Tennessee Valley Authority
Form 10-Q
August 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)
x QUARTERLY REPORT PURSUANT TO SECTION 13, 15(d), OR 37 OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-52313

TENNESSEE VALLEY AUTHORITY
(Exact name of registrant as specified in its charter)

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

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

None
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

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GLOSSARY OF COMMON ACRONYMS

Following are definitions of terms or acronyms that may be used in this Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (the “Quarterly Report”):

Term or Acronym	Definition
AFUDC	Allowance for funds used during construction
ARO	Asset retirement obligation
ART	Asset Retirement Trust
ASLB	Atomic Safety and Licensing Board
BEST	Bellefonte Efficiency and Sustainability Team
BREDL	Blue Ridge Environmental Defense League
CAA	Clean Air Act
CAIR	Clean Air Interstate Rule
CCOLA	Combined construction and operating license application
CCP	Coal combustion products
CCR	Coal combustion residual
CME	Chicago Mercantile Exchange
CO_2	Carbon dioxide
COLA	Cost-of-living adjustment
CSAPR	Cross State Air Pollution Rule
CTs	Combustion turbine unit(s)
CVA	Credit valuation adjustment
CY	Calendar year
DOE	Department of Energy
EPA	Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FTP	Financial Trading Program
GAAP	Accounting principles generally accepted in the United States of America
GAO	Government Accountability Office
GHG	Greenhouse gas
GWh	Gigawatt hour(s)
JSCCG	John Sevier Combined Cycle Generation LLC
kWh	Kilowatt hour(s)
LIBOR	London Interbank Offered Rate
LPC	Local power company customer of TVA
MD&A	Management’s Discussion and Analysis of Financial Condition and Results of Operations
MISO	Midcontinent Independent System Operator, Inc.
mmBtu	Million British thermal unit(s)
MtM	Mark-to-market
MW	Megawatt
NAV	Net asset value
NDT	Nuclear Decommissioning Trust
NEPA	National Environmental Policy Act
NERC	North American Electric Reliability Corporation
NO_x	Nitrogen oxides
NPDES	National Pollutant Discharge Elimination System
NRC	Nuclear Regulatory Commission

OCI	Other Comprehensive Income (Loss)
PM	Particulate matter

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QTE	Qualified technological equipment and software
REIT	Real Estate Investment Trust
SACE	Southern Alliance for Clean Energy
SCCG	Southaven Combined Cycle Generation, LLC
SCRs	Selective catalytic reduction systems
SEC	Securities and Exchange Commission
SERP	Supplemental Executive Retirement Plan
Seven States	Seven States Power Corporation
SHLLC	Southaven Holdco, LLC
SMR	Small modular reactor(s)
SO_2	Sulfur dioxide
SSSL	Seven States Southaven, LLC
TCWN	Tennessee Clean Water Network
TDEC	Tennessee Department of Environment & Conservation
TOU	Time-of-use
TVARS	Tennessee Valley Authority Retirement System
TN Board	Tennessee Board of Water Quality, Oil, and Gas
USEC	United States Enrichment Corporation
VIE	Variable interest entity
XBRL	eXtensible Business Reporting Language

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FORWARD-LOOKING INFORMATION

This Quarterly Report contains forward-looking statements relating to future events and future performance. All statements other than those that are purely historical may be forward-looking statements. In certain cases, forward-looking statements can be identified by the use of words such as "may," "will," "should," "expect," "anticipate," "beli "intend," "project," "plan," "predict," "assume," "forecast," "estimate," "objective," "possible," "probably," "likely," "potentia other similar expressions.

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

- New or amended laws, regulations, or administrative determinations, including those related to environmental matters, and the costs of complying with these laws, regulations, and administrative determinations;
- The requirement or decision to make additional contributions to TVA's pension or other post-retirement benefit plans or to TVA's Nuclear Decommissioning Trust ("NDT") or Asset Retirement Trust ("ART");
- Events at a TVA facility, which, among other things, could result in loss of life, damage to the environment, damage to or loss of the facility, and damage to the property of others;
- Events at a nuclear facility, whether or not operated by or licensed to TVA, which, among other things, could lead to increased regulation or restriction on the construction, ownership, operation, and decommissioning of nuclear facilities or on the storage of spent fuel, obligate TVA to pay retrospective insurance premiums, reduce the availability and affordability of insurance, increase the costs of operating TVA's existing nuclear units, negatively affect the cost and schedule for completing Watts Bar Nuclear Plant ("Watts Bar") Unit 2 and preserving Bellefonte Nuclear Plant ("Bellefonte") Unit 1 for possible completion, or cause TVA to forego future construction at these or other facilities;
- Significant delays, cost increases, or cost overruns associated with the construction of generation or transmission assets;
- Costs and liabilities that are not anticipated in TVA's financial statements for third-party claims, natural resource damages, or fines or penalties associated with events such as the Kingston Fossil Plant ("Kingston") ash spill;
- Failure of TVA's assets to operate as planned;
- Failure of TVA's cyber security program to protect TVA's assets from cyber attacks;
- The outcome of legal and administrative proceedings;
- Significant changes in demand for electricity which may result from, among other things, economic downturns, loss of customers, increased energy efficiency and conservation, and improvements in distributed generation and other alternative generation technologies;
- Addition or loss of customers;
- The failure of TVA's generation, transmission, flood control, and related assets, including coal combustion residual ("CCR") facilities, to operate as anticipated, resulting in lost revenues, damages, and other costs that are not reflected in TVA's financial statements or projections;
- The cost of complying with known, anticipated, and new emissions reduction requirements, some of which could render continued operation of many of TVA's aging coal-fired generation units not cost-effective and result in their removal from service, perhaps permanently;
- Disruption of fuel supplies, which may result from, among other things, weather conditions, production or transportation difficulties, labor challenges, or environmental laws or regulations affecting TVA's fuel suppliers or transporters;
- Purchased power price volatility and disruption of purchased power supplies;
- Events or changes involving transmission lines, dams, and other facilities not operated by TVA, including those that affect the reliability of the interstate transmission grid of which TVA's transmission system is a part

and those that increase flows across TVA's transmission grid, as well as inadequacies in the supply of water to TVA's generation facilities;

- Inability to obtain, or loss of, regulatory approval for the construction or operation of assets, including Watts Bar Unit 2;
- Weather conditions;
- Catastrophic events such as fires, earthquakes, solar events, floods, hurricanes, tornadoes, pandemics, wars, national emergencies, terrorist activities, and other similar events, especially if these events occur in or near TVA's service area;
- Restrictions on TVA's ability to use or manage real property currently under its control;
- Reliability and creditworthiness of counterparties;
- Changes in the market price of commodities such as coal, uranium, natural gas, fuel oil, crude oil, construction materials, reagents, electricity, and emission allowances;
- Changes in the market price of equity securities, debt securities, and other investments;
- Changes in interest rates, currency exchange rates, and inflation rates;
- Changes in the timing or amount of pension and health care costs;
- Increases in TVA's financial liability for decommissioning its nuclear facilities and retiring other assets;
- Limitations on TVA's ability to borrow money which may result from, among other things, TVA's approaching or substantially reaching the limit on bonds, notes, and other evidences of indebtedness specified in the TVA Act of 1933;

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- An increase in TVA's cost of capital which may result from, among other things, changes in the market for TVA's debt securities, changes in the credit rating of TVA or the U.S. government, and an increased reliance by TVA on alternative financing arrangements as TVA approaches its debt ceiling;
- Actions taken, or inaction, by the U.S. government to address the situation of approaching its debt limit;
- Changes in the economy and volatility in financial markets;
- Ineffectiveness of TVA's disclosure controls and procedures and its internal control over financial reporting;
- Problems attracting and retaining a qualified workforce;
- Changes in technology;
- Inability to eliminate identified deficiencies in TVA's systems, standards, controls, and corporate culture;
- Differences between estimates of revenues and expenses and actual revenues earned and expenses incurred; and
- Unforeseeable events.

See also Item 1A, Risk Factors, and Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations in TVA’s Annual Report on Form 10-K for the fiscal year ended September 30, 2013 (the “Annual Report”) and
Part I, Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report for a discussion of factors that could cause actual results to differ materially from those in a forward-looking statement. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA’s business or cause results to differ materially from those contained in any forward-looking statement. TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur after the statement is made.

GENERAL INFORMATION

Fiscal Year

References to years (2014, 2013, etc.) in this Quarterly Report are to TVA’s fiscal years ending September 30. Years that are preceded by “CY” are references to calendar years.

Notes

References to “Notes” are to the Notes to Consolidated Financial Statements contained in Part I, Item 1, Financial Statements in this Quarterly Report.

Available Information

TVA's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports are available on TVA's web site, free of charge, as soon as reasonably practicable after such reports are electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). TVA's web site is www.tva.gov. Information contained on TVA’s web site shall not be deemed to be incorporated into, or to be a part of, this Quarterly Report. TVA's SEC reports are also available to the public without charge from the web site maintained by the SEC at www.sec.gov.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(in millions)

	Three Months Ended June 30		Nine Months Ended June 30	
	2014	2013	2014	2013
Operating revenues				
Sales of electricity	$2,618	$2,572	$7,869	$7,830
Other revenue	33	30	102	92
Total operating revenues	2,651	2,602	7,971	7,922
Operating expenses				
Fuel	698	652	1,904	2,118
Purchased power	279	263	843	796
Operating and maintenance	880	866	2,480	2,662
Depreciation and amortization	463	412	1,357	1,248
Tax equivalents	133	131	395	404
Total operating expenses	2,453	2,324	6,979	7,228
Operating income	198	278	992	694
Other income (expense), net	10	10	37	36
Interest expense				
Interest expense	334	343	1,009	1,057
Allowance for funds used during construction and nuclear fuel expenditures	(45)	(43)	(127)	(124)
Net interest expense	289	300	882	933
Net income (loss)	$(81)	$(12)	$147	$(203)

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

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)
(in millions)

	Three Months Ended June 30		Nine Months Ended June 30	
	2014	2013	2014	2013
Net income (loss)	$(81)	$(12)	$147	$(203)
Other comprehensive income (loss)				
Net unrealized gain (loss) on cash flow hedges	1	9	23	(7)
Reclassification to earnings from cash flow hedges	(26)	(1)	(55)	57
Total other comprehensive income (loss)	$(25)	$8	$(32)	$50
Total comprehensive income (loss)	$(106)	$(4)	$115	$(153)

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED BALANCE SHEETS
(in millions)
ASSETS

	June 30, 2014	September 30, 2013
Current assets	(Unaudited)	
Cash and cash equivalents	$505	$1,602
Restricted cash and investments	—	33
Accounts receivable, net	1,550	1,567
Inventories, net	1,063	1,091
Regulatory assets	566	561
Other current assets	70	52
Total current assets	3,754	4,906
Property, plant, and equipment		
Completed plant	47,243	47,073
Less accumulated depreciation	(24,233)	(23,157)
Net completed plant	23,010	23,916
Construction in progress	5,624	4,704
Nuclear fuel	1,275	1,256
Capital leases	59	47
Total property, plant, and equipment, net	29,968	29,923
Investment funds	1,903	1,701
Regulatory and other long-term assets		
Regulatory assets	8,566	9,131
Other long-term assets	504	445
Total regulatory and other long-term assets	9,070	9,576
Total assets	$44,695	$46,106

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED BALANCE SHEETS
(in millions)
LIABILITIES AND PROPRIETARY CAPITAL

	June 30, 2014	September 30, 2013
Current liabilities	(Unaudited)	
Accounts payable and accrued liabilities	$1,722	$1,627
Environmental cleanup costs - Kingston ash spill	82	102
Accrued interest	312	378
Current portion of leaseback obligations	75	69
Current portion of energy prepayment obligations	100	100
Regulatory liabilities	181	212
Short-term debt, net	1,759	2,432
Current maturities of power bonds	1,032	32
Current maturities of long-term debt of variable interest entities	31	30
Total current liabilities	5,294	4,982
Other liabilities		
Post-retirement and post-employment benefit obligations	5,410	5,348
Asset retirement obligations	3,067	3,472
Other long-term liabilities	1,911	1,861
Leaseback obligations	617	692
Energy prepayment obligations	335	410
Environmental cleanup costs - Kingston ash spill	—	67
Regulatory liabilities	2	1
Total other liabilities	11,342	11,851
Long-term debt, net		
Long-term power bonds, net	21,012	22,315
Long-term debt of variable interest entities	1,295	1,311
Total long-term debt, net	22,307	23,626
Total liabilities	38,943	40,459
Proprietary capital		
Power program appropriation investment	261	268
Power program retained earnings	4,917	4,767
Total power program proprietary capital	5,178	5,035
Nonpower programs appropriation investment, net	603	609
Accumulated other comprehensive income (loss)	(29)	3
Total proprietary capital	5,752	5,647
Total liabilities and proprietary capital	$44,695	$46,106

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
For the nine months ended June 30
(in millions)

	2014	2013
Cash flows from operating activities		
Net income (loss)	$147	$(203)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization (including amortization of debt issuance costs and premiums/discounts)	1,391	1,280
Amortization of nuclear fuel cost	205	186
Non-cash retirement benefit expense	429	467
Prepayment credits applied to revenue	(75)	(77)
Fuel cost adjustment deferral	(91)	93
Fuel cost tax equivalents	1	2
Environmental cleanup costs – Kingston ash spill – non cash	51	54
Changes in current assets and liabilities		
Accounts receivable, net	15	169
Inventories and other, net	33	(58)
Accounts payable and accrued liabilities	22	(258)
Accrued interest	(66)	(52)
Regulatory assets costs	(49)	(8)
Pension contributions	(132)	(6)
Environmental cleanup costs – Kingston ash spill	(65)	(81)
Insurance recoveries	175	5
Other, net	(4)	(35)
Net cash provided by operating activities	1,987	1,478
Cash flows from investing activities		
Construction expenditures	(1,694)	(1,510)
Nuclear fuel expenditures	(272)	(238)
Loans and other receivables		
Advances	(3)	(4)
Repayments	5	7
Other, net	3	—
Net cash used in investing activities	(1,961)	(1,745)
Cash flows from financing activities		
Long-term debt		
Issues of power bonds	—	1,080
Redemptions and repurchases of power bonds	(363)	(1,417)
Redemptions of variable interest entities	(15)	(6)
Short-term debt issues (redemptions), net	(674)	887
Payments on leases and leasebacks	(70)	(78)
Financing costs, net	—	(7)
Payments to U.S. Treasury	(10)	(19)
Other, net	9	(61)
Net cash (used in) provided by financing activities	(1,123)	379
Net change in cash and cash equivalents	(1,097)	112
Cash and cash equivalents at beginning of period	1,602	868

Cash and cash equivalents at end of period	$505	$980

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

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (Unaudited)
For the three months ended June 30, 2014 and 2013
(in millions)

