totaled $30 million. TVA has no additional financial obligations beyond the purchase power agreement with respect to the facility.

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. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. 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 of changes in accounting principles. 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, non-financial 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 2007 with early adoption permitted for accounting changes and corrections of errors made in fiscal years beginning after May 2005, the date the statement was issued.

Accounting for Inventory Transactions. At its September 28, 2005, meeting, the FASB reached consensus on Emerging Issues Task Force ("EITF") Issue No. 04-13, "*Accounting for Purchases and Sales of Inventory with the Same Counterparty."* In certain situations, a company may enter into a nonmonetary transaction to sell inventory to another company in the same line of business from which it also purchases inventory. Questions have arisen regarding how the guidance in APB Opinion No. 29, *"Accounting for Nonmonetary Transactions,"* should be applied in these situations. The consensus reached states that inventory purchase and sales transactions with the same counterparty that are entered into in contemplation of one another should be combined for purposes of applying Opinion 29. The Task Force also agreed that the issuance of invoices and the exchange of offsetting cash payments is not a factor in determining whether two or more inventory transactions with the same counterparty should be considered as a single nonmonetary inventory transaction within the scope of Opinion 29. The Task Force also reached a consensus that a nonmonetary exchange within the same line of business involving the transfer of raw materials in exchange for the receipt of raw materials should not be recognized at fair value. This EITF should be applied to transactions completed in reporting periods beginning after March 15, 2006, whether pursuant to arrangements that were in place at the date of initial application of the consensus or arrangements executed subsequent to that date. The carrying amount of the inventory that was acquired under these types of arrangements prior to the initial application of the consensus, and that still remains in an entity's statement of financial position at the date of initial application of the consensus, should not be adjusted for this consensus. TVA will adopt EITF Issue No. 04-13 beginning in the second quarter of 2006 and is currently evaluating the potential implications of this issue which may or may not be material to its financial position or results of operations.

Put and Call Options. In September 2005, the Derivatives Implementation Group ("DIG") of the FASB discussed several issues related to the settlement of a debtor's obligation on the exercise of a call or put option and the exercise only by the debtor of the right to accelerate settlement of a debt with an embedded call option. DIG Implementation Issue No. B38, *"Embedded Derivatives: Evaluation of Net Settlement with Respect to the Settlement of a Debt Instrument through Exercise of an Embedded Put Option or Call Option,"* addresses whether the settlement of a debtor's obligation on exercise of a call or put option meets the net settlement criterion in paragraph 9(a) of SFAS No. 133, as amended. DIG Implementation Issue No. B39, "*Embedded Derivatives: Application of Paragraph 13(b) to Call Options That Are Exercisable Only by the Debtor,"* addresses whether or not Paragraph 13(b) of SFAS No. 133, as amended, applies to a call option embedded with a debt host if the right to accelerate settlement of the debt can be exercised only by the debtor. The effective date of the implementation guidance in these issues is the first day of the first fiscal quarter beginning after December 15, 2005. The issue will become effective for TVA beginning in the second quarter of 2006. TVA is currently evaluating the potential implications of this issue which may or may not be material to its financial position or results of operations.

Accounting for Rental Costs. On October 6, 2005 the FASB issued FSP FAS 13-1, "*Accounting for Rental Costs Incurred during a Construction Period."* The FASB concludes in this FSP that rental costs associated with ground or building operating leases that are incurred during a construction period should be expensed. FASB Technical Bulletin ("FTB") No. 88-1, *"Issues Relating to Accounting for Leases,"* requires that rental costs associated with operating leases be allocated on a straight-line basis in accordance with FASB Statement No. 13, "*Accounting for Leases*," and FTB 85-3, "*Accounting for Operating Leases with Scheduled Rent Increases*," starting with the beginning of the lease term. The FASB believes there is no distinction between the right to use a leased asset during the construction period and the right to use that asset after the construction period. TVA will apply this guidance beginning with the quarterly reporting period ending March 31, 2006. TVA is currently evaluating the potential implications of this staff position which may or may not be material to its financial position or results of operations.

Impairment of Investments. On November 3, 2005, the FASB released FSP FAS 115-1 and FAS 124-1,*"The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments."* This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of an "other-than-temporary" impairment and requires certain disclosures about unrealized losses that have not been recognized as "other-than-temporary" impairments. The adoption of the guidance in this FSP will be applied to reporting periods beginning after December 15, 2005. TVA is currently evaluating the potential implications of this staff position which may or may not be material to its financial position or results of operations.

2. Accumulated Other Comprehensive Income

SFAS No. 130, *"Reporting Comprehensive Income,"* requires the disclosure of comprehensive income to reflect changes in capital that result from transactions and economic events from non-owner sources. The increase for the three months ended December 31, 2005, and 2004, is due to unrealized gains related to mark-to-market valuation adjustments for certain derivative instruments.

Accumulated Other Comprehensive Income (Loss) Activity

	Three Months Ended December 31	
	2005	2004
Accumulated other comprehensive income (loss) at beginning of period	$ 27	$ (52)
Changes in fair value		
Inflation swap	(10)	–
Foreign currency swaps	27	66
Accumulated other comprehensive income at end of period	$ 44	$ 14

3. Debt Securities

Debt Securities Activity

TVA issues power bonds pursuant to Section 15d of the TVA Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution. Power Bonds in each series must be further authorized by Supplemental Resolution. The table below summarizes TVA's debt securities activity for the period from October 1, 2005, to December 31, 2005.

	Date	Amount	Interest Rate
Redemptions/Maturities:			
electronotes®	First Quarter 2006	$ 152	5.88%
Issues:			
electronotes®	First Quarter 2006	$ 49	5.19%

Note:
electronotes® interest rate is a weighted average rate.

Debt Outstanding

Debt outstanding at December 31, 2005, includes net translation losses of $104 million related to long-term debt and a translation gain of $92 million related to the current portion of long-term debt.

4. Risk Management Activities and Derivative Transactions

TVA is exposed to market risks including changes in interest rates, inflation 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 an interest rate swap agreement, an inflation swap agreement, foreign currency swap contracts and option and swaption contracts.

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

Mark-to-Market Values of Derivative Transactions
Asset/(Liability)

	At December 31 2005	At September 30 2005
Inflation swap	$ 15	$ 17
Interest rate swap	(144)	(158)
Currency swaps:		
Deutschemark (DM1.5 billion)	(89)	(68)
Sterling (GBP200 million)	20	21
Sterling (GBP250 million)	93	89
Sterling (GBP150 million)	40	36
Total currency swaps	64	78
Swaptions:		
$1 billion notional	(321)	(314)
$28 million notional	(4)	(4)
$14 million notional	(2)	(2)
Total swaptions	(327)	(320)
Coal contracts	873	791
Purchase power contracts	(34)	(42)

5. Benefit Plans

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

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

	Pension Benefits Three Months Ended December 31		Other Benefits Three Months Ended December 31	
	2005	2004	2005	2004
Service Cost	$ 32	$ 31	$ 2	$ 2
Interest Cost	110	109	8	6
Expected return on plan assets	(123)	(114)	–	–
Amortization of prior service costs	9	9	1	1
Amortization of losses	33	33	4	2
Net periodic benefit	$ 61	$ 68	$ 15	$ 11

During the three months ended December 31, 2005, TVA did not make contributions to its pension plan. However, the Board approved $75 million in pension contributions during 2006 with scheduled contributions of $37 million and $38 million to be made in March and September, respectively. TVA does not separately set aside assets to fund other benefit costs, but rather funds such costs on an as-paid basis. TVA provided approximately $5 million during the three months ended December 31, 2005, to fund other benefits costs.