	Power Program Appropriation Investment	Power Program Retained Earnings	Nonpower Programs Appropriation Investment, Net	Accumulated Other Comprehensive Income (Loss) from Net Gains (Losses) on Cash Flow Hedges	Total
Balance at March 31, 2013 (unaudited)	$278	$4,302	$616	$(32)	$5,164
Net income (loss)	—	(9)	(3)	—	(12)
Total other comprehensive income (loss)	—	—	—	8	8
Return on power program appropriation investment	—	(1)	—	—	(1)
Return of power program appropriation investment	(5)	—	—	—	(5)
Balance at June 30, 2013 (unaudited)	$273	$4,292	$613	$(24)	$5,154
Balance at March 31, 2014 (unaudited)	$263	$4,997	$605	$(4)	$5,861
Net income (loss)	—	(79)	(2)	—	(81)
Total other comprehensive income (loss)	—	—	—	(25)	(25)
Return on power program appropriation investment	—	(1)	—	—	(1)
Return of power program appropriation investment	(2)	—	—	—	(2)
Balance at June 30, 2014 (unaudited)	$261	$4,917	$603	$(29)	$5,752

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

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (Unaudited)
For the nine months ended June 30, 2014 and 2013
(in millions)

	Power Program Appropriation Investment	Power Program Retained Earnings	Nonpower Programs Appropriation Investment, Net	Accumulated Other Comprehensive Income (Loss) from Net Gains (Losses) on Cash Flow Hedges	Total
Balance at September 30, 2012	$288	$4,492	$620	$(74)	$5,326

Net income (loss)	—	(196)	(7)	—	(203)
Total other comprehensive income (loss)	—	—	—	50	50
Return on power program appropriation investment	—	(4)	—	—	(4)
Return of power program appropriation investment	(15)	$—	—	—	(15)
Balance at June 30, 2013 (unaudited)	$273	$4,292	$613	$(24)	$5,154
Balance at September 30, 2013	$268	$4,767	$609	$3	$5,647
Net income (loss)	—	153	(6)	—	147
Total other comprehensive income (loss)	—	—	—	(32)	(32)
Return on power program appropriation investment	—	(3)	—	—	(3)
Return of power program appropriation investment	(7)	—	—	—	(7)
Balance at June 30, 2014 (unaudited)	$261	$4,917	$603	$(29)	$5,752

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

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

1. Summary of Significant Accounting Policies

General

The Tennessee Valley Authority ("TVA") is a corporate agency and instrumentality of the United States that was created in 1933 by legislation enacted by the United States ("U.S.") Congress in response to a request by President Franklin D. Roosevelt. TVA was created to, among other things, improve navigation on the Tennessee River, reduce the damage from destructive flood waters within the Tennessee River system and downstream on the lower Ohio and Mississippi Rivers, further the economic development of TVA's service area in the southeastern United States, and sell the electricity generated at the facilities TVA operates.

Today, TVA operates the nation's largest public power system and supplies power in most of Tennessee, northern Alabama, northeastern Mississippi, and southwestern Kentucky and in portions of northern Georgia, western North Carolina, and southwestern Virginia to a population of over nine million people.

TVA also manages the Tennessee River, its tributaries, and certain shorelines to provide, among other things, year-round navigation, flood damage reduction, and affordable and reliable electricity. Consistent with these primary purposes, TVA also manages the river system to provide recreational opportunities, adequate water supply, improved water quality, natural resource protection, and economic development.

The power program has historically been separate and distinct from the stewardship programs. It is required to be self-supporting from power revenues and proceeds from power financings, such as proceeds from the issuance of bonds, notes, or other evidences of indebtedness ("Bonds"). Although TVA does not currently receive congressional appropriations, it is required to make annual payments to the U.S. Treasury in repayment of and as a return on the government's appropriation investment in TVA's power facilities (the "Power Program Appropriation Investment"). In the 1998 Energy and Water Development Appropriations Act, Congress directed TVA to fund essential stewardship activities related to its management of the Tennessee River system and nonpower or stewardship properties with power revenues in the event that there were insufficient appropriations or other available funds to pay for such activities in any fiscal year. Congress has not provided any appropriations to TVA to fund such activities since 1999. Consequently, during 2000, TVA began paying for essential stewardship activities primarily with power revenues, with the remainder funded with user fees and other forms of revenues derived in connection with those activities. The activities related to stewardship properties do not meet the criteria of an operating segment under accounting principles generally accepted in the United States of America ("GAAP"). Accordingly, these assets and properties are included as part of the power program, TVA's only operating segment.

Power rates are established by the TVA Board of Directors (the "TVA Board") as authorized by the Tennessee Valley Authority Act of 1933, as amended, 16 U.S.C. §§ 831-831ee (as amended, the “TVA Act”). The TVA Act requires TVA to charge

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

Fiscal Year

TVA's fiscal year ends September 30. Years (2014, 2013, etc.) refer to TVA's fiscal years unless they are preceded by “CY,” in which case the references are to calendar years.

Cost-Based Regulation

Since the TVA Board is authorized by the TVA Act to set rates for power sold to its customers, TVA is self-regulated. Additionally, TVA's regulated rates are designed to recover its costs. In view of demand for electricity and the level of competition, TVA believes that rates, set at levels that will recover TVA's costs, can be charged and collected. As a result of these factors, TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred or deferral of gains that will be credited to customers in future periods. TVA assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, potential legislation, and changes in technology. Based on these assessments, TVA believes the existing regulatory assets are probable of future recovery. This determination reflects the current regulatory and political environment and is subject to change in the future. If future recovery of regulatory assets ceases to be probable, or any of the other factors described above cease to be applicable, TVA would no longer be considered to be a regulated entity and would be required to write off these costs. Most regulatory asset write offs would be required to be recognized in earnings in the period in which future recovery ceases to be probable.

Basis of Presentation

TVA prepares its consolidated interim financial statements in conformity with GAAP for consolidated interim financial information. Accordingly, TVA's consolidated interim financial statements do not include all of the information and notes required by GAAP for annual financial statements. As such, they should be read in conjunction with the audited financial statements for the year ended September 30, 2013, and the notes thereto, which are contained in TVA's Annual Report on Form 10-K for the year ended September 30, 2013 (the “Annual Report”). In the opinion of management, all adjustments (consisting of items of a normal recurring nature) considered necessary for fair presentation are included in the interim financial statements.

The accompanying consolidated interim financial statements include the accounts of TVA and three variable interest entities ("VIEs"), of which TVA is the primary beneficiary. See Note 8. Intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Reclassifications

Certain reclassifications have been made to the Consolidated Statement of Cash Flows for the nine months ended June 30, 2014 in the Cash flows from operating activities section as $(14) million previously reported as Other, net was reclassified to $(8) million of Regulatory assets costs and $(6) million of Pension contributions. In addition, $5 million previously reported as Environmental cleanup costs — Kingston ash spill, net was reclassified to $5 million of Insurance recoveries.

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Allowance for Uncollectible Accounts

The allowance for uncollectible accounts reflects TVA's estimate of probable losses inherent in its accounts and loans receivable balances. TVA determines the allowance based on known accounts, historical experience, and other currently available information including events such as customer bankruptcy and/or a customer failing to fulfill payment arrangements after 90 days. It also reflects TVA's corporate credit department's assessment of the financial condition of customers and the credit quality of the receivables.

The allowance for uncollectible accounts was $1 million at both June 30, 2014 and September 30, 2013 for accounts receivable. Additionally, loans receivable of $105 million and $73 million at June 30, 2014 and September 30, 2013, respectively, are included in Other long-term assets and reported net of allowances for uncollectible accounts of $10 million.

Depreciation

Depreciation expense was $391 million and $341 million for the three months ended June 30, 2014, and 2013, and $1.1 billion and $1.0 billion for the nine months ended June 30, 2014, and 2013, respectively. On November 14, 2013, TVA determined that Paradise Fossil Plant ("Paradise") Units 1 and 2 will be idled on March 31, 2017, and depreciation expense is being accelerated over the remaining useful life. This resulted in additional depreciation expense of $21 million and $34 million during the three and nine months ended June 30, 2014, respectively. It is expected that the decision to idle Paradise Units 1 and 2 on March 31, 2017, will increase depreciation expense by approximately $21 million for the remainder of 2014.

Asset Retirement Obligations

TVA recognizes legal obligations associated with the future retirement of certain tangible long-lived assets. These obligations relate to nuclear generating plants, fossil fuel-fired generating plants, hydroelectric generating plants/dams, transmission structures, and other property-related assets. These other property-related assets include, but are not limited to, easements and coal rights. Activities involved with retiring these assets could include decontamination and demolition of structures, removal and disposal of wastes, and site reclamation. Revisions to the estimates of asset retirement obligations ("AROs") are made whenever factors indicate that the timing or amounts of estimated cash flows have changed. Any accretion or depreciation expense related to these liabilities and assets is charged to a regulatory asset. See Note 11 — Asset Retirement Obligations.

Blended Low-Enriched Uranium Program

Under the blended low-enriched uranium ("BLEU") program, TVA, the Department of Energy ("DOE"), and certain nuclear fuel contractors have entered into agreements providing for the DOE's surplus of enriched uranium to be blended with other uranium down to a level that allows the blended uranium to be fabricated into fuel that can be used in nuclear power plants. Under the terms of an interagency agreement between TVA and the DOE, in exchange for supplying highly enriched uranium materials to the appropriate third-party fuel processors for processing into usable BLEU fuel for TVA, the DOE participates to a degree in the savings generated by TVA’s use of this blended nuclear fuel. Over the life of the program, TVA projects that the DOE’s share of savings generated by TVA’s use of this blended nuclear fuel could result in payments to the DOE of as much as $160 million. TVA accrues an obligation with each BLEU reload batch related to the portion of the ultimate future payments estimated to be attributable to the BLEU fuel currently in use. At June 30, 2014, TVA had paid out approximately $101 million for this program, and the obligation recorded was $16 million.

2. Impact of New Accounting Standards and Interpretations

The following accounting standards became effective for TVA on October 1, 2013.

Balance Sheet. In December 2011, the Financial Accounting Standards Board ("FASB") issued guidance that requires additional disclosures relating to the rights of offset or other netting arrangements of assets and liabilities that are presented on a net or gross basis in the consolidated balance sheets. In January 2013, FASB issued additional guidance to limit the scope of the new offsetting disclosure requirements to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and lending transactions. The guidance requires the disclosure of the gross amounts subject to offset, actual amounts offset in accordance with GAAP, and the related net exposure. These changes became effective for TVA on October 1, 2013, and have been applied on a retrospective basis. This guidance relates solely to enhanced disclosures in the notes to the consolidated financial statements and did not have an impact on TVA's financial condition, results of operations, or cash flows.

Comprehensive Income. In February 2013, FASB issued guidance that requires public reporting companies under the Securities Act of 1933 to present information about reclassification adjustments from accumulated other comprehensive income (loss) ("AOCI") in their annual and interim financial statements in a single location. The guidance requires that companies present the effect of significant amounts reclassified from each component of AOCI based on its source and the income statement line items affected by the reclassification. This information may be disclosed either in a single note or parenthetically on the face of the financial statements. If a component is not required to be reclassified to net income in its entirety, companies

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must cross reference to the related footnote for additional information. These changes became effective for TVA on October 1, 2013, and have been applied on a prospective basis. TVA has chosen to disclose the required information in a single note. This guidance relates solely to enhanced disclosures and did not have an impact on TVA's financial condition, results of operations, or cash flows.

The following accounting standards have been issued, but as of June 30, 2014, were not effective and had not been adopted by TVA.

Revenue Recognition. In May 2014, the FASB issued a new revenue recognition standard that applies to revenue from contracts with customers. The standard requires that an entity recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard becomes effective for TVA on October 1, 2017, and allows for either a full retrospective or a modified retrospective application. Early adoption of the standard is not permitted. TVA is currently evaluating the potential impact of these changes on its consolidated financial statements and related disclosures and the application method to be used.

Liabilities. In February 2013, FASB issued ASU 2013-04, "Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date," which defines how entities measure obligations from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date and for which no guidance exists, except for obligations addressed within existing guidance in GAAP. The guidance also requires entities to disclose the nature and amount of the obligation as well as other information about those obligations. The standard becomes effective for TVA on October 1, 2014. Retrospective presentation for all comparative periods presented is required and early adoption is permitted. TVA has evaluated the impact of adopting this guidance and expects no material impact on TVA's financial condition, results of operations, or cash flows.

3. Restructuring

TVA is undertaking cost reduction initiatives with the goal of keeping rates low, keeping reliability high, and continuing to fulfill its broader mission of environmental stewardship and economic development. TVA’s current focus is on reducing operating and maintenance costs through further efficiency gains and streamlining the organization. TVA’s goal is to reduce operating and maintenance costs by $500 million by 2015 as compared to its 2013 budget. Certain employees will be eligible for severance payments as a result of these cost reduction initiatives. During the three and nine months ended June 30, 2014, TVA recorded expense for probable estimated severance. These amounts are included in Accounts payable and accrued liabilities on the June 30, 2014 Consolidated Balance Sheet. The table below summarizes the activity related to severance costs:

Severance Cost Liability Activity

	Three Months Ended June 30, 2014	Nine Months Ended June 30, 2014
Severance cost liability at beginning of period	$32	$—
Liabilities incurred during the period	21	56
Actual costs paid during the period	(7)	(10)
Severance cost liability at end of period	$46	$46

4. Accounts Receivable, Net

Accounts receivable primarily consist of amounts due from customers for power sales. The table below summarizes the types and amounts of TVA’s accounts receivable:

Accounts Receivable, Net

	At June 30, 2014	At September 30, 2013
Power receivables	$1,484	$1,495
Other receivables	67	73
Allowance for uncollectible accounts	(1)	(1)
Accounts receivable, net	$1,550	$1,567

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5. Inventories, Net

The table below summarizes the types and amounts of TVA’s inventories:
Inventories, Net

	At June 30, 2014	At September 30, 2013
Materials and supplies inventory	$611	$620
Fuel inventory	479	494
Emission allowance inventory	13	14
Allowance for inventory obsolescence	(40)	(37)
Inventories, net	$1,063	$1,091

6. Other Long-Term Assets

The table below summarizes the types and amounts of TVA’s other long-term assets:
Other Long-Term Assets

	At June 30, 2014	At September 30, 2013
EnergyRight® receivables	$119	$117
Unamortized debt issue cost of power bonds	65	75
Loans and other long-term receivables, net	105	73
Prepaid capacity payments	55	62
Restricted cash	56	—
Currency swap asset, net	15	28
Coal contract derivative assets	2	1
Other	87	89
Other long-term assets	$504	$445

In association with the EnergyRight® Solutions program, local power company customers of TVA ("LPCs") offer financing to end-use customers for the purchase of energy-efficient equipment. TVA purchases the resulting loans receivable from its LPCs. The loans receivable are then transferred to a third-party bank with which TVA has agreed to repay in full any loan receivable that has been in default for 180 days or more or that TVA has determined is uncollectible. Given this continuing involvement, TVA accounts for the transfer of the loans receivable as secured borrowings. The current and long-term portions of the loans receivable are reported in Accounts receivable, net and Other long-term assets, respectively, on TVA’s Consolidated Balance Sheets. As of June 30, 2014 and September 30, 2013, the carrying amount of the loans receivable, net of discount, reported in Accounts receivable, net was approximately $33 million. See Note 10 for information regarding the associated financing obligation.

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7. Regulatory Assets and Liabilities

Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred or deferrals of gains that will be credited to customers in future periods. Components of regulatory assets and regulatory liabilities are summarized in the table below:

Regulatory Assets and Liabilities

	At June 30, 2014	At September 30, 2013
Current regulatory assets		
Deferred nuclear generating units	$237	$237
Unrealized losses on commodity derivatives	137	183
Environmental agreements	77	73
Environmental cleanup costs - Kingston ash spill	53	68
Fuel cost adjustment receivable	62	—
Total current regulatory assets	566	561
Non-current regulatory assets		
Deferred pension costs and other post-retirement benefits costs	3,875	4,076
Unrealized losses on interest rate derivatives	898	808
Nuclear decommissioning costs	898	893
Environmental cleanup costs - Kingston ash spill	449	681
Non-nuclear decommissioning costs	577	571
Deferred nuclear generating units	1,308	1,438
Environmental agreements	139	189
Unrealized losses on commodity derivatives	112	139
Other non-current regulatory assets	310	336
Total non-current regulatory assets	8,566	9,131
Total regulatory assets	$9,132	$9,692
Current regulatory liabilities		
Fuel cost adjustment tax equivalents	$177	$176
Fuel cost adjustment liability	—	29
Unrealized gains on commodity derivatives	4	7
Total current regulatory liabilities	181	212
Non-current regulatory liabilities		
Unrealized gains on commodity derivatives	2	1
Total non-current regulatory liabilities	2	1
Total regulatory liabilities	$183	$213

8. Variable Interest Entities

A VIE is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of owning a controlling financial interest. The analysis to determine whether an entity is a VIE considers factors such as contracts with an entity, credit support for an entity, the adequacy of the equity investment of an entity, the extent of an entity's activities that either involve or are conducted on behalf of an investor with disproportionate voting rights, and the relationship of voting power to the amount of equity invested in an entity. A VIE is consolidated by its primary beneficiary. The primary beneficiary has both (i) the power to direct the activities that most significantly impact the entity's economic performance and (ii) the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. The determination of the primary beneficiary requires continual reassessment.

When TVA determines that it has a variable interest in a variable interest entity, a qualitative evaluation is performed to assess which interest holders have the power to direct the activities that most significantly impact the economic performance of the entity and have the obligation to absorb losses or receive benefits that could be significant to the entity. The evaluation considers the purpose and design of the business, the risks that the business was designed to create and pass along to other entities, the activities of the business that can be directed and which party can direct them, and the expected relative impact of

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those activities on the economic performance of the business through its life. TVA has the power to direct the activities of an entity when it has the ability to make key operating and financing decisions, including, but not limited to, capital investment and the issuance of debt.

Southaven

On August 9, 2013, TVA entered into a lease financing arrangement with Southaven Combined Cycle Generation, LLC ("SCCG") for the lease by TVA of the Southaven Combined Cycle Facility ("Southaven CCF"). SCCG is a special single-purpose limited liability company formed in June 2013 to finance the Southaven CCF through a $360 million secured notes issuance (the “SCCG notes”) and the issuance of $40 million of membership interests subject to mandatory redemption. The membership interests were purchased by Southaven Holdco, LLC ("SHLLC"). SHLLC is a special single-purpose entity, also formed in June 2013, established to acquire and hold the membership interests of SCCG. A non-controlling interest in SHLLC is held by a third party through nominal membership interests, to which none of the income, expenses, and cash flows of SHLLC are allocated.

The membership interests held by SHLLC were purchased with proceeds from the issuance of $40 million of secured notes (the “SHLLC notes”) and are subject to mandatory redemption pursuant to scheduled amortizing, semi-annual payments due each August 15 and February 15, with a final payment due on August 15, 2033. The payment dates for the mandatorily redeemable membership interests are the same as those of the SHLLC notes. The sale of the SCCG notes, the membership interests in SCCG, and the SHLLC notes all closed on August 9, 2013. The SCCG notes are secured by TVA’s lease payments, and the SHLLC notes are secured by SHLLC’s investment in, and amounts receivable from, SCCG. TVA’s lease payments to SCCG are payable on the same dates as SCCG’s and SHLLC’s semi-annual debt service payments and are equal to the sum of (i) the amount of SCCG’s semi-annual debt service payments, (ii) the amount of SHLLC’s semi-annual debt service payments, and (iii) the amount of scheduled pre-determined payments to be made to Seven States Southaven, LLC on each lease payment date by SHLLC as agreed in SHLLC’s formation documents. In addition to the lease payments, TVA pays administrative and miscellaneous expenses incurred by SCCG and SHLLC. Certain agreements related to this transaction contain default and acceleration provisions.

TVA participated in the design, business conduct, and financial support of SCCG and has determined that it has a direct variable interest in SCCG resulting from risk associated with the value of the Southaven CCF at the end of the lease term. Based on its analysis, TVA has determined that it is the primary beneficiary of SCCG and, as such, is required to account for the VIE on a consolidated basis.

John Sevier

On January 17, 2012, TVA entered into a $1.0 billion construction management agreement and lease financing arrangement with John Sevier Combined Cycle Generation LLC ("JSCCG") for the completion and lease by TVA of the John Sevier Combined Cycle Facility ("John Sevier CCF"). JSCCG is a special single-purpose limited liability company formed in January 2012 to finance the John Sevier CCF through a $900 million secured note issuance (the “JSCCG notes”) and the issuance of $100 million of membership interests subject to mandatory redemption. The membership interests were purchased by John Sevier Holdco LLC ("Holdco"). Holdco is a special single-purpose entity, also formed in January 2012, established to acquire and hold the membership interests in JSCCG. A non-controlling interest in Holdco is held by a third party through nominal membership interests, to which none of the income, expenses, and cash flows are allocated.

The membership interests held by Holdco in JSCCG were purchased with proceeds from the issuance of $100 million of secured notes (the “Holdco notes") and are subject to mandatory redemption pursuant to scheduled amortizing, semi-annual payments due each January 15 and July 15, with a final payment due on January 15, 2042. The payment dates for the mandatorily redeemable membership interests are the same as those of the Holdco notes. The sale of the JSCCG notes, the membership interests in JSCCG, and the Holdco notes all closed on January 17, 2012. The JSCCG notes are secured by TVA’s lease payments, and the Holdco notes are secured by Holdco's investment in, and amounts receivable from, JSCCG. TVA’s lease payments to JSCCG are equal to and payable on the same dates as JSCCG’s and Holdco’s semi-annual debt service payments. In addition to the lease payments, TVA pays administrative and miscellaneous expenses incurred by JSCCG and Holdco. Certain agreements related to this transaction contain default and acceleration provisions.

Due to its participation in the design, business conduct, and credit and financial support of JSCCG and Holdco, TVA has determined that it has a variable interest in both of these entities. Based on its analysis, TVA has concluded that it is the primary beneficiary of JSCCG and Holdco and, as such, is required to account for the VIEs on a consolidated basis. Holdco’s membership interests in JSCCG are eliminated in consolidation.

The financial statement items attributable to carrying amounts and classifications of JSCCG, Holdco, and SCCG as of June 30, 2014 and September 30, 2013, as reflected in the Consolidated Balance Sheets are as follows:

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Summary of Impact of VIEs on Consolidated Balance Sheets

	At June 30, 2014	At September 30, 2013
Current liabilities of VIE		
Accrued interest of VIE	$27	$12
Current portion of membership interests of VIE subject to mandatory redemption	2	2
Current maturities of long-term debt of VIE	31	30
Total current liabilities of VIE	60	44
Other liabilities of VIE		
Membership interests of VIE subject to mandatory redemption	37	38
Long-term debt of VIE, net		
Long-term debt of VIE	1,295	1,311
Total liabilities of VIE	$1,392	$1,393

Creditors of the VIEs do not have any recourse to the general credit of TVA. TVA does not have any obligations to provide financial support to the VIEs other than as prescribed in the terms of the agreements related to these transactions.

9. Kingston Fossil Plant Ash Spill

The Event

In December 2008, one of the dredge cells at the Kingston Fossil Plant ("Kingston") failed, and over five million cubic yards of water and coal fly ash flowed out of the cell. TVA is continuing cleanup and recovery efforts in conjunction with federal and state agencies. TVA completed the removal of time-critical ash from the river during the third quarter of 2010. In November 2012, the Environmental Protection Agency ("EPA") and the Tennessee Department of Environment and Conservation ("TDEC") approved a plan to allow the Emory River's natural processes to remediate the remaining ash in the river, and to conduct a long-term monitoring program. TVA estimates that the physical cleanup work (final cleanup work and closure) will be completed in the spring of 2015. A final assessment, issuance of a completion report, and approval by the State of Tennessee and the EPA are expected to occur by the third quarter of 2015.

Claims and Litigation

See Note 18 — Legal Proceedings — Legal Proceedings Related to the Kingston Ash Spill and Civil Penalty and Natural Resource Damages for the Kingston Ash Spill.

Financial Impact

Because of the uncertainty at this time of the final costs to complete the work prescribed by the ash disposal plan, a range of reasonable estimates has been developed by cost category. Known amounts, most likely scenarios, or the low end of the range for each category have been accumulated and evaluated to determine the total estimate. The range of costs varies from approximately $1.1 billion to approximately $1.2 billion.

TVA recorded an estimate of $1.1 billion for the cost of cleanup related to this event. In August 2009, TVA began using regulatory accounting treatment to defer all actual costs already incurred and expected future costs related to the ash spill. The cost is being charged to expense as it is collected in rates over 15 years, beginning October 1, 2009. As the estimate changes, additional costs may be deferred and charged to expense prospectively as they are collected in future rates.

As work continues to progress and more information is available, TVA will review its estimates and revise them as appropriate. Amounts spent since the event through June 30, 2014, totaled $1.0 billion. The remaining estimated liability at June 30, 2014, was $82 million and is included in Current liabilities.

TVA has not included the following categories of costs in the above estimate since it has been determined that these costs are currently either not probable or not reasonably estimable: penalties (other than the penalties set out in a June 2010 TDEC order), regulatory directives, natural resources damages (other than payments required under a memorandum of agreement with TDEC and the U.S. Fish and Wildlife Service establishing a process and a method for resolving the natural resource damages claim), future lawsuits, future claims, long-term environmental impact costs, final long-term disposition of the ash processing area, and costs associated with new laws and regulations. There are certain other costs that will be incurred that have not been included in the estimate as they are appropriately accounted for in other areas of the consolidated financial statements. Associated capital asset purchases are recorded in property, plant, and equipment. Ash handling and disposition costs from current plant operations are recorded in operating expenses. A portion of the dredge cell closure costs are also excluded from the estimate, as they are included in the non-nuclear ARO liability.

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Insurance

TVA had property and excess liability insurance programs in place at the time of the Kingston ash spill. TVA pursued claims under both the property and excess liability programs and has settled all of its property insurance claims and some of its excess liability insurance claims. In April 2012, TVA initiated arbitration proceedings against the remaining three excess liability insurance companies in accordance with the policies' dispute resolution provisions. TVA has successfully resolved two of these proceedings and is pursuing the third, which began in June 2014. TVA is seeking recovery of certain costs incurred in the cleanup project, including the costs of removing ash from property or waters owned by the State of Tennessee, and related expenses. TVA has received insurance proceeds of $267 million, of which $14 million and $175 million were received during the three and nine months ended June 30, 2014, respectively. The insurance proceeds are being recorded as reductions to the regulatory asset and will reduce amounts collected in future rates.

10. Other Long-Term Liabilities

Other long-term liabilities consist primarily of liabilities related to certain derivative instruments as well as liabilities under agreements related to compliance with certain environmental regulations (see Note 18 — Legal Proceedings — Environmental Agreements). The table below summarizes the types and amounts of Other long-term liabilities:

Other Long-Term Liabilities

	At June 30, 2014	At September 30, 2013
Interest rate swap liabilities	$1,289	$1,199
Environmental agreements liability	139	190
EnergyRight® purchase obligation	150	149
Coal contract derivative liabilities	53	35
Membership interests of VIE subject to mandatory redemption	37	38
Commodity swap derivative liabilities	18	36
Currency swap liabilities	2	15
Other	223	199
Total other long-term liabilities	$1,911	$1,861

TVA purchases certain loans receivable from its LPCs in association with the EnergyRight® Solutions program. The loans receivable are then transferred to a third-party bank with which TVA has agreed to repay in full any loan receivable that has been in default for 180 days or more or that TVA has determined is uncollectible. Given this continuing involvement, TVA accounts for the transfer of the loans receivable as secured borrowings. The current and long-term portions of the resulting financing obligation are reported in Accounts payable and accrued liabilities and Other long-term liabilities, respectively, on TVA's Consolidated Balance Sheets. As of June 30, 2014 and September 30, 2013, the carrying amount of the financing obligation reported in Accounts payable and accrued liabilities was approximately $37 million. See Note 6 for information regarding the associated loans receivable.

11. Asset Retirement Obligations

During the nine months ended June 30, 2014, TVA's total ARO liability decreased $352 million.