6. Commitments and Contingencies

The estimated cash commitments for TVA as of December 31, 2005 are as follows:

	Cash Requirements and Contractual Obligations						
	2006*	2007	2008	2009	2010	Thereafter	Total
Debt	$ 5,365	$ 977	$ 91	$ 2,030	$ 42	$ 14,762	$ 23,267
Interest on debt	817	1,029	1,003	947	893	12,212	16,901
Leases	56	87	77	66	63	46	395
Lease/leaseback	78	85	89	85	89	1,209	1,635
Power purchase obligations	137	165	133	138	139	3,565	4,277
Other obligations	311	150	111	5	3	7	587
Fuel purchase obligations	797	322	358	243	207	476	2,403
Pension contribution	75	–	–	–	–	–	75
Total	$ 7,636	$ 2,815	$ 1,862	$ 3,514	$ 1,436	$ 32,277	$ 49,540

* Period January 1 – September 30, 2006

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

	Contractual Obligations Related to Energy Prepayments						
	2006*	2007	2008	2009	2010	Thereafter	Total
Energy prepayment obligations	$ 79	$ 106	$ 106	$ 105	$ 105	$ 822	$ 1,323

* Period January 1 – September 30, 2006

7. Legal Proceedings

On August 31, 1999, Birmingham Steel Corporation filed a lawsuit in the U.S. District Court for the Northern District of Alabama alleging that TVA overcharged for ESP during the summer of 1998. The lawsuit was filed as a class action on behalf of industrial customers who participated in TVA's ESP program. Under ESP contracts, the hourly ESP energy price is calculated using TVA's actual incremental cost of supplying the ESP load in each hour. The plaintiff alleges that TVA overcharged for ESP during the summer of 1998 by including in the price of ESP some costs that were added to TVA's incremental cost. The complaint seeks over $100 million in damages on behalf of Birmingham Steel and the other class members. In September 2002, the district court decertified the class and then dismissed Birmingham Steel's individual claim without prejudice on a jurisdictional issue. The class lawyers appealed the ruling on class decertification, and in December 2003, the U.S. Court of Appeals for the Eleventh Circuit reversed that ruling and sent the case back to the district court to allow the class lawyers a reasonable time to find a new class representative. The district court allowed the substitution of Johns Manvill Corporation to represent the class. Motions for summary judgment were filed in October 2005.

In December 2004, a federal judge in Nashville, Tennessee, dismissed a lawsuit filed against TVA and 22 electric cooperatives by Tennessee residents and customers of some of the cooperatives, in part challenging TVA's practice of setting rates for electric power charged by distributors via its contracts. Both TVA and the cooperatives had filed motions to dismiss, which the court granted. The judge dismissed the plaintiffs' claims alleging violations of state law because the plaintiffs failed to carry out the steps necessary to bring these claims in court. The dismissal was without prejudice, allowing the plaintiffs to re-file the claims if these steps are carried out and suit is filed within the statutory limitations period. As to the plaintiffs' allegations of federal law violations, the court found that Congress had specifically authorized TVA to set the rates charged by distributors via its contracts. In the face of such express Congressional authorization, the plaintiffs' federal law claims failed as a matter of law and were dismissed with prejudice, precluding them from being brought again. The plaintiffs moved for reconsideration of the dismissal, and the judge denied the plaintiffs' motion. The plaintiffs subsequently appealed to the Sixth Circuit. Briefing is now taking place and will be completed in February 2006. No date for oral argument has been set at this time. TVA has no further or new conclusions concerning the case.

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 alleges both public and private nuisance, was filed against the same defendants by Open Space Institute, Inc., Open Space Conservancy, Inc., and the Audubon Society of New Hampshire. There are no Clean Air Act ("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. In September 2005, the district court dismissed both lawsuits, concluding that they raised political questions that should not be decided by the courts. The plaintiffs have filed notices of appeal to the Court of Appeals for the Second Circuit. The parties are currently briefing the case, with briefing expected to conclude in February 2006.

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 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 were made in October 2005. A decision was not issued in calendar year 2005, and the court has not indicated when to expect it.

The National Parks Conservation Association, Inc., and Sierra Club, Inc. filed suit in 2001 in federal district court in Birmingham, Alabama, alleging TVA violated the CAA and implementing regulations at TVA's Colbert Fossil Plant. Plaintiffs allege that TVA made major modifications to Colbert without obtaining preconstruction permits (in alleged violation of the Prevention of Significant Deterioration ("PSD") program and the Nonattainment New Source Review ("NNSR") program) and without complying with emission standards (in alleged violation of the New Source Performance Standards ("NSPS") program). Plaintiffs seek injunctive relief, civil penalties of $25,000 per day for each violation before January 30, 1997, and $27,500 per day for each violation after that date, an order that TVA pay up to $100,000 for beneficial mitigation projects, and costs of litigation, including attorney and expert witness fees. On November 29, 2005, the court granted in part TVA's motion for summary judgment, holding on sovereign immunity grounds that plaintiffs could not seek civil penalties against TVA, and dismissing on statute of limitations grounds plaintiffs' claims arising from 1982 and 1983 work projects at TVA's Colbert Unit 5 (the PSD and NNSR claims). By order dated December 8, 2005, the court clarified its November 29 ruling, stating that the only remaining PSD and NNSR claims are those, if any, that (1) fall within the five-year statute of limitations, and (2) assert that TVA's operations of Colbert Unit 5 violate the Clean Air Act. On December 21, 2005, the district court granted TVA's motion to dismiss the NSPS claim because plaintiffs failed to comply with statutory presuit notification requirements. On January 17, 2006, the district court issued a final order dismissing the action, concluding that there were no remaining issues to be decided. Plaintiffs filed a notice of appeal to the Court of Appeals for the Eleventh Circuit on January 25, 2006. If the decision is reversed on appeal, there is a reasonable possibility that TVA will be found liable, but the amount of monetary damages cannot be estimated at this time.

The National Parks Conservation Association ("NPCA") and the Sierra Club filed suit in the Eastern District of Tennessee in 2001 alleging that TVA modified its Bull Run Fossil Plant ("Bull Run") without complying with the New Source Review requirements of the CAA. In March 2005, the district court granted TVA's motion to dismiss the lawsuit in the Bull Run case. The plaintiffs' motion for reconsideration was denied, and they have appealed to the Court of Appeals for the Sixth Circuit ("Sixth Circuit"). Twelve states have filed amicus curie briefs with the Sixth Circuit supporting the appeal filed by the plaintiffs. The states are New York, Connecticut, Illinois, Iowa, Maryland, New Hampshire, New Jersey, New Mexico, Rhode Island, Kentucky, Massachusetts, and Pennsylvania.