To estimate its decommissioning obligation related to its nuclear generating stations, TVA uses a probability-weighted, discounted cash flow model which, on a unit-by-unit basis, considers multiple outcome scenarios that include significant estimations and assumptions. Those assumptions include (1) estimates of the cost of decommissioning, (2) the method of decommissioning and the timing of the related cash flows, (3) the license period of the nuclear plant, considering the probability of license extensions, (4) cost escalation factors, and (5) the credit adjusted risk free rate to measure the obligation at the present value of the future estimated costs. Prior to June 30, 2014, TVA based its decommissioning cost estimates on cost elements prescribed by the Nuclear Regulatory Commission ("NRC") to dismantle and decommission the radioactive portion of each site with the assumption that decommissioning would occur within the first seven years after plant shut down, which approximates the DECON method of decommissioning. The DECON method requires that radioactive contamination is removed from a site and safely disposed of or decontaminated to a level that permits the site to be released for unrestricted use shortly after it ceases operation. On June 30, 2014, TVA recorded a change in estimate based on site-specific decommissioning cost studies. Additionally, TVA determined it appropriate to reflect an increase in the probability that certain of its nuclear operating licenses will be extended and that there is a probability that it will be able to delay ultimate decommissioning activities under a SAFSTOR method of decommissioning. The SAFSTOR method allows nuclear facilities to be placed and maintained in a condition that allows the facilities to be safely stored and subsequently decontaminated to levels that permit release for unrestricted use. As such, TVA ascribed probabilities to both the SAFSTOR and DECON methods of decommissioning in order

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to estimate its decommissioning obligation. Decommissioning cost studies will be updated for each of TVA's nuclear units at least every five years.
Additionally, both the nuclear and non-nuclear liabilities were increased by periodic accretion. This was partially offset by ash area settlement projects that were conducted during the nine months ended June 30, 2014. The nuclear and non-nuclear accretion were deferred as regulatory assets, and $30 million of the related regulatory assets was amortized into expense as this amount was collected in rates.
Asset Retirement Obligation Activity

	Nuclear	Non-Nuclear	Total
Balance at September 30, 2013	$2,399	$1,089	$3,488
Settlements (ash storage areas)	—	(10)	(10)
Change in estimate as a result of nuclear site-specific studies	(471)	—	(471)
Change in estimate (ash storage areas)	—	(10)	(10)
Accretion (recorded as regulatory asset)	100	39	139
Balance at June 30, 2014	$2,028	$1,108	$3,136 (1)

Note
(1) The current portion of ARO in the amount of $69 million is included in Accounts payable and accrued liabilities at June 30, 2014.

12. Debt and Other Obligations

Debt Outstanding

Total debt outstanding at June 30, 2014, and September 30, 2013, consisted of the following:
Debt Outstanding

	At June 30, 2014	At September 30, 2013
Short-term debt		
Short-term debt, net	$1,759	$2,432
Current maturities of long-term debt of variable interest entities	31	30
Current maturities of power bonds	1,032	32
Total current debt outstanding, net	2,822	2,494
Long-term debt		
Long-term debt of variable interest entities	1,295	1,311
Long-term power bonds(1)	21,092	22,400
Unamortized discounts, premiums, and other	(80)	(85)
Total long-term debt, net	22,307	23,626
Total outstanding debt	$25,129	$26,120

Note
(1) Includes net exchange losses from currency transactions of $98 million at June 30, 2014 and $43 million at September 30, 2013.

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Debt Securities Activity

The table below summarizes the long-term debt securities activity for the period from October 1, 2013, to June 30, 2014.

Debt Securities Activity

	Date	Amount	Interest Rate	
Redemptions/Maturities[1]				
electronotes®	First Quarter 2014	$4	3.56	%
electronotes®	Second Quarter 2014	326	4.52	%
electronotes®	Third Quarter 2014	3	3.14	%
2009 Series A	November 2013	2	2.25	%
2009 Series B	December 2013	1	3.77	%
2009 Series A	May 2014	2	2.25	%
2009 Series B	June 2014	25	3.77	%
Total redemptions/maturities of power bonds		363		
Variable interest entities	Second Quarter 2014	15	4.30	%
Total redemptions/maturities of debt		$378		

Note

(1) All redemptions were at 100 percent of par.

Credit Facility Agreements

TVA and the U.S. Treasury, pursuant to the TVA Act, have entered into a memorandum of understanding under which the U.S. Treasury provides TVA with a $150 million credit facility. This credit facility was renewed for 2014 with a maturity date of September 30, 2014. Access to this credit facility or other similar financing arrangements with the U.S. Treasury has been available to TVA since the 1960s. TVA plans to use the U.S. Treasury credit facility as a secondary source of liquidity. The interest rate on any borrowing under this facility is based on the average rate on outstanding marketable obligations of the United States with maturities from date of issue of one year or less. There were no outstanding borrowings under the facility at June 30, 2014. The availability of this credit facility may be impacted by how the U.S. government addresses the situation of approaching its debt limit.

TVA also has funding available in the form of three long-term revolving credit facilities totaling $2.5 billion. One $1.0 billion credit facility matures on June 25, 2017, another $1.0 billion credit facility matures on December 13, 2017, and the $500 million credit facility matures on April 5, 2018. The interest rate on any borrowing under these facilities varies based on market factors and the rating of TVA's senior unsecured long-term non-credit-enhanced debt. TVA is required to pay an unused facility fee on the portion of the total $2.5 billion that TVA has not borrowed or committed under letters of credit. This fee, along with letter of credit fees, may fluctuate depending on the rating of TVA's senior unsecured long-term non-credit-enhanced debt. At June 30, 2014, and September 30, 2013, there were approximately $900 million and $800 million, respectively, of letters of credit outstanding under the facilities, and there were no borrowings outstanding. See Note 14 — Other Derivative Instruments — Collateral.

Lease/Leaseback Obligations

Prior to 2004, TVA received approximately $945 million in proceeds by entering into lease/leaseback transactions for 24 new peaking combustion turbine units. TVA also received approximately $389 million in proceeds by entering into lease/leaseback transactions for qualified technological equipment and software in 2003. Due to TVA's continuing involvement in the operation and maintenance of the leased units and equipment and its control over the distribution of power produced by the combustion turbine facilities during the leaseback term, TVA accounted for the lease proceeds as financing obligations. At June 30, 2014, and September 30, 2013, the outstanding lease/leaseback obligations were $692 million and $761 million, respectively.

13. Accumulated Other Comprehensive Income (Loss)

AOCI represents market valuation adjustments related to TVA’s currency swaps. The currency swaps are cash flow hedges and are the only derivatives in TVA’s portfolio that have been designated and qualify for hedge accounting treatment. TVA records exchange rate gains and losses on its foreign currency-denominated debt in net income and marks its currency swap assets and liabilities to market through other comprehensive income (loss) ("OCI"). TVA then reclassifies an amount out of AOCI into net income, offsetting the exchange gain/loss recorded on the debt. During the three and nine months ended

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June 30, 2014, TVA reclassified $26 million and $55 million, respectively, of gains related to its cash flow hedges from AOCI to Interest expense. See Note 14.

TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. As such, certain items that would generally be reported in AOCI or that would impact the statements of operations are recorded as regulatory assets or regulatory liabilities. See Note 7, Note 14 — Overview of Accounting Treatment, Note 15 — Fair Value Measurements, and Note 17.

14. Risk Management Activities and Derivative Transactions

TVA is exposed to various risks. These include risks related to commodity prices, investment prices, interest rates, currency exchange rates, inflation, and counterparty credit and performance risks. To help manage certain of these risks, TVA has entered into various derivative transactions, principally commodity option contracts, forward contracts, swaps, swaptions, futures, and options on futures. Other than certain derivative instruments in investment funds, TVA's policy is to enter into these derivative transactions solely for hedging purposes and not for speculative purposes.

Overview of Accounting Treatment

TVA recognizes certain of its derivative instruments as either assets or liabilities on its Consolidated Balance Sheets at fair value. The accounting for changes in the fair value of these instruments depends on (1) whether TVA uses regulatory accounting to defer the derivative gains and losses, (2) whether the derivative instrument has been designated and qualifies for hedge accounting treatment, and (3) if so, the type of hedge relationship (for example, cash flow hedge).

The following tables summarize the accounting treatment that certain of TVA's financial derivative transactions receive:
Summary of Derivative Instruments That Receive Hedge Accounting Treatment (part 1)
Amount of Mark-to-Market Gain (Loss) Recognized in OCI

			Three Months Ended June 30		Nine Months Ended June 30	
Derivatives in Cash Flow Hedging Relationship	Objective of Hedge Transaction	Accounting for Derivative Hedging Instrument	2014	2013	2014	2013
Currency swaps	To protect against changes in cash flows caused by changes in foreign currency exchange rates (exchange rate risk)	Unrealized gains and losses are recorded in AOCI and reclassified to interest expense to the extent they are offset by gains and losses on the hedged transaction	$1	$9	$23	$(7)

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Summary of Derivative Instruments That Receive Hedge Accounting Treatment (part 2)
Amount of Gain (Loss) Reclassified from OCI to Interest Expense

	Three Months Ended June 30		Nine Months Ended June 30	
Derivatives in Cash Flow Hedging Relationship	2014	2013	2014	2013
Currency swaps	$26	$1	$55	$(57)

Note
There were no ineffective portions or amounts excluded from effectiveness testing for any of the periods presented. Based on forecasted foreign currency exchange rates, TVA expects to reclassify approximately $30 million of losses from AOCI to interest expense within the next twelve months to offset amounts anticipated to be recorded in interest expense related to exchange gain on the debt.

Summary of Derivative Instruments That Do Not Receive Hedge Accounting Treatment
Amount of Gain (Loss) Recognized in Income on Derivatives

			Three Months Ended June 30[1]		Nine Months Ended June 30[1]	
Derivative Type	Objective of Derivative	Accounting for Derivative Instrument	2014	2013	2014	2013
Interest rate swaps	To fix short-term debt variable rate to a fixed rate (interest rate risk)	Mark-to-market gains and losses are recorded as regulatory assets or liabilities until settlement, at which time the gains/losses are recognized in gain/loss on derivative contracts.	$—	$—	$—	$—
Commodity contract derivatives	To protect against fluctuations in market prices of purchased coal or natural gas (price risk)	Mark-to-market gains and losses are recorded as regulatory assets or liabilities. Realized gains and losses due to contract settlements are recognized in fuel expense as incurred.	—	(2)	—	(2)
Commodity derivatives under financial trading program ("FTP")	To protect against fluctuations in market prices of purchased commodities (price risk)	Mark-to-market gains and losses are recorded as regulatory assets or liabilities. Realized gains and losses are recognized in fuel expense or purchased power expense when the related commodity is used in production.	(6)	(21)	(29)	(99)

Note
(1) All of TVA's derivative instruments that do not receive hedge accounting treatment have unrealized gains (losses) that would otherwise be recognized in income
but instead are deferred as regulatory assets and liabilities. As such, there was no related gain (loss) recognized in income for these unrealized gains (losses) for the three months and nine months ended June 30, 2014 and 2013.

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Mark-to-Market Values of TVA Derivatives

	At June 30, 2014		At September 30, 2013	
Derivatives that Receive Hedge Accounting Treatment				
	Balance	Balance Sheet Presentation	Balance	Balance Sheet Presentation
Currency swaps				
£200 million Sterling	$(2)	Other long-term liabilities	$(15)	Other long-term liabilities
£250 million Sterling	64	Other long-term assets	51	Other long-term assets
£150 million Sterling	7	Other long-term assets	10	Other long-term assets
Derivatives that Do Not Receive Hedge Accounting Treatment				
	Balance	Balance Sheet Presentation	Balance	Balance Sheet Presentation
Interest rate swaps				
$1.0 billion notional	(946)	Other long-term liabilities	(886)	Other long-term liabilities
$476 million notional	(331)	Other long-term liabilities	(300)	Other long-term liabilities
$42 million notional	(12)	Other long-term liabilities	(13)	Other long-term liabilities
Commodity contract derivatives	(150)	Other long-term assets $2; Other current assets $3; Other long-term liabilities $(54); Accounts payable and accrued liabilities $(101)	(141)	Other long-term assets $1; Other current assets $2; Other long-term liabilities $(35); Accounts payable and accrued liabilities $(109)
Derivatives under FTP[(1)]	(90)	Other current assets $(56); Other long-term liabilities $(18); Accounts payable and accrued liabilities $(16)	(166)	Other current assets $(97); Other long-term liabilities $(36); Accounts payable and accrued liabilities $(33)

Note

(1) Fair values of certain derivatives under the FTP that were in net liability positions totaling $57 million and $100 million at June 30, 2014 and September 30, 2013, respectively, are recorded in TVA's margin cash accounts in Other current assets. These derivatives are transacted with futures commission merchants, and cash deposits have been posted to the margin cash accounts held with each futures commission merchant to offset the net liability positions in full.

Cash Flow Hedging Strategy for Currency Swaps

To protect against exchange rate risk related to three British pound sterling denominated Bond transactions, TVA entered into foreign currency hedges at the time the Bond transactions occurred. TVA had the following currency swaps outstanding as of June 30, 2014:

Currency Swaps Outstanding
At June 30, 2014

Effective Date of Currency Swap Contract	Associated TVA Bond Issues Currency Exposure	Expiration Date of Swap	Overall Effective Cost to TVA
1999	£200 million	2021	5.81%
2001	£250 million	2032	6.59%
2003	£150 million	2043	4.96%

When the dollar strengthens against the British pound sterling, the transaction gain on the Bond liability is offset by a currency exchange loss on the swap contract. Conversely, when the dollar weakens against the British pound sterling, the transaction loss on the Bond liability is offset by an exchange gain on the swap contract. All such exchange gains or losses on the Bond liability are included in Long-term debt, net. The offsetting exchange losses or gains on the swap contracts are recognized in AOCI. If any gain (loss) were to be incurred as a result of the early termination of the foreign currency swap contract, the resulting income (expense) would be amortized over the remaining life of the associated Bond as a component of Interest expense.

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Derivatives Not Receiving Hedge Accounting Treatment

Interest Rate Derivatives. TVA uses regulatory accounting treatment to defer the mark-to-market ("MtM") gains and losses on its interest rate swaps. The net deferred unrealized gains and losses are classified as regulatory assets or liabilities on TVA's Consolidated Balance Sheets and are included in the ratemaking formula when the transactions settle. The values of these derivatives are included in Other long-term assets or Other long-term liabilities on the Consolidated Balance Sheets, and realized gains and losses, if any, are included in TVA's Consolidated Statements of Operations.

For the three months ended June 30, 2014 and 2013, the changes in market value of the interest rate swaps resulted in deferred unrealized gains (losses) of $(65) million and $252 million, respectively. For the nine months ended June 30, 2014 and 2013, the changes in market value of the interest rate swaps resulted in deferred unrealized gains (losses) of $(90) million and $465 million, respectively.

Commodity Derivatives. TVA enters into certain derivative contracts for coal and natural gas that require physical delivery of the contracted quantity of the commodity. TVA marks to market all such contracts and defers the market values as regulatory assets or liabilities on a gross basis. At June 30, 2014, TVA's coal and natural gas contract derivatives had terms of four years and up to two years, respectively.