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 potentially 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 because all of the challenged emissions were within Alabama's two percent de minimis rule (which provided a safe harbor if emissions did not exceed allowable opacity limits more than two percent each quarter), 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 Circuit"). On November 22, 2005, the Eleventh Circuit issued its opinion, affirming the lower court in part and reversing in part. The Eleventh Circuit held that the Alabama de minimis rule was not applicable because it attempted to revise the opacity limits without going through the appropriate amendment process and receiving EPA approval. The appeals court therefore reversed summary judgment in favor of TVA and indicated that it would remand the case to the district court for further proceedings. The Eleventh Circuit affirmed the lower court's dismissal of the claims for civil penalties, holding that sovereign immunity principles preclude assessing civil penalties in citizen suits brought under the CAA against federal entities such as TVA. The lower court has indicated that it views the Eleventh Circuit's decision as a determination that TVA is in violation of opacity requirements at Colbert. On January 5, 2006, TVA filed a petition seeking rehearing of the Eleventh Circuit's decision. TVA does not have sufficient information at this time to form a reasoned opinion on the impact of the decision.

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

8. Stewardship Responsibilities

During the first quarter of 2006, 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, nonpower programs were primarily funded with federal appropriations. Certain nonpower program activities have also been funded with user fees and outside services revenues. 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 revenues from TVA's power program and other TVA revenue sources in the event that there were insufficient appropriations 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 revenues (along with user fees and other forms of nonpower revenues) to continue to fund these stewardship activities. TVA spent approximately $20 million on essential stewardship activities during the first three months of 2006 and $17 million during the first three months of 2005, and recognized depreciation expense on nonpower assets of $3 million in each period.

9. Subsequent Events

Debt Securities
In January 2006, TVA issued $5 million of electronotes® with an interest rate of 5.13 percent which mature in 2021 and are callable in 2009.

Legal
On January 30, 2006, North Carolina's Attorney General filed suit against TVA alleging that TVA's operation of its coal-fired power plants in Tennessee, Alabama, and Kentucky constitute public nuisances. TVA is evaluating the lawsuit and presently believes it has little merit.

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

(Dollars in millions 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 2005 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.
- Retiring total financing obligations and driving to higher interest-coverage ratios in order to provide the financial flexibility needed to tolerate the higher levels of revenue and cost volatility associated with a more competitive market.
- Maintaining and operating its generation and transmission assets so that it can continue to fulfill its supply obligations in a safe and reliable manner.

For an in-depth discussion of TVA's business strategy and economic factors, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* in TVA's 2005 Information Statement.

Material Changes in Liquidity and Capital Resources

Comparative Cash Flow Analysis

Net cash provided by operating activities increased $82 million from $117 million to $199 million for the three month periods ending December 31, 2004, and 2005, respectively. The increase is primarily due to a decrease in cash used for working capital components of $144 million, which is discussed below, and:

- An increase in cash-related operating revenues of $218 million due to increased rates and increased volume; offset by
- An increase of $5 million in expenditures for fossil and hydro outages;
- An increase in cash outlays for fuel and purchased power of $267 million primarily due to higher coal prices and higher market prices for purchased power;
- An increase in cash outlays for routine and recurring operating costs of $14 million; and
- An increase of $10 million during the first quarter for performance incentive compensation accrual which was not present in the prior year as the compensation program for 2005 was not approved until the second quarter of 2005.

Cash used for working capital components decreased $144 million, from $308 million in the first quarter of 2005 to $164 million in the first quarter of 2006. This decrease resulted from:

- A larger source from the collections of accounts receivable of $60 million due to higher late summer power sales in 2005;
- A smaller decrease in accounts payable and accrued liabilities of $162 million due to timing of accruals made for fuel and purchased power during the first quarter of 2006 that will be paid in the second quarter of 2006, combined with one time payments made during the first quarter of 2005 ($40 million for the Browns Ferry Unit 1 restart and $9 million for a breach of contract settlement); and
- A smaller reduction in accrued interest of $14 million due to a lower level of long-term debt outstanding and lower interest payments.

This decrease was partially offset by:

- A larger increase in inventories and other assets of $92 million in the first quarter of 2006 as compared to 2005, primarily due to higher fuel inventory prices and the rebuilding of combustion turbine plant inventories in the first quarter of 2006.

Cash used in investing activities decreased $66 million, from $445 million to $379 million for the three month periods ending December 31, 2004, and 2005, respectively, primarily due to:

- A decrease in expenditures for capital projects of $47 million, primarily due to decreases in nuclear projects and Browns Ferry Unit 1 restart expenditures; and
- Purchases of short-term investments of $114 million in 2005 not present in the current year; offset by
- Proceeds received from the sale of certain power distributor loans receivable of $55 million in the prior year; and
- An increase in the fabrication of nuclear fuel of $32 million in preparation for the upcoming reloads during 2006.

Net cash provided by financing activities was $161 million for the three months ended December 31, 2005, compared with $51 million for the same period of 2004. The change is related primarily to:

- An increase in net short-term debt issues of $210 million in the first quarter of 2006 compared to the same period in the prior year; offset by
- A net increase of $100 million in long-term debt redemptions for the first quarter of 2006 as compared to the first quarter of 2005.

Working Capital

At December 31, 2005, TVA had negative working capital of $5,107 million, largely attributable to current maturities of long-term debt of $3,129 million and short-term indebtedness of $2,744 million. The table below summarizes the components of working capital and discount notes with maturities of less than 90 days. It is TVA's cash management policy to use short-term notes to meet current obligations, and TVA plans to continue to use such financing instruments as long as short-term interest rates remain favorable.

Working Capital and Short-Term Debt

	December 31 2005	September 30 2005
Current assets	$ 2,272	$ 2,269
Current liabilities	(7,379)	(6,817)
Working capital	$ (5,107)	$ (4,548)
Discount notes <90 days	$ 2,744	$ 2,469
Current maturities of long-term debt	3,129	2,693
Total short-term debt	$ 5,873	$ 5,162

On November 9, 2005, TVA and a national bank extended the term of an existing revolving credit facility agreement until May 22, 2006. The facility provides TVA with an unsecured revolving line of credit of up to $2.5 billion. The interest rate on any borrowing under this agreement is variable and based on market factors and the rating of TVA's senior unsecured long-term non-credit enhanced debt at the time TVA draws on the facility. TVA is required to pay an unused facility fee on the portion of the $2.5 billion against which TVA has not borrowed. This fee is similar to fees charged in the banking industry to similar customers for similar products and may fluctuate depending upon the rating of TVA's senior unsecured long-term non-credit enhanced debt. There were no outstanding borrowings under the facility at December 31, 2005.

Capital Resources

Debt Securities Activity. From October 1, 2005, to December 31, 2005, TVA redeemed at par $152 million of electronotes® carrying an average interest rate of 5.88 percent. During the same period, TVA issued $49 million of electronotes® with an average interest rate of 5.19 percent.

Sale of Loans. On December 2, 2004, TVA sold a portfolio of 51 power distributor loans receivable. The portfolio was sold for $55 million without recourse and contained loans with maturities ranging from less than one year to over 34

years. The principal amount due on the loans at the time of the sale was $57 million. The $2 million loss is reported in OTHER INCOME, NET on the Income Statement for the quarter ended December 31, 2004.