Commodity Contract Derivatives

	At June 30, 2014			At September 30, 2013		
	Number of Contracts	Notional Amount	Fair Value (MtM)	Number of Contracts	Notional Amount	Fair Value (MtM)
Coal contract derivatives	34	47 million tons	$(146)	19	43 million tons	$(140)
Natural gas contract derivatives	33	63 million mmBtu	$(4)	13	39 million mmBtu	$(1)

Derivatives Under FTP. TVA has an FTP under which it may purchase and sell futures, swaps, options, and combinations of these instruments (as long as they are standard in the industry) to hedge TVA’s exposure to (1) the price of natural gas, fuel oil, electricity, coal, emission allowances, nuclear fuel, and other commodities included in TVA’s fuel cost adjustment calculation, (2) the price of construction materials, and (3) contracts for goods priced in or indexed to foreign currencies. The combined transaction limit for the fuel cost adjustment and construction material transactions is $130 million (based on one-day value at risk). In addition, the maximum hedge volume for the construction material transactions is 75 percent of the underlying net notional volume of the material that TVA anticipates using in approved TVA projects, and the market value of all outstanding hedging transactions involving construction materials is limited to $100 million at the execution of any new transaction. The portfolio value at risk limit for the foreign currency transactions is $5 million and is separate and distinct from the $130 million transaction limit discussed above. TVA's policy prohibits trading financial instruments under the FTP for speculative purposes.

At June 30, 2014 and September 30, 2013, the risks hedged under the FTP were the economic risks associated with the prices of natural gas, fuel oil, and crude oil. At June 30, 2014 and September 30, 2013, TVA had no outstanding coal contract derivatives under the FTP. There were no futures contracts or options contracts outstanding under the FTP at June 30, 2014, and swap contracts under the FTP had remaining terms of four years or less. TVA plans to continue to manage fuel price volatility through various methods, but is currently evaluating the future use of financial instruments.

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Derivatives Under Financial Trading Program

	At June 30, 2014		At September 30, 2013	
	Notional Amount	Fair Value (MtM) (in millions)	Notional Amount	Fair Value (MtM) (in millions)
Natural gas (in mmBtu)				
Futures contracts	—	$—	—	$—
Swap contracts	117,575,000	(91)	152,922,500	(169)
Option contracts	—	—	—	—
Natural gas financial positions	117,575,000	$(91)	152,922,500	$(169)
Fuel oil/crude oil (in barrels)				
Futures contracts	—	$—	—	$—
Swap contracts	—	1	1,205,000	3
Option contracts	—	—	—	—
Fuel oil/crude oil financial positions	—	$1	1,205,000	$3

Note
Fair value amounts presented are based on net commodity position with the futures commission merchant or other counterparty. Notional amounts disclosed represent the net absolute value of contractual amounts.

TVA defers all FTP unrealized gains (losses) as regulatory liabilities (assets) and records only realized gains or losses to match the delivery period of the underlying commodity. In addition to the open commodity derivatives disclosed above, TVA had closed derivative contracts with market values of $(3) million at June 30, 2014, and $(8) million at September 30, 2013. Unrealized gains and losses related to the FTP at June 30, 2014 and September 30, 2013 were as follows:

Financial Trading Program Unrealized Gains (Losses)

FTP unrealized gains (losses) deferred as regulatory liabilities (assets)	At June 30, 2014	At September 30, 2013
Natural gas	$(91)	$(169)
Fuel oil/crude oil	1	3

Realized gains and losses related to the FTP for the three and nine months ended June 30, 2014 and 2013 were as follows:

Financial Trading Program Realized Gains (Losses)

	For the Three Months Ended June 30		For the Nine Months Ended June 30	
Decrease (increase) in fuel expense	2014	2013	2014	2013
Natural gas	$(5)	$(13)	$(23)	$(60)
Fuel oil/crude oil	—	—	2	2
Coal	—	—	—	(1)

Financial Trading Program Realized Gains (Losses)

Decrease (increase) in purchased power expense	For the Three Months Ended June 30 2014	2013	For the Nine Months Ended June 30 2014	2013
Natural gas	$(1)	$(8)	$(9)	$(40)

Offsetting of Derivative Assets and Liabilities

The amounts of TVA's derivative instruments as reported in the Consolidated Balance Sheets as of June 30, 2014, and September 30, 2013, are shown in the table below.

	As of June 30, 2014		
	Gross Amounts of Recognized Assets/Liabilities	Gross Amounts Offset in the Balance Sheet (1)	Net Amounts of Assets/Liabilities Presented in the Balance Sheet (2)
Assets			
Currency swaps	$71	$(56)	$15
Commodity derivatives under FTP	56	(55)	1
Total derivatives subject to master netting or similar arrangement	127	(111)	16
Total derivatives not subject to master netting or similar arrangement	5	—	5
Total	$132	$(111)	$21
Liabilities			
Currency swap (3)	$(2)	$—	$(2)
Interest rate swaps (3)	(1,289)	—	(1,289)
Commodity derivatives under FTP	(146)	112	(34)
Total derivatives subject to master netting or similar arrangement	(1,437)	112	(1,325)
Total derivatives not subject to master netting or similar arrangement	(155)	—	(155)
Total	$(1,592)	$112	$(1,480)

	As of September 30, 2013		
	Gross Amounts of Recognized Assets/Liabilities	Gross Amounts Offset in the Balance Sheet (1)	Net Amounts of Assets/Liabilities Presented in the Balance Sheet (2)
Assets			
Currency swaps	$61	$(33)	$28
Commodity derivatives under FTP	101	(98)	3
Total derivatives subject to master netting or similar arrangement	162	(131)	31
	3	—	3

Total derivatives not subject to master netting or similar arrangement			
Total	$165	$(131)	$34
Liabilities			
Currency swap (3)	$(15)	$—	$(15)
Interest rate swaps (3)	(1,199)	—	(1,199)
Commodity derivatives under FTP	(267)	198	(69)
Total derivatives subject to master netting or similar arrangement	(1,481)	198	(1,283)
Total derivatives not subject to master netting or similar arrangement	(144)	—	(144)
Total	$(1,625)	$198	$(1,427)

Notes

(1) Amounts primarily include counterparty netting of derivative contracts, margin account deposits for futures commission merchants transactions, and cash collateral received or paid in accordance with the accounting guidance for derivatives and hedging transactions.

(2) There are no derivative contracts subject to a master netting arrangement or similar agreement which are not offset in the balance sheets.

(3) Letters of credit of approximately $900 million and $800 million were posted as collateral at June 30, 2014 and September 30, 2013, respectively, to partially secure the liability positions of one of the currency swaps and one of the interest rate swaps in accordance with the collateral requirements for these derivatives.

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Other Derivative Instruments

Investment Fund Derivatives. Investment funds consist primarily of funds held in the Nuclear Decommissioning Trust ("NDT"), Asset Retirement Trust ("ART"), and Supplemental Executive Retirement Plan ("SERP"). All securities in the trusts are classified as trading. See Note 15 — Investments for a discussion of the trusts' objectives and the types of investments included in the various trusts. These trusts may invest in derivative instruments which may include swaps, futures, options, forwards, and other instruments. At June 30, 2014, and September 30, 2013, the fair value of derivative instruments in these trusts was not material to TVA's consolidated financial statements.

Collateral. TVA's interest rate swaps and currency swaps contain contract provisions that require a party to post collateral (in a form such as cash or a letter of credit) when the party's liability balance under the agreement exceeds a certain threshold. At June 30, 2014, the aggregate fair value of all derivative instruments with credit-risk related contingent features that were in a liability position was $1.3 billion. TVA's collateral obligations at June 30, 2014, under these arrangements were approximately $900 million, for which TVA had posted approximately $900 million in letters of credit. These letters of credit reduce the available balance under the related credit facilities. TVA's assessment of the risk of its nonperformance includes a reduction in its exposure under the contract as a result of this posted collateral.

For all of its derivative instruments with credit-risk related contingent features:

- If TVA remains a majority-owned U.S. government entity but Standard & Poor's Financial Services, LLC ("S&P") or Moody's Investors Service, Inc. ("Moody's") downgrades TVA's credit rating to AA or Aa2, respectively, TVA's collateral obligations would likely increase by $22 million; and

- If TVA ceases to be majority-owned by the U.S. government, TVA's credit rating would likely be downgraded and TVA would be required to post additional collateral.

Counterparty Credit Risk

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

Credit of Customers. The majority of TVA's counterparty credit risk is associated with trade accounts receivable from delivered power sales to LPCs, all located in the Tennessee Valley region. To a lesser extent, TVA is exposed to credit risk from industries and federal agencies directly served and from exchange power arrangements with a small number of investor-owned regional utilities related to either delivered power or the replacement of open positions of longer-term purchased power or fuel agreements. TVA had concentrations of accounts receivable from three LPCs that represented 27 percent of total outstanding accounts receivable at both June 30, 2014 and September 30, 2013.

Credit of Derivative Counterparties. TVA has entered into derivative contracts for hedging purposes, and TVA's NDT fund and defined benefit pension plan have entered into derivative contracts for investment purposes. If a counterparty to one of TVA's hedging transactions defaults, TVA might incur substantial costs in connection with entering into a replacement hedging transaction. If a counterparty to the derivative contracts into which the NDT fund and the pension plan have entered for investment purposes defaults, the value of the investment could decline significantly or perhaps become worthless. TVA has concentrations of credit risk from the banking and coal industries because multiple companies in these industries serve as counterparties to TVA in various derivative transactions. At June 30, 2014, all of TVA's currency swaps, interest rate swaps, and commodity derivatives under the FTP were with counterparties whose Moody's credit rating was Baa2 or higher. At June 30, 2014, all of TVA's coal contract derivatives were with counterparties whose Moody's credit rating, or TVA's internal analysis when such information was unavailable, was Caa1 or higher. See Derivatives Not Receiving Hedge Accounting Treatment.

TVA currently utilizes two active futures commission merchants ("FCMs") to clear commodity contracts, including futures, options, and similar financial derivatives. These transactions are executed under the FTP by the FCMs on exchanges on behalf of TVA. TVA maintains margin cash accounts with the FCMs. TVA makes deposits to the margin cash accounts to adequately cover any net liability positions on its derivatives transacted with the FCMs. See the note to the Mark-to-Market Values of TVA Derivatives table.

Credit of Suppliers. If one of TVA's fuel or purchased power suppliers fails to perform under the terms of its contract with TVA, TVA might lose the money that it paid to the supplier under the contract and have to purchase replacement fuel or power on the spot market, perhaps at a significantly higher price than TVA was entitled to pay under the contract. In addition, TVA might not be able to acquire replacement fuel or power in a timely manner and thus might be unable to satisfy its own obligations to deliver power. To help ensure a reliable supply of coal, TVA had coal contracts with multiple suppliers at June 30, 2014. The contracted supply of coal is sourced from multiple geographic regions of the United States and is to be delivered via

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various transportation methods (for example, barge, rail and truck). TVA purchases the majority of its natural gas requirements from a variety of suppliers under short-term contracts.

TVA has a power purchase agreement that expires on March 31, 2032, with a supplier of electricity for 440 megawatts ("MW") of summer net capability from a lignite-fired generating plant. TVA has determined that the supplier has the equivalent of a non-investment grade credit rating; therefore, the supplier has provided credit assurance to TVA under the terms of the agreement.

The United States Enrichment Corporation ("USEC"), a subsidiary of the parent company, USEC, Inc., was TVA's largest directly served customer in 2013. On May 24, 2013, USEC announced its intention to cease enrichment activities at its Paducah, Kentucky site. TVA and USEC have subsequently completed agreements to extend power sales to facilitate the cessation of enrichment activities and to support non-enrichment activities at the site at a greatly reduced level. On March 5, 2014, USEC, Inc. filed a voluntary petition and a plan of reorganization under Chapter 11 of the bankruptcy code in the U.S. Bankruptcy Court for the District of Delaware. USEC was not included as a debtor in the Chapter 11 filing for the parent company.

While USEC is a TVA supplier of enrichment services for uranium for fueling TVA's nuclear units, TVA has sufficient nuclear fuel inventory available to mitigate near-term supply risks, and also expects to be able to procure material at reasonable rates in the market for nuclear fuel.

15. Fair Value Measurements

Fair value is determined based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the asset or liability's principal market, or in the absence of a principal market, the most advantageous market for the asset or liability in an orderly transaction between market participants. TVA uses market or observable inputs as the preferred source of values, followed by assumptions based on hypothetical transactions in the absence of market inputs.

Valuation Techniques

The measurement of fair value results in classification into a hierarchy by the inputs used to determine the fair value as follows:

Level 1	—	Unadjusted quoted prices in active markets accessible by the reporting entity for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing.
Level 2	—	Pricing inputs other than quoted market prices included in Level 1 that are based on observable market data and that are directly or indirectly observable for substantially the full term of the asset or liability. These include quoted market prices for similar assets or liabilities, quoted market prices for identical or similar assets in markets that are not active, adjusted quoted market prices, inputs from observable data such as interest rate and yield curves, volatilities and default rates observable at commonly quoted intervals, and inputs derived from observable market data by correlation or other means.
Level 3	—	Pricing inputs that are unobservable, or less observable, from objective sources. Unobservable inputs are only to be used to the extent observable inputs are not available. These inputs maintain the concept of an exit price from the perspective of a market participant and should reflect assumptions of other market participants. An entity should consider all market participant assumptions that are available without unreasonable cost and effort. These are given the lowest priority and are generally used in internally

developed methodologies to generate management's best estimate of the fair value when no observable market data is available.

A financial instrument's level within the fair value hierarchy (where Level 3 is the lowest and Level 1 is the highest) is based on the lowest level of input significant to the fair value measurement.

The following sections describe the valuation methodologies TVA uses to measure different financial instruments at fair value. Except for gains and losses on SERP assets, all changes in fair value of these assets and liabilities have been reflected as changes in regulatory assets, regulatory liabilities, or AOCI on TVA's Consolidated Balance Sheets and Consolidated Statements of Comprehensive Income (Loss). Except for gains and losses on SERP assets, there has been no impact to the Consolidated Statements of Operations or the Consolidated Statements of Cash Flows related to these fair value measurements.

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Investments

At June 30, 2014, Investment funds were composed of $1.9 billion of securities classified as trading and measured at fair value and less than $1 million of equity investments not required to be measured at fair value. Trading securities are held in the NDT, ART, and SERP. The NDT holds funds for the ultimate decommissioning of TVA's nuclear power plants. The ART holds funds primarily for the costs related to the future closure and retirement of TVA's other long-lived assets. TVA established a SERP for certain executives in critical positions to provide supplemental pension benefits tied to compensation that exceeds limits set by Internal Revenue Service rules applicable to the qualified defined benefit pension plan. The NDT and SERP are invested in a mix of investments generally designed to achieve a return in line with overall equity market performance, and the ART is invested in a mix of investments generally designed to achieve a return in line with equity and fixed-income market performance.

The NDT, ART, and SERP are composed of multiple types of investments and are managed by external institutional managers. Most U.S. and international equities, Treasury inflation-protected securities, real estate investment trust securities, and cash securities and certain derivative instruments are measured based on quoted exchange prices in active markets and are classified as Level 1 valuations. Fixed-income investments, high-yield fixed-income investments, currencies, and most derivative instruments are non-exchange traded and are classified as Level 2 valuations. These measurements are based on market and income approaches with observable market inputs.