Energy Prepayment Obligations. As of December 31, 2005, TVA had entered into sales agreements for 54.5 Discounted Energy Units totalling $54.5 million. There have been no energy prepayment transactions during 2005 or 2006. Total credits applied to power billings on a cumulative basis during the life of the program through December 31, 2005, exceed $16 million. Of this amount, over $1 million was recognized as revenue for the quarterly periods ended December 31, 2005, and 2004.

In November 2003, TVA, Memphis Light, Gas and Water Division ("MLGW"), and the City of Memphis entered into an arrangement whereby MLGW prepaid a portion of its power requirements for 15 years for a fixed amount of kilowatt-hours. The prepayment will be applied to MLGW's monthly power bill on a straight-line basis over the same 15-year period. The amount of the prepayment was $1.5 billion. Total credits applied to power billings on a cumulative basis during the life of the program through December 31, 2005, exceed $215 million. Of this amount, $25 million was recognized as revenue for the quarterly periods ended December 31, 2005, and 2004. These amounts were based on the ratio of kilowatt-hours of electricity delivered to the total kilowatt-hours under contract.

At December 31, 2005, and September 30, 2005, obligations under these programs were $1,323 million and $1,350 million, respectively. These amounts are included in ENERGY PREPAYMENT OBLIGATIONS and CURRENT PORTION OF ENERGY PREPAYMENT OBLIGATIONS on the December 31, 2005, and September 30, 2005, Balance Sheets.

Cash Requirements and Contractual Obligations

The estimated cash requirements and contractual obligations for TVA as of December 31, 2005, are as follows:

Cash Requirements and Contractual Obligations

	2006*	2007	2008	2009	2010	Thereafter	Total
Debt	$ 5,365	$ 977	$ 91	$ 2,030	$ 42	$ 14,762	$ 23,267
Interest on debt	817	1,029	1,003	947	893	12,212	16,901
Leases	56	87	77	66	63	46	395
Lease/leaseback	78	85	89	85	89	1,209	1,635
Power purchase obligations	137	165	133	138	139	3,565	4,277
Other obligations	311	150	111	5	3	7	587
Fuel purchase obligations	797	322	358	243	207	476	2,403
Pension contribution	75	–	–	–	–	–	75
Total	$ 7,636	$ 2,815	$ 1,862	$ 3,514	$ 1,436	$ 32,277	$ 49,540

* Period January 1 – September 30, 2006

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

Contractual Obligations Related to Energy Prepayments

	2006*	2007	2008	2009	2010	Thereafter	Total
Energy prepayment obligations	$ 79	$ 106	$ 106	$ 105	$ 105	$ 822	$ 1,323

* Period January 1 – September 30, 2006

As of December 31, 2005, TVA's decommissioning trust funds totaled approximately $856 million, which is less than the present value of the estimated future decommissioning costs calculated in accordance with Nuclear Regulatory Commission ("NRC") requirements. In March 2003, TVA submitted its biennial letter to the NRC on the funding status of the Nuclear Decommissioning Trust versus its liabilities. In the letter, TVA stated that it is considering several alternatives to provide additional funding assurance methods and is assessing the need for future action on an ongoing basis. The current status of the fund has been primarily influenced by declines in market value as well as increases in the projected decommissioning costs. TVA is monitoring the monetary value of its nuclear decommissioning trust fund in light of recent market performance and believes that, over the long term and before cessation of nuclear plant operations and commencement of decommissioning activities, adequate funds from investments will be available to support decommissioning. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations" — "Critical Accounting Policies and Estimates" — "Nuclear Decommissioning"* in the 2005 Information Statement.

Results of Operations

Net loss for the first quarter of 2006 was $53 million compared to net income of $90 million for the same period of 2005. Significant items contributing to the $143 million change in net income for the three months ended December 31, 2005, as compared to December 31, 2004, include decreased operating income of $174 million, partially offset by increased unrealized gains on derivative contracts of $10 million and lower net interest expense of $19 million.

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

	Operating Revenues Three months ended December 31		
	2005	2004	Percent Change
Operating revenues			
Sales of electricity			
Municipalities and cooperatives	$ 1,769	$ 1,525	16.0%
Industries directly served	230	215	7.0%
Federal agencies and other	26	73	(64.4%)
Other revenue	27	21	28.6%
Total operating revenues	$ 2,052	$ 1,834	11.9%

Significant items contributing to the $218 million increase in operating revenue for the three months ended December 31, 2005, as compared to December 31, 2004, include:

- A $244 million increase in revenues from municipalities and cooperatives due to increased rates and a higher power demand, and
- A $15 million increase in revenues from industries directly served reflecting increased rates.

The rate increase, effective the first quarter of 2006, contributed about $75 million to the increase in revenues over the same period in 2005.

These items were partially offset by a $51 million decrease in off-system sales (included in FEDERAL AGENCIES AND OTHER) attributable to a decreased generation available for sale and unfavorable market conditions.

A detailed table of electricity sales for the three month periods ended December 31, 2005, and 2004 is as follows:

	Electricity Sales Three months ended December 31		
(millions of kWh)	2005	2004	Percent Change
Sales of electricity			
Municipalities and cooperatives	33,104	31,485	5.1%
Industries directly served	7,912	8,241	(4.0%)
Federal agencies and other	459	1,768	(74.0%)
Total sales of electricity	41,475	41,494	(0.0%)

Significant items contributing to the 19 million kilowatt-hour decrease in electricity sales include:

- A 329 million kilowatt-hour decrease in sales to directly served industries due primarily to decreased demand by a large volume customer, and
- A 1,346 million kilowatt-hour decrease in off-system electricity sales (included in FEDERAL AGENCIES AND OTHER) attributable to decreased generation available for sale and increased market prices.

These items were partially offset by a 1,619 million kilowatt-hour increase in sales to municipalities and cooperatives as a result of more extreme weather this year versus last.

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

Operating Expenses
Three months ended
December 31

	2005	2004	Percent Change
Operating expenses			
Fuel and purchased power	$ 745	$ 477	56.2%
Operating and maintenance	600	582	3.1%
Depreciation, amortization, and accretion	388	285	36.1%
Tax-equivalents	94	91	3.3%
Total operating expenses	$ 1,827	$ 1,435	27.3%

Significant items contributing to the $392 million increase in operating expenses include:

- A $94 million increase in fossil fuel cost attributable to higher market prices and increased generation at the combustion turbine plants,
- A $173 million increase in purchased power cost due to an increase in the amount of power purchased and increased market prices; and
- A $99 million increase in amortization attributable mainly to the amortization of deferred cost of nuclear generating units at Bellefonte Nuclear Plant.

Other Income, Net
Net other income was $2 million higher for the three months ended December 31, 2005, as compared to the three months ended December 31, 2004, due to an increase in non-electric business activity.

Unrealized Gain on Derivative Contracts, Net
Significant items contributing to the $10 million increase in net unrealized gain on derivative contracts for the three months ended December 31, 2005, as compared to the same period in 2004 include a $4 million net gain on the mark-to-market ("MTM") valuation adjustment of derivative contracts during the first quarter of 2005 reflecting changes in interest rates from the first quarter of 2005 to the first quarter of 2006 and a $6 million unrealized net loss related to the MTM valuation of SO_2 emissions allowance call options during the first quarter of 2005.

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

Interest Expense
Three months ended
December 31

	2005	2004	Percent Change
Interest expense			
Interest on debt	$ 330	$ 339	(2.7%)
Amortization of debt discount, issue, and reacquisition costs, net	5	5	0.0%
Allowance for funds used during construction	(36)	(26)	38.5%
Net interest expense	$ 299	$ 318	(6.0%)

Significant items contributing to the $19 million decrease in net interest expense include:

- A decrease in the average long-term interest rate from 6.30 percent to 6.06 percent,
- A reduction of $755 million in the average balance of long-term outstanding debt, and
- A $10 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 short-term interest rate from 1.93 percent to 3.61 percent, and
- An increase of approximately $1.1 billion in the average balance of short-term outstanding debt.

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*," which was revised by FASB Interpretation No. 46R ("46R") in December 2003. FIN 46(R) establishes consolidation criteria for entities for which "control" is not easily discernable under Accounting Research Bulletin ("ARB") 51, *"Consolidated Financial Statements,"* which is based on the premise that holders of the equity of an entity control the entity by virtue of voting rights. FIN 46(R) provides guidance for identifying the party with a controlling financial interest resulting from arrangements or financial interests rather than from voting interests. FIN 46(R) defines the term "variable interest entity" ("VIE") and is based on the premise that if a business enterprise absorbs a majority of the VIE's expected losses and/or receives a majority of its expected residual returns (measures of risk and reward), that enterprise (the primary beneficiary) is deemed to have a controlling financial interest in the VIE. An enterprise that bears the majority of the economic risk is considered to have a controlling financial interest in a VIE, even if it has no decision making (voting) authority or equity interest. TVA adopted FIN 46 and FIN 46(R) effective October 1, 2005, for VIEs created before December 31, 2003, and immediately for VIEs created after December 31, 2003.

In February 1997, TVA entered a purchase power agreement with Choctaw Generation, Inc. (subsequently assigned to Choctaw Generation Limited Partnership) to purchase all the power generated from its facility located in Choctaw County, Mississippi. The facility had a committed capacity of 440 megawatts and the term of the agreement was 30 years. Under the accounting guidance provided by FIN 46(R), TVA may be deemed to be the primary beneficiary under the contract; however, TVA does not have access to the financial records of Choctaw Generation Limited Partnership. As a result, TVA was unable to determine whether FIN 46R would require TVA to consolidate Choctaw Generation Limited Partnerships' balance sheet, results of operations and cash flows for the quarter ended December 31, 2005. Power purchases for the first quarter of 2006 under the agreement totaled $30 million. TVA has no additional financial obligations beyond the purchase power agreement with respect to the facility.

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. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. 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 of changes in accounting principles. 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 2007 with early adoption permitted for accounting changes and corrections of errors made in fiscal years beginning after May 2005 — the date the statement was issued.

Accounting for Inventory Transactions

At its September 28, 2005, meeting, the FASB reached consensus on Emerging Issues Task Force ("EITF") Issue No. 04-13, "*Accounting for Purchases and Sales of Inventory with the Same Counterparty."* In certain situations, a company may enter into a nonmonetary transaction to sell inventory to another company in the same line of business from which it also purchases inventory. Questions have arisen regarding how the guidance in APB Opinion No. 29, *"Accounting for Nonmonetary Transactions,"* should be applied in these situations. The consensus reached states that inventory purchase and sales transactions with the same counterparty that are entered into in contemplation of one another should be combined for purposes of applying Opinion 29. The Task Force also agreed that the issuance of invoices and the exchange of offsetting cash payments is not a factor in determining whether two or more inventory transactions with the same counterparty should be considered as a single nonmonetary inventory transaction within the scope of Opinion 29. The Task Force also reached a consensus that a nonmonetary exchange within the same line of business involving the transfer of raw materials in exchange for the receipt of raw materials should not be recognized at fair value. This EITF should be applied to transactions completed in reporting periods beginning after March 15, 2006, whether pursuant to arrangements that were in place at the date of initial application of the consensus or arrangements executed subsequent to that date. The carrying amount of the inventory that was acquired under these types of arrangements prior to the initial application of the consensus, and that still remains in an entity's statement of financial position at the date of initial application of the consensus, should not be adjusted for this consensus. TVA will adopt EITF Issue No. 04-13 beginning in the second quarter of 2006 and is currently evaluating the potential implications of this issue which may or may not be material to its financial position or results of operations.

Put and Call Options

In September 2005, the Derivatives Implementation Group ("DIG") of the FASB discussed several issues related to the settlement of a debtor's obligation on the exercise of a call or put option and the exercise only by the debtor of the right to accelerate settlement of a debt with an embedded call option. DIG Implementation Issue No. B38, *"Embedded Derivatives: Evaluation of Net Settlement with Respect to the Settlement of a Debt Instrument through Exercise of an Embedded Put Option or Call Option,"* addresses whether the settlement of a debtor's obligation on exercise of a call or put option meets the net settlement criterion in paragraph 9(a) of SFAS No. 133, as amended. DIG Implementation Issue No. B39, "*Embedded Derivatives: Application of Paragraph 13(b) to Call Options That Are Exercisable Only by the Debtor,"* addresses whether or not Paragraph 13(b) of SFAS No. 133, as amended, applies to a call option embedded with a debt host if the right to accelerate settlement of the debt can be exercised only by the debtor. The effective date of the implementation guidance in these issues is the first day of the first fiscal quarter beginning after December 15, 2005. The issue will become effective for TVA beginning in the second quarter of 2006. TVA is currently evaluating the potential implications of this issue which may or may not be material to its financial position or results of operations.

Accounting for Rental Costs

On October 6, 2005, the FASB issued FSP FAS 13-1, "*Accounting for Rental Costs Incurred during a Construction Period."* The FASB concludes in this FSP that rental costs associated with ground or building operating leases that are incurred during a construction period should be expensed. FASB Technical Bulletin ("FTB") No. 88-1, *"Issues Relating to Accounting for Leases,"* requires that rental costs associated with operating leases be allocated on a straight-line basis in accordance with FASB Statement No. 13, "*Accounting for Leases*," and FTB 85-3, "*Accounting for Operating Leases with Scheduled Rent Increases*," starting with the beginning of the lease term. The FASB believes there is no distinction between the right to use a leased asset during the construction period and the right to use that asset after the construction period. TVA will apply this guidance beginning with the quarterly reporting period ending March 31, 2006. TVA is currently evaluating the potential implications of this staff position which may or may not be material to its financial position or results of operations.

Impairment of Investments

On November 3, 2005, the FASB released FSP FAS 115-1 and FAS 124-1,*"The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments."* This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of an "other-than-temporary" impairment and requires certain disclosures about unrealized losses that have not been recognized as "other-than-temporary" impairments. The adoption of the guidance in this FSP will be applied to reporting periods beginning after December 15, 2005. TVA is currently evaluating the potential implications of this staff position which may or may not be material to its financial position or results of operations.

Risk Factors and Forward-Looking Statements

Weather Risk

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

Operational Risk

The financial risks associated with the operation of the transmission system are modest over periods of one year or longer. 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, and the likeliness of such interruptions increases with an aging generation fleet. TVA does, however, have outage insurance in place which is intended to minimize the financial impact of interruptions.