Private partnership investments may include holdings of investments in private real estate, venture capital, buyout, mezzanine or subordinated debt, restructuring or distressed debt, and special situations through funds managed by third-party investment managers. Investments in private partnerships generally involve a three-to-four-year period where the investor contributes capital. This is followed by a period of distribution, typically over several years. The investment period is generally, at a minimum, ten years or longer. The NDT had unfunded commitments related to private partnerships of $128 million at June 30, 2014. These investments have no redemption or limited redemption options and may also have imposed restrictions on the NDT’s ability to liquidate its investment. There are no readily available quoted exchange prices for these investments. The fair value of the investments is based on TVA’s ownership percentage of the fair value of the underlying investments as provided by the investment managers. These investments are typically valued on a quarterly basis. TVA’s private partnership investments are valued at net asset values ("NAV") as a practical expedient for fair value. TVA classifies its interest in these types of investments as Level 3 within the fair value hierarchy.

Commingled funds represent investment funds comprising multiple individual financial instruments. The commingled funds held by the NDT, ART, and SERP consist of a single class of securities, such as equity, debt, or foreign currency securities, or multiple classes of securities. All underlying positions in these commingled funds are either exchange traded (Level 1) or measured using observable inputs for similar instruments (Level 2). The fair value of commingled funds is based on NAV per fund share (the unit of account), derived from the prices of the underlying securities in the funds. These commingled funds can be redeemed at the measurement date NAV and are classified as Level 2 valuations.

Realized and unrealized gains and losses on trading securities are recognized in current earnings and are based on average cost. The gains and losses of the NDT and ART are subsequently reclassified to a regulatory liability or asset account in accordance with TVA's regulatory accounting policy. See Note 1 — Cost-Based Regulation. TVA recorded unrealized gains and losses related to its trading securities held as of the end of each period as follows:

Unrealized Investment Gains (Losses)

	For the Three Months Ended June 30		For the Nine Months Ended June 30	
Financial Statement Presentation	2014	2013	2014	2013

SERP	Other income (expense)	$1	$(1)	$2	$—
NDT	Regulatory asset	36	(42)	72	16
ART	Regulatory asset	9	(6)	27	16

Currency and Interest Rate Swaps

See Note 14 — Cash Flow Hedging Strategy for Currency Swaps and Derivatives Not Receiving Hedge Accounting Treatment for a discussion of the nature, purpose, and contingent features of TVA's currency swaps and interest rate swaps. These swaps are classified as Level 2 valuations and are valued based on income approaches using observable market inputs for similar instruments.

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Commodity Contract Derivatives and Commodity Derivatives Under FTP

Commodity Contract Derivatives. These contracts are classified as Level 3 valuations and are valued based on income approaches. TVA develops an overall coal price forecast using widely used short-term and mid-range market data from an external pricing specialist in addition to long-term internal estimates. To value the volume option component of applicable coal contracts, TVA uses a Black-Scholes pricing model which includes inputs from the overall coal price forecast, contract-specific terms, and other market inputs.

Commodity Derivatives Under FTP. These contracts are valued based on market approaches which utilize Chicago Mercantile Exchange ("CME") quoted prices and other observable inputs. Futures and options contracts settled on the CME are classified as Level 1 valuations. Swap contracts are valued using a pricing model based on CME inputs and are subject to nonperformance risk outside of the exit price. These contracts are classified as Level 2 valuations.

See Note 14 — Derivatives Not Receiving Hedge Accounting Treatment — Commodity Derivatives and — Derivatives Under FTP for a discussion of the nature and purpose of coal contracts and derivatives under TVA's FTP.

Nonperformance Risk

The assessment of nonperformance risk, which includes credit risk, considers changes in current market conditions, readily available information on nonperformance risk, letters of credit, collateral, other arrangements available, and the nature of master netting arrangements. TVA is a counterparty to currency swaps, interest rate swaps, commodity contracts, and other derivatives which subject TVA to nonperformance risk. Nonperformance risk on the majority of investments and certain exchange-traded instruments held by TVA is incorporated into the exit price that is derived from quoted market data that is used to mark the investment to market.

Nonperformance risk for most of TVA's derivative instruments is an adjustment to the initial asset/liability fair value. TVA adjusts for nonperformance risk, both of TVA (for liabilities) and the counterparty (for assets), by applying credit valuation adjustments ("CVAs"). TVA determines an appropriate CVA for each applicable financial instrument based on the term of the instrument and TVA's or the counterparty's credit rating as obtained from Moody's. For companies that do not have an observable credit rating, TVA uses internal analysis to assign a comparable rating to the company. TVA discounts each financial instrument using the historical default rate (as reported by Moody's for CY 1983 to CY 2013) for companies with a similar credit rating over a time period consistent with the remaining term of the contract. The application of CVAs resulted in a $3 million decrease in the fair value of assets and a $1 million decrease in the fair value of liabilities at June 30, 2014.

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Fair Value Measurements

The following tables set forth by level, within the fair value hierarchy, TVA's financial assets and liabilities that were measured at fair value on a recurring basis as of June 30, 2014, and September 30, 2013. Financial assets and liabilities have been classified in their entirety based on the lowest level of input that is significant to the fair value measurement. TVA's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the determination of the fair value of the assets and liabilities and their classification in the fair value hierarchy levels.

Fair Value Measurements
At June 30, 2014

Assets	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investments				
Equity securities	$177	$—	$—	$177
Debt securities				
U.S. government corporations and agencies	58	42	—	100
Corporate debt securities	—	313	—	313
Residential mortgage-backed securities	—	13	—	13
Commercial mortgage-backed securities	—	7	—	7
Collateralized debt obligations	—	26	—	26
Private partnerships	—	—	188	188
Commingled funds(2)				
Equity security commingled funds	—	931	—	931
Debt security commingled funds	—	147	—	147
Total investments	235	1,479	188	1,902
Currency swaps	—	15	—	15
Commodity contract derivatives	—	—	5	5
Commodity derivatives under FTP				
Swap contracts	—	1	—	1
Total	$235	$1,495	$193	$1,923

Liabilities	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Currency swaps	$—	$2	$—	2
Interest rate swaps	—	1,289	—	1,289
Commodity contract derivatives	—	4	151	155
Commodity derivatives under FTP				
Swap contracts	—	34	—	34

Total	$—	$1,329	$151	$1,480

Notes

(1) Due to the right of setoff and method of settlement, TVA elects to record commodity derivatives under the FTP based on its net commodity position with the counterparty or FCM. Deposits are made to TVA's margin cash accounts held with each FCM to offset any net liability positions in full for derivatives that are transacted with FCMs. TVA records currency swaps net of cash collateral received from or paid to the counterparty. See Note 14 — Offsetting of Derivative Assets and Liabilities.

(2) Commingled funds represent investment funds comprising multiple individual financial instruments and are classified in the table based on their existing investment portfolio as of the measurement date. Commingled funds primarily composed of one class of security are classified in that category.

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Fair Value Measurements
At September 30, 2013

Assets	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)[1]	Significant Unobservable Inputs (Level 3)	Total
Investments				
Equity securities	$151	$—	$—	$151
Debt securities				
U.S. government corporations and agencies	38	67	—	105
Corporate debt securities	—	255	—	255
Residential mortgage-backed securities	—	25	—	25
Commercial mortgage-backed securities	—	7	—	7
Collateralized debt obligations	—	10	—	10
Private partnerships	—	—	159	159
Commingled funds[2]				
Equity security commingled funds	—	741	—	741
Debt security commingled funds	—	248	—	248
Total investments	189	1,353	159	1,701
Currency swaps	—	28	—	28
Commodity contract derivatives	—	—	3	3
Commodity derivatives under FTP				
Swap contracts	—	3	—	3
Total	$189	$1,384	$162	$1,735

Liabilities	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Currency swaps	$—	$15	$—	15
Interest rate swaps	—	1,199	—	1,199
Commodity contract derivatives	—	1	143	144
Commodity derivatives under FTP				
Swap contracts	—	69	—	69
Total	$—	$1,284	$143	$1,427

Notes
(1) Due to the right of setoff and method of settlement, TVA elects to record commodity derivatives under the FTP based on its net commodity position with the counterparty or FCM. Deposits are made to TVA's margin cash accounts held with each FCM to offset any net liability positions in full for derivatives that are transacted with FCMs. TVA records currency swaps net of cash collateral received from or paid to the counterparty. See Note 14 — Offsetting of Derivative Assets and Liabilities.

(2) Commingled funds represent investment funds comprising multiple individual financial instruments and are classified in the table based on their existing investment portfolio as of the measurement date. Commingled funds primarily composed of one class of security are classified in that category.

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TVA uses internal and external valuation specialists for the calculation of its fair value measurements classified as Level 3. Analytical testing is performed on the change in fair value measurements each period to ensure the valuation is reasonable based on changes in general market assumptions. Significant changes to the estimated data used for unobservable inputs, in isolation or combination, may result in significant variations to the fair value measurement reported.

The following table presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

Fair Value Measurements Using Significant Unobservable Inputs

	For the Three Months Ended June 30		For the Nine Months Ended June 30	
	Private Partnerships	Commodity Contract Derivatives	Private Partnerships	Commodity Contract Derivatives
Balance at beginning of period	$137	$(148)	$53	$(267)
Purchases	9	—	93	—
Issuances	—	—	—	—
Sales	(1)	—	(3)	—
Settlements	—	—	—	—
Net unrealized gains (losses) deferred as regulatory assets and liabilities	5	39	7	158
Balance at June 30, 2013	$150	$(109)	$150	$(109)
Balance at beginning of period	$180	$(131)	$159	$(140)
Purchases	7	—	23	—
Issuances	—	—	—	—
Sales	(6)	—	(7)	—
Settlements	—	—	—	—
Net unrealized gains (losses) deferred as regulatory assets and liabilities	7	(15)	13	(6)
Balance at June 30, 2014	$188	$(146)	$188	$(146)

There were no realized gains or losses related to the instruments measured at fair value using significant unobservable inputs that affected net income during the three and nine months ended June 30, 2014. All unrealized gains and losses related to these instruments have been reflected as increases or decreases in regulatory assets and liabilities. See Note 7.

The following table presents quantitative information related to the significant unobservable inputs used in the measurement of fair value of TVA's assets and liabilities classified as Level 3 in the fair value hierarchy:

Quantitative Information about Level 3 Fair Value Measurements

	Fair Value at June 30, 2014	Valuation Technique(s)	Unobservable Inputs	Range
Assets				
Commodity contract derivatives	$5	Discounted cash flow	Credit risk	26%*
		Pricing model		

			Coal supply and demand	0.9 - 1.1 billion tons/year
			Long-term market prices	$12.00 - $67.07/ton
Liabilities				
Commodity contract derivatives	$151	Pricing model	Coal supply and demand	0.9 - 1.1 billion tons/year
			Long-term market prices	$12.00 - $67.07/ton

* Applies to only one contract.

Other Financial Instruments Not Recorded at Fair Value

TVA uses the methods and assumptions described below to estimate the fair value of each significant class of financial instrument. The fair values of the financial instruments held at June 30, 2014, and September 30, 2013, may not be representative of the actual gains or losses that will be recorded when these instruments mature or are called or presented for early redemption. The estimated fair values of TVA's financial instruments not recorded at fair value at June 30, 2014, and September 30, 2013, were as follows:

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Estimated Values of Financial Instruments Not Recorded at Fair Value

		At June 30, 2014		At September 30, 2013	
	Valuation Classification	Carrying Amount	Fair Value	Carrying Amount	Fair Value
EnergyRight® receivables (including current portion)	Level 2	$152	$152	$150	$150
Loans and other long-term receivables, net	Level 2	$105	$96	$73	$67
EnergyRight® purchase obligation (including current portion)	Level 2	$187	$204	$186	$210
Membership interest of variable interest entity subject to mandatory redemption (including current portion)	Level 2	$39	$50	$40	$50
Long-term outstanding power bonds (including current maturities), net	Level 2	$22,044	$25,603	$22,347	$24,603
Long-term debt of variable interest entities (including current maturities)	Level 2	$1,326	$1,441	$1,341	$1,386

Due to the short-term maturity of Cash and cash equivalents, Restricted cash and investments, and Short-term debt, net, each considered a Level 1 valuation classification, the carrying amounts of these instruments approximate their fair values.

The fair values of the EnergyRight® Solutions receivables and loans and other long-term receivables are estimated by determining the present values of future cash flows using discount rates equal to lending rates for similar loans made to borrowers with similar credit ratings and similar remaining maturities, where applicable.

The fair value of the long-term debt traded in the public market is determined by multiplying the par value of the debt by the indicative market price at the balance sheet date. The fair values of the EnergyRight® Solutions purchase obligation and other long-term debt are estimated by determining the present value of future cash flows using current market rates for similar obligations, giving effect to credit ratings and remaining maturities.

16. Other Income (Expense), Net

Income and expenses not related to TVA's operating activities are summarized in the following table:

Other Income (Expense), Net

	For the Three Months Ended June 30		For the Nine Months Ended June 30	
	2014	2013	2014	2013
External services	$3	$6	$15	$17
Interest income	6	5	17	17
Gains (losses) on investments	2	—	4	2
Miscellaneous	(1)	(1)	1	—
Total other income (expense), net	$10	$10	$37	$36

17. Benefit Plans

TVA sponsors a qualified defined benefit pension plan (the "Plan") that covers most of its full-time employees, a qualified defined contribution plan that covers most of its full-time employees, two unfunded post-retirement health care plans that provide for non-vested contributions toward the cost of eligible retirees' medical coverage, other postemployment benefits, such as workers' compensation, and the SERP.

On April 11, 2014, the Tennessee Valley Authority Retirement System ("TVARS") Board approved amendments to the qualified defined benefit plan effective June 30, 2014. These amendments close the defined benefit plan to new employees and certain rehires. These employees will be eligible for a retirement benefit as participants in the defined contribution plan only.

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The benefit structures of the qualified defined benefit plan for current employees and retirees — Original Benefit Structure and Cash Balance Benefit Structure — have not been changed. The provisions of the defined contribution plan for these employees will also remain unchanged.

For those employees who are eligible to participate in the new defined contribution plan only, TVA will provide an automatic, non-elective contribution equal to 4.5 percent of base compensation. In addition, TVA will contribute 75 cents to a matching account for each dollar contributed on a before- and/or after-tax basis, with maximum matching contributions of 4.5 percent of base compensation.