Additionally, during the quarter ended December 31, 2005, a supplier with whom TVA has contracts for purchased power filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. There is a possibility that the company may reject, or fail to perform, under an existing power purchase agreement. TVA currently has an agreement with the supplier for power through August 2007. See *"Quantitative and Qualitative Disclosures about Market Risk"—"Credit Risk."*

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.

TVA continues to monitor the cost of fuel and purchased power. Current projections have these costs increasing significantly above the amount upon which the October 1, 2005, rate increase was based. This will place upward pressure on rates and could possibly result in further rate actions in the near term.

Risk of Loss of Customers

The 1959 amendments to the TVA Act provide that, subject to certain minor exceptions, neither TVA nor its distributors may be a source of power supply outside TVA's defined service area. This statutory provision is referred to as the "Fence" because it bounds TVA's sales activities, essentially limiting TVA to power sales within a defined service territory that includes most of Tennessee and parts of six other states: Kentucky, Mississippi, Alabama, Georgia, North Carolina, and Virginia.

While the Fence confines TVA to the Tennessee Valley, the so-called "Anti-Cherrypicking Provision" of the TVA Act 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.

The Anti-Cherrypicking Provision minimizes the financial exposure of TVA to loss of distributor customers due to their limited access to transmission resources.

In January 2006, FERC issued a final order directing TVA to interconnect with the East Kentucky Power Cooperative ("EKPC") at three locations on the TVA transmission system. If upheld, this order would allow EKPC 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 believes this would be contrary to the provisions of the Federal Power Act which restrict power providers from using TVA's transmission system to serve customers in TVA's service area. If TVA seeks a rehearing and FERC denies it, TVA may seek review in the federal courts of appeal.

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

During the quarter ended December 31, 2005, a directly-served customer filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. TVA did not experience any losses as a result of the customer bankruptcy. Sales to the customer generated approximately 0.1 percent of TVA's total operating revenues in 2005.

Compliance with Environmental Regulations

As is the case across the utility industry and in other industrial sectors, TVA's activities are subject to certain federal, state and local environmental statutes and regulations, primarily in the areas of air quality control, water quality control and management and disposal of solid and hazardous wastes. TVA has incurred, and continues to incur, significant capital and operating/maintenance costs associated with compliance with evolving environmental regulations, many of which are associated with the operation of TVA's 59 coal-fired generating units. These costs could be even more significant in the future as a result of changes in legislation and other factors.

Through 2005, TVA had spent $4.4 billion on clean air projects and is spending $1.3 billion more on additional environmental projects. TVA continues to consider better, more cost-effective ways to further reduce emissions in light of evolving emission reduction requirements. TVA's objective is to optimize its coal-fired assets and strategy for compliance with clean air regulations by maintaining the flexibility to respond to changing market conditions and allowing an adequate timeline to mitigate uncertainties. In light of the continuing progress in reducing its emissions, TVA expects to have a several-year window available before deciding on significant additional investments beyond those already announced. TVA's plan will manage uncertainties and risks, provide flexibility to match predicted loads, and allow time to evaluate market conditions and make changes to other strategies as business conditions dictate without requiring major additional financial commitments.

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.

Some examples of forward-looking statements include statements regarding strategic objectives; estimates of costs for disposing of certain asset retirement obligations; expectations about the adequacy of TVA's nuclear decommissioning fund; estimates regarding the reduction of total financing obligations; the impact of new accounting pronouncements and interpretations, including Statement of Financial Accounting Standards No. 151, *"Inventory Costs — an amendment of ARB No. 43, Chapter 4"* and Financial Accounting Standards Board ("FASB") Interpretation No. 47, *"Accounting for Conditional Asset Retirement Obligations — an interpretation of FASB Statement No. 143;"* TVA's plans to continue using short-term debt to meet current obligations; and the anticipated cost and timetable for 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 the 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 or systems 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 materially 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

TVA Governance
President Bush has nominated people for six of the seven open positions on the restructured TVA Board. The nominees are Dennis Bottorff of Nashville, Tennessee; Donald R. DePriest of Columbus, Mississippi; Robert Mike Duncan of Inez, Kentucky; William B. Sansom of Knoxville, Tennessee; Howard A. Thrailkill of Huntsville, Alabama; and Susan Richardson Williams of Knoxville, Tennessee. Hearings on all six nominations began on February 8, 2006. Once three new directors take office, the new Board structure will become effective. See *"Management's Discussion and Analysis of Financial Condition and Results of Operation" — "Legislative and Regulatory Matters" — "TVA Governance"* in the 2005 Information Statement.

Kentucky Distributors
Senator Mitch McConnell of Kentucky is continuing to look for support for S. 1499, a bill that would effectively remove any area within Kentucky from the coverage 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 TVA's service area that is within Kentucky. See *"Management's Discussion and Analysis of Financial Condition and Results of Operation" — "Risk Management Activities" — "Risk of Loss of Customers"* in the 2005 Information Statement.

Other

Fossil Fuels Inventories
As a result of hurricanes Katrina and Rita during the summer of 2005, offshore Gulf of Mexico natural gas production remains shut-in (meaning the gas wells are not able to produce) although indications are that the situation is improving. TVA has natural gas supply in storage and plans to continue making forward purchases of natural gas to meet TVA's expected demand.

TVA has been notified of problems with three of its coal suppliers. This will result in a shortfall of coal to the fossil plants. Replacement coal and transportation for these shortfalls have been located and contracted for; however, these replacement coals are originating in places not normally utilized by TVA and present disruption risks. While inventories are improving slightly, negative inventory impacts may still occur. TVA continues to assess the impact and make plans to secure the necessary tonnage to compensate for the shortfalls.

Bellefonte Nuclear Plant
In September 2005, NuStart Development LLC ("NuStart"), selected Bellefonte as one of the two sites in the country for a new advanced design nuclear plant. Although neither TVA nor NuStart have decided to build an advanced nuclear reactor at this time, NuStart does intend to seek a combined construction and operating license for the site for the new Advanced Passive 1000 reactor design by Westinghouse Electric Co. TVA also led a team which prepared a cost and schedule study in August 2005 on building an Advanced Boiling Water Reactor ("ABWR") on the Bellefonte site and submitted the results to DOE. Other members of the team, operating under the DOE's Nuclear Power 2010 program, include Toshiba Corp., General Electric Corp., Bechtel Corp., United States Enrichment Corporation, and Global Nuclear Fuels–Americas. The ABWR has been design-certified in the United States by the Nuclear Regulatory Commission ("NRC"). The study was designed to verify the costs of building a new ABWR plant, which could provide another option for utilities interested in preserving the nuclear option for the future.

In December 2005, TVA notified the NRC that it has placed Bellefonte Nuclear Plant Units 1 and 2 in terminated status and that it intends to submit for NRC approval a request for withdrawal of construction permits for these units. Canceling the construction status of the existing plant facilities and withdrawal of the related construction permits are necessary in order to facilitate other future uses of the Bellefonte site. The placement of the partially constructed Bellefonte units in terminated status does not prevent the future use of the Bellefonte site for other uses, including the construction of any new nuclear or non-nuclear power facilities.

Bear Creek Dam Seepage
Bear Creek Dam is experiencing foundation problems as evidenced by seepage through the foundation of the dam. Continued monitoring indicates that remedial work such as grouting and sinkhole repair have reduced but not eliminated the problem. With the concurrence of third party independent reviewers, TVA will begin the environmental, economic, and engineering study to determine and evaluate potential options and identify a recommendation on how to proceed.