The components of net periodic benefit cost and other amounts recognized as changes in regulatory assets for the three and nine months ended June 30, 2014, and 2013, were as follows:

Components of TVA's Benefit Plans

	For the Three Months Ended June 30				For the Nine Months Ended June 30			
	Pension Benefits		Other Post-Retirement Benefits		Pension Benefits		Other Post-Retirement Benefits	
	2014	2013	2014	2013	2014	2013	2014	2013
Service cost	$33	$38	$5	$6	$98	$115	$14	$18
Interest cost	139	117	8	8	418	351	24	23
Expected return on plan assets	(109)	(107)	—	—	(326)	(321)	—	—
Amortization of prior service cost	(5)	(6)	(2)	(2)	(16)	(17)	(5)	(5)
Recognized net actuarial loss	71	95	3	6	214	283	8	19
Total net periodic benefit cost recognized	$129	$137	$14	$18	$388	$411	$41	$55

TVA contributes to the Plan such amounts as are necessary on an actuarial basis to provide the Plan with assets sufficient to meet TVA-funded benefit obligations to be paid to members. In consideration of TVA's $1.0 billion contribution to the Plan in September 2009, the Plan's Rules and Regulations ("Plan's Rules") were amended to temporarily suspend the minimum annual contribution requirements for a four year period from 2010 through 2013. In August 2013, the TVA Board approved a $250 million contribution to the Plan for 2014, which exceeds the minimum required by the Plan's Rules. As of June 30, 2014, TVA had contributed $126 million and will contribute the remaining $124 million by September 30, 2014. TVA does not separately set aside assets to fund other benefit costs, but rather funds such costs on an as-paid basis. For the nine months ended June 30, 2014, TVA provided approximately $23 million, net of rebates and subsidies, to other post-retirement benefit plans and approximately $6 million to the SERP. For the nine months ended June 30, 2013, TVA provided approximately $34 million, net of rebates and subsidies, to other post-retirement benefit plans and approximately $6 million to the SERP.

18. Contingencies and Legal Proceedings

Contingencies

Nuclear Insurance. The Price-Anderson Act provides a layered framework of protection to compensate for losses arising from a nuclear event in the United States. For the first layer, all of the NRC nuclear plant licensees, including TVA, purchase $375 million of nuclear liability insurance from American Nuclear Insurers for each plant with an operating license. Funds for the second layer, the Secondary Financial Program, would come from an assessment of up to $127 million from the licensees of each of the 104 NRC licensed reactors in the United States. The assessment for any nuclear accident would be limited to $19 million per year per unit. American Nuclear Insurers, under a contract with the NRC, administers the Secondary Financial Program. With its six licensed units, TVA could be required to pay a maximum of $764 million per nuclear incident, but it would have to pay no more than $114 million per incident in any one year. When the contributions of the nuclear plant licensees are added to the insurance proceeds of $375 million, over $13.0 billion, including a five percent surcharge for legal expenses, would be available. Under the Price-Anderson Act, if the first two layers are exhausted, the U.S. Congress is required to take action to provide additional funds to cover the additional losses.

TVA carries property, decommissioning, and decontamination insurance of $4.6 billion for its licensed nuclear plants, with up to $2.1 billion available for a loss at any one site, to cover the cost of stabilizing or shutting down a reactor after an accident. Some of this insurance, which is purchased from Nuclear Electric Insurance Limited ("NEIL"), may require the payment of retrospective premiums up to a maximum of approximately $120 million.

TVA purchases accidental outage (business interruption) insurance for TVA’s nuclear sites from NEIL. In the event that an accident covered by this policy takes a nuclear unit offline or keeps a nuclear unit offline, NEIL will pay TVA, after a waiting period, an indemnity (a set dollar amount per week) up to a maximum indemnity of $490 million per unit. This insurance policy may require the payment of retrospective premiums up to a maximum of approximately $35 million.

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Decommissioning Costs. TVA recognizes legal obligations associated with the future retirement of certain tangible long-lived assets related primarily to coal-fired generating plants and nuclear generating plants, hydroelectric generating plants/dams, transmission structures, and other property-related assets.

Nuclear. At June 30, 2014, the present value of the estimated future decommissioning cost of $2.0 billion was included in AROs. The actual decommissioning costs may vary from TVA's estimates because of, among other things, changes in current assumptions, such as decommissioning method, the assumed dates of decommissioning, changes in regulatory requirements, changes in technology, and changes in the cost of labor, materials, and equipment. Utilities that own and operate nuclear plants are required to use different procedures in calculating nuclear decommissioning obligations under GAAP than those that are used in calculating nuclear decommissioning obligations when reporting to the NRC for the purposes of the NRC minimum funding requirements calculation. The estimated decommissioning obligations as calculated using the NRC methodology differ from the AROs recorded by TVA under GAAP primarily due to differences in the type of costs included in the estimates, the basis for estimating such costs, and assumptions regarding the decommissioning alternatives to be used, potential license renewals, and decommissioning cost escalation rates.

TVA maintains a NDT to provide funding for the ultimate decommissioning of its nuclear power plants. Under NRC regulations, if the minimum funding requirements calculated under the NRC methodology are less than the future value of the NTD funds, also calculated under the NRC methodology, then the NRC requires either further funding or other financial assurance. TVA monitors the value of its NDT and believes that, over the long term and before cessation of nuclear plant operations and commencement of decommissioning activities, adequate funds from investments will be available to support decommissioning. TVA’s nuclear power units are currently authorized to operate until 2020-2036, depending on the unit. It may be possible to extend the operating life of some of the units with approval from the NRC. See Note 7 and Note 11.

Non-Nuclear Decommissioning. The present value of the estimated future non-nuclear decommissioning ARO was $1.1 billion at June 30, 2014. This decommissioning cost estimate involves estimating the amount and timing of future expenditures and making judgments concerning whether or not such costs are considered a legal obligation. Estimating the amount and timing of future expenditures includes, among other things, making projections of the timing and duration of the asset retirement process and how costs will escalate with inflation. The actual decommissioning costs may vary from the derived estimates because of changes in current assumptions, such as the assumed dates of decommissioning, changes in regulatory requirements, changes in technology, and changes in the cost of labor, materials, and equipment.

TVA maintains an ART to help fund the ultimate decommissioning of its non-nuclear power assets. Estimates involved in determining if additional funding will be made to the ART include inflation rate and rate of return projections on the fund investments. See Note 7 and Note 11.

Environmental Matters. TVA’s power generation activities, like those across the utility industry and in other industrial sectors, are subject to most federal, state, and local environmental laws and regulations. Major areas of regulation affecting TVA’s activities include air quality control, water quality control, and management and disposal of solid and hazardous wastes. In the future, regulations in all of these areas are expected to become more stringent. Regulations are also expected to apply to new emissions and sources, with a particular emphasis on climate change, renewable generation, and energy efficiency.

TVA has incurred, and expects to continue to incur, substantial capital and operating and maintenance costs to comply with evolving environmental requirements primarily associated with, but not limited to, the operation of TVA’s coal-fired generating units. It is likely that environmental requirements placed on the operation of TVA’s coal-fired and other generating units will continue to become more restrictive and potentially apply to new emissions and sources. Litigation over emissions or discharges from coal-fired generating units is also occurring, including litigation against TVA. Failure to comply with environmental and safety laws can result in TVA being subject to enforcement actions, which can lead to the imposition of significant civil liability, including fines and penalties, criminal sanctions, and/or the shutting down of non-compliant facilities.

TVA estimates that compliance with future Clean Air Act ("CAA") requirements (excluding greenhouse gas ("GHG") requirements) could lead to costs of $1.1 billion from 2014 to 2025. There could be additional material costs if reductions of GHGs, including carbon dioxide, are mandated under the CAA or by legislation or regulation, or if future legislative, regulatory, or judicial actions lead to more stringent emission reduction requirements for conventional pollutants. These costs cannot reasonably be predicted at this time because of the uncertainty of such potential actions.

Liability for releases and cleanup of hazardous substances is primarily regulated by the federal Comprehensive Environmental Response, Compensation, and Liability Act, and other federal and parallel state statutes. In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances over the years.

TVA operations at some TVA facilities have resulted in oil spills and other contamination that TVA is addressing. At June 30, 2014, TVA's estimated liability for cleanup and similar environmental work for those sites for which sufficient information is available to develop a cost estimate was approximately $16 million on a non-discounted basis and was included in Accounts payable and accrued liabilities and Other long-term liabilities on the Consolidated Balance Sheet.

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Legal Proceedings

From time to time, TVA is party to or otherwise involved in lawsuits, claims, proceedings, investigations, and other legal matters ("Legal Proceedings") that have arisen in the ordinary course of conducting TVA's activities, as a result of a catastrophic event or otherwise.

General. At June 30, 2014, TVA had accrued approximately $254 million of probable losses with respect to Legal Proceedings and estimated the range of these losses to be from $254 million to $256 million. Of the accrued amount, $139 million is included in Other long-term liabilities, $87 million is included in Accounts payable and accrued liabilities, and $28 million is included in Regulatory assets. TVA is currently unable to estimate any amount or any range of amounts of reasonably possible losses, and no assurance can be given that TVA will not be subject to significant additional claims and liabilities. If actual liabilities significantly exceed the estimates made, TVA's results of operations, liquidity, and financial condition could be materially adversely affected.

Environmental Agreements. In April 2011, TVA entered into two substantively similar agreements, a Federal Facilities Compliance Agreement with the EPA and a consent decree with Alabama, Kentucky, North Carolina, Tennessee, and three environmental advocacy groups: the Sierra Club, National Parks Conservation Association, and Our Children's Earth Foundation (collectively, the "Environmental Agreements"). They became effective in June 2011. Under the Environmental Agreements, TVA committed to (1) retire on a phased schedule 18 coal-fired units with a combined summer net dependable capability of 2,200 MW, (2) control, convert, or retire additional coal-fired units with a combined summer net dependable capability of 3,500 MW, (3) comply with annual, declining emission caps for sulfur dioxide ("SO_2") and nitrogen oxides ("NO_x"), (4) invest $290 million in certain TVA environmental projects, (5) provide $60 million to Alabama, Kentucky, North Carolina, and Tennessee to fund environmental projects, and (6) pay civil penalties of $10 million. In exchange for these commitments, most existing and possible claims against TVA based on alleged New Source Review and associated violations were waived and cannot be brought against TVA. Some possible claims for sulfuric acid mist and GHG emissions can still be brought against TVA, and claims for increases in particulates can also be pursued at many of TVA’s coal-fired units. Additionally, the Environmental Agreements do not address compliance with new laws and regulations or the cost associated with such compliance.

The liabilities related to the Environmental Agreements are included in Accounts payable and accrued liabilities and Other long-term liabilities on the June 30, 2014 Consolidated Balance Sheet. In conjunction with the approval of the Environmental Agreements, the TVA Board determined that it was appropriate to record TVA's liabilities under the Environmental Agreements as regulatory assets, and they are included as such on the June 30, 2014 Consolidated Balance Sheet and will be recovered in rates in future periods.

Several legal and administrative clean air proceedings have already been terminated in connection with the Environmental Agreements. Additionally, the proceeding discussed below involving the John Sevier Fossil Plant ("John Sevier") CAA permit is expected to be narrowed in scope.

Legal Proceedings Related to the Kingston Ash Spill. Seventy-eight lawsuits based on the Kingston ash spill were filed in the United States District Court for the Eastern District of Tennessee. The plaintiffs - residents, businesses, and property owners in the Kingston area - sought unspecified compensatory and punitive damages for various tort claims, court orders to clean up properties, and other relief. Fifteen of these lawsuits were dismissed prior to the third quarter of 2014. On August 4, 2014, the court issued an agreed order that implements a mediated global resolution of pending claims. Under the order, the 63 pending cases were dismissed with prejudice and TVA was directed to pay $28 million to the court, which will disburse the funds. The order anticipates that further legal proceedings will be required to resolve the claims of nine of the plaintiffs, and a portion of the $28 million has been set aside under the order to cover the anticipated costs of resolving these claims.

TVA has received several notices of intent to sue under various environmental statutes from both individuals and environmental groups, but no such suits have been filed.

Civil Penalty and Natural Resource Damages for the Kingston Ash Spill. In June 2010, TDEC issued a civil penalty order of approximately $12 million to TVA for the Kingston ash spill, citing violations of the Tennessee Solid Waste Disposal Act and the Tennessee Water Quality Control Act. Of the $12 million, TVA initially paid $10 million, and agreed to undertake environmental projects valued at $2 million as a credit against the remaining penalty amount. TVA completed several of those projects and has now decided to pay TDEC the remaining difference rather than do more projects. TVA has paid TDEC $750 thousand toward the remaining amount and still must pay another small amount.

Case Involving Tennessee Valley Authority Retirement System. In March 2010, eight current and former participants in and beneficiaries of TVARS filed suit in the United States District Court for the Middle District of Tennessee against the six then-current members of the TVARS Board. The lawsuit challenged the TVARS Board's decision to suspend the TVA contribution requirements for 2010 through 2013, and to amend the TVARS Rules and Regulations to (1) reduce the calculation for COLA benefits for CY 2010 through CY 2013, (2) reduce the interest crediting rate for the fixed fund accounts, and (3) increase the eligibility age to receive COLAs from age 55 to 60. The plaintiffs allege that these actions violated the TVARS Board members' fiduciary duties to the plaintiffs (and the purported class) and the plaintiffs' contractual rights, among other claims. The plaintiffs

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sought, among other things, unspecified damages, an order directing the TVARS Board to rescind the amendments, and the appointment of a seventh TVARS Board member. Five of the six individual defendants filed motions to dismiss the lawsuit, while the remaining defendant filed an answer to the complaint. In July 2010, TVA moved to intervene in the suit in the event it was not dismissed. In September 2010, the district court dismissed the breach of fiduciary duty claim against the directors without prejudice, allowing the plaintiffs to file an amended complaint within 14 days against TVARS and TVA but not the individual directors. The plaintiffs previously had voluntarily withdrawn their constitutional claims, so the court also dismissed those claims without prejudice. The court dismissed with prejudice the plaintiffs' claims for breach of contract, violation of the Internal Revenue Code, and appointment of a seventh TVARS Board member.

In September 2010, the plaintiffs filed an amended complaint against TVARS and TVA. The plaintiffs allege, among other things, violations of their constitutional rights (due process, equal protection, and property rights), violations of the Administrative Procedure Act, and breach of statutory duties owed to the plaintiffs. They seek a declaratory judgment and appropriate relief for the alleged statutory and constitutional violations and breaches of duty. TVA filed its answer to the amended complaint in December 2010. In May 2012, the court granted the parties' joint motion to administratively close the case subject to reopening to allow the parties the opportunity to engage in mediation. In July 2013, the court granted the plaintiffs' motion to reopen the lawsuit, and in November 2013, TVA filed a motion for summary judgment. The motion is still pending.

Case Involving Paradise Fossil Plant. In July 2014, the Kentucky Coal Association, Inc., and a group of individuals and businesses filed suit against TVA in the United States District Court for the Western District of Kentucky. The plaintiffs allege, among other things, that TVA violated the National Environmental Policy Act ("NEPA") in various ways, including not preparing an Environmental Impact Statement ("EIS") for the retirement of two of the three units at Paradise and the construction of a natural gas power plant, and violated the TVA Act by not choosing the least-cost alternative. The plaintiffs seek, among other things, an injunction barring TVA from taking any action with regard to retiring and replacing the two Paradise units until TVA complies with NEPA.