Fuel Fabrication Claims

On November 9, 2005, TVA received two invoices totaling $76 million from Areva ("Areva") and Framatome ANP, Inc., the predecessor of Babcock and Wilcox Company ("B&W"). In 1970, TVA and B&W entered into a contract for fuel fabrication services for the Bellefonte Nuclear Plant. Areva's invoices are based upon its belief that the 1970 contract required TVA to buy more fuel fabrication services from B&W than TVA did. TVA is reviewing Areva's claim.

President's 2007 Budget, TFO Reductions

On February 6, 2006, the Office of Management & Budget submitted the President's 2007 budget to Congress. The budget calls for increased reductions in TVA's total financing obligations ("TFOs") through 2016. For 2007, the TFO reduction target is $529 million.

TVA estimates it will reduce TFOs by a total of $7.8 billion for 2004 through 2016. This estimate is based on the assumptions that TVA will recover fuel and purchased-power cost increases through revenues and that TVA will be able to keep growth in other operating and maintenance costs at ½ of one percent below the rate of inflation. As with any type of long term planning, business model uncertainties and assumptions, most of which are out of TVA's control, may negatively impact TVA's ability to meet the reductions in TFO targets. See *"Forward-Looking Statements."*

Through 2005, TVA has reduced its TFOs by $2.1 billion since the beginning of 1997. As of December 31, 2005, TVA had $25.7 billion of TFOs outstanding.

Medicare Part D

Beginning in 2006, Medicare will provide prescription drug coverage under Medicare Part D to Medicare beneficiaries. For employers that provide prescription drug plans for retirees, a retiree drug subsidy is available if the plans pass a two-part actuarial equivalence test. TVA determined that its retiree prescription drug plan did not meet the second part of the test and that it could not continue to provide its then current plan for retirees and receive the direct subsidy from Medicare. After analyzing the additional options available to employers for integration with Medicare Part D, TVA elected to provide an employer-sponsored Part D prescription drug plan, commonly referred to as an Enhanced PDP. The newly established Enhanced PDP (1) provides alternative coverage over and above Medicare standard Part D coverage for Medicare-eligible retirees who participate in TVA's Medicare supplement and (2) receives subsidies from Medicare that are required to be passed through to reduce the drug portion of participant premiums.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Mark-to-Market Valuation

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

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

As of December 31, 2005, closing prices, the MTM value of TVA's electricity portfolio for the next 12 months was $3.0 billion. The fair value calculation determines a profit or loss for each source of fair value (e.g. load revenue) based on market prices. Market prices for electricity have a small impact on TVA margins because only a small portion of TVA's energy needs are bought or sold in the market.

Derivatives

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

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

Cash flow hedges included in ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) on the Balance Sheets at December 31, 2005, include the following:

	Accumulated Other Comprehensive Income (Loss)	
	December 31, 2005	September 30, 2005
Inflation swaps	$ (8)	$ 2
Foreign currency swaps	52	25
Total	$ 44	$ 27

Other derivative contracts include swaption agreements, an interest rate swap, various purchased power option contracts, coal contracts that contain volume options, and options on futures contracts. One of TVA's swaption agreements qualifies for fair value hedge accounting under SFAS No. 133, as amended, and the gains and losses on the hedged item and the hedging item are recognized immediately in the determination of earnings. TVA elected to forego hedge

accounting treatment for two other swaption agreements, and the gains and losses on these swaption agreements, as well as the gains and losses on an interest rate swap that does not qualify for hedge accounting treatment under SFAS No. 133, as amended, are recognized immediately in the determination of earnings.

TVA has purchased power option contracts and coal contracts that contain volume options. Gains or losses on these contracts are deferred and regarded as regulatory assets or liabilities in accordance with SFAS No. 71 until settlement, at which time they are recognized in fuel and purchased power expenses. This treatment reflects TVA's ability and intent to account for these derivative instruments on a settlement basis for rate-making purposes. In addition, TVA holds purchased options related to futures contracts, and the changes in fair value of these options are recognized immediately in the determination of earnings.

Credit Risk

TVA's credit risk has not changed materially from that reported in the 2005 Information Statement. However, during the quarter ended December 31, 2005, a supplier of purchased power filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. Because of the nature of business and the supplier's position in the marketplace, TVA is exposed to the supplier under various contractual arrangements. TVA does not expect to experience any cash losses as a result of the supplier's bankruptcy.

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 NO_x emission allowances. This provides TVA the same ability to transact in the new and evolving NO_x emissions allowance market as the SO_2 emissions allowance market.

Financial Trading Program

A financial trading program to reduce TVA's economic risk exposure associated with TVA's physical electricity generation, purchases, and sales was approved by the Board on May 17, 2005. The program enables TVA to trade certain futures contracts and options on futures contracts for the purpose of managing economic risks directly associated with the cost of natural gas and fuel oil for TVA's power generation operations; broadens 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 purchase or sale arrangements where the energy price is based at least in part upon a fuel price index or proxy; and 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.

At December 31, 2005, TVA had 328 derivative contracts outstanding under the program with an approximate net market value of $33.2 million. The program has enabled TVA to effectively hedge the price risk associated with a portion of its natural gas and power purchases. During the three-month period ended December 31, 2005, TVA recognized unrealized losses of approximately $1.2 million which offset previously accumulated gains of about $0.5 million and included all such losses in purchased power expense for the period ended December 31, 2005.

Financial Trading Program Activity
Three Months Ended December 31

	2005 Notional Amount (in mmBtu)	2005 Contract Value	2004 Notional Amount (in mmBtu)	2004 Contract Value
Futures contracts				
Financial positions at beginning of period, net	880,000	$ 9.6	–	$ –
Purchased	2,420,000	26.1	600,000	4.0
Sold	(140,000)	(1.8)	(50,000)	(0.3)
Realized gains (losses)	–	–	–	–
Net positions–long	3,160,000	33.9	550,000	3.7
Options Contracts				
Financial positions at beginning of period, net	240,000	–	–	–
Calls purchased	–	–	150,000	0.1
Puts sold	–	–	(300,000)	(0.1)
Positions closed or expired	(120,000)	–	–	–
Net positions	120,000	–	(150,000)	–
Holding gains (losses)				
Unrealized gains at the beginning of period, net	–	0.5	–	–
Unrealized (losses) for the period	–	(1.2)	–	(0.3)
Unrealized (losses) at end of period, net	–	(0.7)	–	(0.3)
Financial positions at end of period, net	3,280,000	$ 33.2	400,000	$ 3.4

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 members of the Board and 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 December 31, 2005. Based on that evaluation, the members of the Board and of the Disclosure Control Committee (including the Chief Financial Officer and the Controller) concluded that, as a result of internal control deficiencies (described below), TVA's disclosure controls and procedures were not effective as of December 31, 2005. However, to assess the financial statement impact of these internal control deficiencies, TVA performed additional analyses, interim procedures, and monitoring activities. As a result of these measures and through reliance on compensating controls, the members of the Board and of the Disclosure Control Committee (including the Chief Financial Officer and the Controller) have determined that there is reasonable assurance that the financial statements included in this 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 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."

During the fourth quarter of 2005, TVA management identified a significant deficiency related to controls over the completeness, accuracy, and authorization of TVA's property, plant, and equipment transactions and balances. To remediate this deficiency, TVA is developing a new process for project approval to include the determination of proper project cost classification, formalizing the accounting review of account balances and transactions, and improving the documentation of management review and approval.

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, a significant 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.

TVA is taking corrective actions to address this deficiency by implementing stronger controls over data and program changes, stricter logging and monitoring processes of data and program changes, and additional documentation and security procedures.

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 stan-

dardized. To improve controls in this area, personnel have performed independent reviews of all new contracts and supplements to be included, and changes made to the valuation model during the quarter ended December 31, 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 December 31, 2005, in TVA's 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 November 22, 2005, the Board approved tax-equivalent payments for 2005 in the amount of $365 million and estimated tax-equivalent payments for 2006 in the amount of $373 million.

ADDITIONAL INFORMATION

Management

In November 2005, Jon Rupert, Vice President of Browns Ferry Unit 1 Restart, announced his retirement, effective January 6, 2006. Masoud Bajestani, Senior Vice President of Maintenance Scheduling and Outage Coordination, has assumed responsibility for the restart project on an interim basis until a final selection is made and approved.

In December 2005, LeAnne Stribley, Executive Vice President of Administration, announced her resignation from TVA, effective January 31, 2006. John E. Long, Executive Vice President of Administrative Services, assumed responsibility for many of the former Administration organizations (including Facilities, Procurement, Information Services, TVA Police, and Enterprise Performance and Analysis) as part of the September 20, 2005, reorganization.

Operations

Browns Ferry Unit 1

In May 2002, the TVA Board initiated activities for the return of Browns Ferry Unit 1 to service in order to meet long-term energy needs in the Tennessee Valley. It is anticipated the Browns Ferry Unit 1 recovery project will add approximately 1,280 megawatts of generation at a cost of approximately $1.8 billion. Unit 1 is expected to return to service in 2007, and the additional generating capacity is expected to lower the average cost of power and provide additional cash flow. As of December 31, 2005, TVA had incurred approximately $1.4 billion of costs (including AFUDC of $120 million) on the Browns Ferry Unit 1 restart project, the planned amount for this period. The restart project was about 75 percent complete at that date and on schedule for completion.

Other

In November 2005, the President of the United States sent to the Senate nominations of five people to serve on the TVA Board. In December 2005, President Bush sent to the Senate the name of a sixth nominee to the TVA Board. The nominees are Dennis Bottorff of Nashville, Tennessee; Donald R. DePriest of Columbus, Mississippi; Robert Mike Duncan of Inez, Kentucky; William B. Sansom of Knoxville, Tennessee; Howard A. Thrailkill of Huntsville, Alabama; and Susan Richardson Williams of Knoxville, Tennessee. Hearings on all six nominations began February 8, 2006. As soon as three new Board members take office, the restructured Board provided for in the Consolidated Appropriations Act, 2005 will take effect. With seven new positions on the restructured Board, one position remains for which a nominee has not been designated. See *"Management's Discussion and Analysis of Financial Condition and Results of Operation" — "Subsequent Events" — "Management"* in the 2005 Information Statement.

Spent Nuclear Fuel

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 announced that it would not begin receiving SNF from any domestic nuclear utility until 2010 at the earliest. TVA, like other utilities, stores SNF in pools at its nuclear sites. Although TVA would have had sufficient space to continue to store SNF in those storage pools at its Sequoyah and Browns Ferry Nuclear Plants indefinitely had DOE begun accepting SNF, DOE's failure to do so required TVA to construct dry cask storage facilities at those 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.) The Sequoyah and Browns Ferry facilities have been constructed and approved by the NRC and are now in use. 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 case went to trial in June 2005, and the proof centered on TVA's claims through 2004. On January 31, 2006, the Court of Federal Claims issued a decision in TVA's favor, awarding TVA nearly $35 million, substantially all the damages sought in the suit. Under the decision, TVA retains the right to bring lawsuits to recover for extra costs incurred after September 30, 2004.

President's 2007 Budget, TFO Reductions

On February 6, 2006, the Office of Management & Budget submitted the President's 2007 budget to Congress. The budget calls for increased reductions in TVA's total financing obligations ("TFOs") through 2016. For 2007, the TFO reduction target is $529 million.

TVA estimates it will reduce TFOs by a total of $7.8 billion for 2004 through 2016. This estimate is based on the assumptions that TVA will recover fuel and purchased-power cost increases through revenues and that TVA will be able to keep growth in other operating and maintenance costs at ½ of one percent below the rate of inflation. As with any type of long-term planning, business model uncertainties and assumptions, most of which are out of TVA's control, may negatively impact TVA's ability to meet the reductions in TFO targets. See *"Forward-Looking Statements."*

Through 2005, TVA has reduced its TFOs by $2.1 billion since the beginning of 1997. As of December 31, 2005, TVA had $25.7 billion of TFOs outstanding.

CERTIFICATIONS OF THE INDIVIDUAL MEMBERS OF THE TVA BOARD OF DIRECTORS

Bill Baxter and Skila Harris individually certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report ("Report") for the quarterly period ended December 31, 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, and for, the periods presented in this Report;
4. The other certifiers and I are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Tennessee Valley Authority is made known to us by others particularly during the period in which this Report is being prepared;

   b) evaluated the effectiveness of the Tennessee Valley Authority's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

   c) disclosed in this Report any change in internal control over financial reporting that occurred during the quarter ended December 31, 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: February 10, 2006

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 December 31, 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, and for, the periods presented in this Report;
4. The other certifiers and I are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and have:

    a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Tennessee Valley Authority is made known to us by others particularly during the period in which this Report is being prepared;

    b) evaluated the effectiveness of the Tennessee Valley Authority's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

    c) disclosed in this Report any change in internal control over financial reporting that occurred during the quarter ended December 31, 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: February 10, 2006

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

CONTACT INFORMATION

GENERAL INQUIRIES

Ellen Robinson
Executive Vice President, Communications
Tennessee Valley Authority
400 West Summit Hill Drive
Knoxville, TN 37902

Phone: 865-632-6263
Fax: 865-632-4760
E-mail: tvainfo@tva.com
Web site: www.tva.com

INVESTOR INQUIRIES

John M. Hoskins
Senior Vice President, Treasurer/Investor Relations
Tennessee Valley Authority
400 West Summit Hill Drive
Knoxville, TN 37902

Phone: 888-882-4975 (toll-free inside the U.S.)
Phone: 888-882-4967 (toll-free outside the U.S.)
E-mail: investor@tva.com
Web site: www.tva.com/finance

E-mail Alert

E-mail alerts are messages that are sent to a subscriber's e-mail address whenever certain new information about TVA bonds is available. To subscribe to e-mail alerts, visit TVA's web site at: www.tva.com/finance

TVA OFFICE OF THE INSPECTOR GENERAL

Richard W. Moore
Inspector General
Tennessee Valley Authority
400 West Summit Hill Drive
Knoxville, TN 37902

Phone: 865-632-4120
Empowerline (formerly, the Hotline); 1-877-866-7840 (toll free) or www.OIGempowerline.com
Fax: 865-632-4130
E-mail: richard.moore@tva.gov
Web site: oig.tva.gov