Case Involving the NRC Waste Confidence Decision on Spent Nuclear Fuel Storage. In June 2012, the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") vacated the NRC's updated Waste Confidence Decision ("WCD"). The WCD, a key component of NRC licensing activities since 1984, is a generic determination by the NRC that spent nuclear fuel can be safely managed until a permanent off-site repository is established. The most recent update provided that the permanent repository would be available when necessary and that spent fuel could be stored for 60 years after a plant's nuclear license had been terminated. The D.C. Circuit vacated this update on the grounds that, among other things, the NRC failed to support it with an adequate NEPA review and the NRC did not evaluate what would happen if the repository was never built.

In June 2012, multiple intervenor groups submitted a petition to the NRC to (1) hold in abeyance all pending reactor licensing decisions that would depend upon the WCD and (2) establish a process for ensuring that the remanded proceeding complies with the public participation requirements of Section 189a of the Atomic Energy Act. In August 2012, the NRC issued an order (the "August 2012 NRC Order") preventing the issuance of a final licensing decision in all proceedings affected by the petition, including Watts Bar Unit 2 and Bellefonte Units 3 and 4. While resolution of unrelated contentions can proceed, the NRC stated that it will not issue final licensing decisions until it has “appropriately addressed” the D.C. Circuit decision, and all pending contentions concerning the WCD are being held in abeyance pending the NRC's completion of an environmental review and generic rulemaking addressing the shortcomings identified by the D.C. Circuit. A draft final rule and Environmental Impact Statement addressing the D.C. Circuit decision were issued by the NRC staff in July 2014. The NRC is currently scheduled to publish the final rule in early October 2014.

Administrative Proceeding Regarding Renewal of Operating License for Sequoyah Nuclear Plant. In May 2013, the Blue Ridge Environmental Defense League ("BREDL"), the Bellefonte Efficiency and Sustainability Team ("BEST"), and Mothers Against Tennessee River Radiation filed a petition with the NRC opposing the renewal of the operating license for Sequoyah Nuclear Plant Units 1 and 2. The petition contains eight specific contentions challenging the adequacy of the license renewal application that TVA submitted to the NRC in January 2013. TVA filed a response with the Atomic Safety and Licensing Board ("ASLB") opposing the admission of all eight of the petitioners' contentions. In July 2013, the ASLB concluded that BREDL is the only one of the three petitioners that has standing to intervene in this proceeding. The ASLB also held that seven of the contentions were inadmissible, and held one portion of the remaining contention related to the WCD in abeyance pending further direction from the NRC. See Case Involving the NRC Waste Confidence Decision on Spent Nuclear Fuel Storage.

Administrative Proceedings Regarding Bellefonte Units 3 and 4. TVA submitted its combined construction and operating license application ("CCOLA") for two Advanced Passive 1000 reactors at Bellefonte Units 3 and 4 to the NRC in October 2007. In June 2008, BEST, BREDL, and Southern Alliance for Clean Energy ("SACE") submitted a joint petition for intervention and a request for a hearing. The ASLB denied standing to BEST and admitted four of the 20 contentions submitted by BREDL and SACE. The NRC reversed the ASLB's decision to admit two of the four contentions, leaving only two contentions (concerning the estimated costs of the new nuclear plant and the impact of the facility's operations on aquatic ecology) to be litigated in a future hearing. In January 2012, TVA notified the ASLB that the NRC had placed the CCOLA in "suspended" status indefinitely at TVA's request, and TVA requested that the ASLB hold the proceeding in abeyance pending a decision by TVA regarding the best path forward with regards to the CCOLA.

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In July 2012, BREDL petitioned for the admission of another new, late-filed contention stemming from the D.C. Circuit's order vacating the WCD. This contention is being held in abeyance pursuant to the August 2012 NRC Order. See Case Involving the NRC Waste Confidence Decision on Spent Nuclear Fuel Storage.

Administrative Proceedings Regarding Watts Bar Unit 2. In July 2009, SACE, the Tennessee Environmental Council, the Sierra Club, We the People, and BREDL filed a request for a hearing and petition to intervene in the NRC administrative process reviewing TVA's application for an operating license for Watts Bar Unit 2. In November 2009, the ASLB granted SACE's request for hearing, admitted two of SACE's seven contentions for hearing, and denied the request for hearing submitted on behalf of the other four petitioners. The ASLB subsequently dismissed one contention, leaving one aquatic impact contention. In July 2013, SACE filed a motion to withdraw its aquatic impact contention. The ASLB granted this motion.

In July 2012, SACE petitioned for the admission of another new, late-filed contention, similar to the one filed in the Bellefonte Units 3 and 4 proceeding, stemming from the D.C. Circuit's order vacating the WCD. Similarly, this contention is being held in abeyance pursuant to the August 2012 NRC Order. See Case Involving the NRC Waste Confidence Decision on Spent Nuclear Fuel Storage.

John Sevier Fossil Plant Clean Air Act Permit. In September 2010, the Environmental Integrity Project, the Southern Environmental Law Center, and the Tennessee Environmental Council filed a petition with the EPA, requesting that the EPA Administrator object to the CAA permit issued to TVA for operation of John Sevier. Among other things, the petitioners allege that repair, maintenance, or replacement activities undertaken at John Sevier Unit 3 in 1986 triggered the Prevention of Significant Deterioration ("PSD") requirements for SO_2 and NO_x. The CAA permit, issued by TDEC, remains in effect pending the disposition of the petition. The Environmental Agreements should narrow the scope of this proceeding. See Environmental Agreements. TVA has now retired two of the four John Sevier coal-fired units and has idled the remaining two units.

NEPA Challenge at Gallatin Fossil Plant. To comply with the Environmental Agreements and the Mercury and Air Toxics Standards, TVA chose to reduce emissions at the Gallatin Fossil Plant by installing controls and an associated landfill. Pursuant to the NEPA, TVA completed an Environmental Assessment in March 2013 to assess the impact of installing these emission controls. In April 2013, the Tennessee Environmental Council, Tennessee Scenic Rivers Association, Sierra Club, and Center for Biological Diversity filed suit in the United States District Court for the Middle District of Tennessee alleging that TVA violated NEPA when it decided to install additional emission controls and construct an associated landfill at the Gallatin Fossil Plant. Plaintiffs are demanding that TVA prepare an Environmental Impact Statement, and are asking the court to enjoin TVA from taking any further action relating to these matters pending compliance with NEPA. This case was transferred to the United States District Court for the Eastern District of Tennessee, and in August 2014, the court granted TVA's motion for summary judgment and dismissed all of the plaintiffs' claims.

Kingston Fossil Plant NPDES Permit Administrative Appeal. The Sierra Club filed a challenge to the National Pollutant Discharge Elimination System ("NPDES") permit issued by Tennessee for the scrubber-gypsum pond discharge at Kingston in November 2009 before the Tennessee Board of Water Quality, Oil and Gas ("TN Board"). TDEC is the defendant in the challenge, and TVA has intervened in support of TDEC's decision to issue the permit. The matter was set for a hearing before the TN Board in February 2011, but has since been stayed by agreement of the parties.

Bull Run Fossil Plant NPDES Permit Administrative Appeal. SACE and the Tennessee Clean Water Network ("TCWN") filed a challenge to the NPDES permit for the Bull Run Fossil Plant in November 2010. TDEC is the defendant in the challenge, and TVA's motion to intervene to support TDEC's decision to issue the permit was granted in January 2011. At the contested case hearing in October 2013, the TN Board granted TDEC's and TVA's joint motion for involuntary dismissal following the conclusion of the petitioners' presentation of evidence. On December 18, 2013, TCWN and SACE filed a petition for review of the TN Board's decision in the Chancery Court for Davidson, County, Tennessee.

Johnsonville Fossil Plant NPDES Permit Administrative Appeal. SACE and TCWN filed a challenge to the NPDES permit for the Johnsonville Fossil Plant in March 2011. TDEC is the defendant in the challenge. TVA's motion to intervene was granted in August 2011. The matter has not yet been given a hearing date before the TN Board.

John Sevier Fossil Plant NPDES Permit Administrative Appeal. SACE and TCWN filed a challenge to the NPDES permit for John Sevier in May 2011. TDEC is the defendant in the challenge. TVA's motion to intervene was granted in August 2011. The matter has not yet been given a hearing date before the TN Board.

Gallatin Fossil Plant NPDES Permit Administrative Appeal. SACE, TCWN, and the Sierra Club filed a challenge to the NPDES permit for the Gallatin Fossil Plant in June 2012. TDEC is the defendant in the challenge. TVA's motion to intervene was granted in September 2012. Petitioners subsequently voluntarily dismissed all but one of their claims, and TVA has moved to dismiss that claim. The matter has been set for a hearing before the TN Board in September 2014.

Petitions Resulting from Japanese Nuclear Events. As a result of events that occurred at the Fukushima Daiichi Nuclear Power Plant in March 2011, petitions have been filed with the NRC which could impact TVA's nuclear program. While some petitions have been dismissed after review, petitions that remain open include the following:

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- Petition to Immediately Suspend the Operating Licenses of GE BWR Mark I Units Pending the Full NRC Review With Independent Expert and Public Participation From Affected Emergency Planning Zone Communities

Beyond Nuclear filed a petition in April 2011, requesting that the NRC take emergency enforcement action against all nuclear reactor licensees that operate units that use the General Electric Mark I BWR design. TVA uses this design at Browns Ferry Units 1, 2, and 3. The petition requests the NRC to take several actions, including the suspension of the operating licenses at the affected nuclear units, including Browns Ferry, until several milestones have been met. In December 2011, the NRC provided its initial response to the petition. The NRC accepted five specific requests that would apply directly or indirectly to Browns Ferry, including issues relating to spent fuel pool use and location, Mark I containment hardened vent systems and design, and backup electrical power. Each of these items was accepted for further investigation, but the requests for immediate action were rejected. The NRC has not yet rendered a decision regarding the petition.

- Twelve separate petitions on various issues

In August 2011, the Natural Resources Defense Council submitted twelve separate letters to the NRC requesting action on various health and safety aspects of operating nuclear facilities in the United States. The NRC is treating these as a single 10 CFR 2.206 Petition. The NRC has not yet rendered a decision regarding the petition.

- Petition Pursuant to 10 CFR 2.206 - Demand For Information Regarding Compliance with 10 CFR 50, Appendix A, General Design Criterion 44, Cooling Water, and 10 CFR 50.49, Environmental Qualification of Electric Equipment Important to Safety for Nuclear Power Plants

A petition was filed by the Union of Concerned Scientists in July 2011, requesting that a demand for information be issued for affected licensees, including TVA with regards to Browns Ferry, describing how the facilities comply with General Design Criterion 44, Cooling Water, within Appendix A to 10 CFR Part 50, and with 10 CFR 50.49, Environmental Qualification of Electric Equipment Important to Safety for Nuclear Power Plants, for all applicable design and licensing bases events. The NRC has not yet rendered a decision regarding the petition.

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ITEM 2. 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 the Tennessee Valley Authority ("TVA"). The MD&A should be read in conjunction with the accompanying unaudited consolidated financial statements and TVA's Annual Report on Form 10-K for the fiscal year ended September 30, 2013 (the "Annual Report").

Executive Overview

TVA had a net loss of $81 million for the three-month period ended June 30, 2014, and net income of $147 million for the nine-month period ended June 30, 2014, as compared with net losses of $12 million and $203 million for the same periods of 2013.

Sales of electricity were lower for the three-month period ended June 30, 2014, and nine-month period ended June 30, 2014, as compared to the same periods of 2013. Sales to local power company customers of TVA ("LPCs") increased slightly during the three-month and increased five percent during the nine-month period ended June 30, 2014, as compared to the same periods of 2013, due to a warmer spring and an extremely colder winter. However, these increases were more than offset by reductions in sales to industrial customers primarily driven by United States Enrichment Corporation ("USEC"), historically TVA's largest directly served customer, as USEC began ceasing operations in May 2013.

Revenues from the sales of electricity were up slightly for the three-month and nine-month periods ended June 30, 2014, compared with the same periods of the prior year. The seven percent increase in revenues from LPCs during the three month period ended June 30, 2014, was due to increased fuel cost recovery during the quarter and increased base revenues resulting from changes in TVA's wholesale base rate approved by the TVA Board in August 2013. For the nine months ended June 30, 2014 as compared to the same periods of 2013 the increase in revenues was due to higher sales to LPCs and a higher wholesale base rate. The increases were offset primarily by a decrease in revenue from USEC.

Operating and maintenance expenses increased slightly for the three-month period ended June 30, 2014 and decreased $182 million for the nine-month period ended June 30, 2014, as compared with the same periods of 2013. The decrease was primarily due to cost savings initiatives undertaken by management. TVA continues to make operational changes to its generating fleet and to pursue cost reduction initiatives across all business units with a goal of keeping its rates competitive.

During the nine months ended June 30, 2014, TVA made the strategic decision to use cash on hand and cash generated from operations to reduce long-term and short-term debt by $1.1 billion.

Recent inspections by the Nuclear Regulatory Commission ("NRC") determined that TVA has met all requirements in connection with the red finding for Browns Ferry Nuclear Plant ("Browns Ferry"), and the NRC has closed this finding. Additionally, Browns Ferry Unit 1's two performance indicators on safety systems returned to the normal band. The NRC has also closed the hydrology issues at Sequoyah Nuclear Plant ("Sequoyah") and Watts Bar Nuclear Plant ("Watts Bar"), and these plants have returned to routine and baseline NRC inspection schedules.

Results of Operations

Sales of Electricity

The following table compares TVA’s energy sales for the three and nine months ended June 30, 2014, and 2013:
Sales of Electricity
(millions of kWh)

	Three Months Ended June 30				Nine Months Ended June 30			
	2014	2013	Change	Percent Change	2014	2013	Change	Percent Change
Local power companies	31,731	31,390	341	1.1 %	101,275	96,077	5,198	5.4 %
Industries directly served	4,450	6,539	(2,089)	(31.9)%	13,026	21,541	(8,515)	(39.5)%
Federal agencies and other	684	1,024	(340)	(33.2)%	2,263	2,746	(483)	(17.6)%
Total sales of electricity	36,865	38,953	(2,088)	(5.4)%	116,564	120,364	(3,800)	(3.2)%

TVA uses degree days to measure the impact of weather on its power operations since weather affects both demand and market prices for electricity. Degree days measure the extent to which average temperatures in the five largest cities in TVA's service area vary from 65 degrees Fahrenheit.

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Degree Days

	2014 Actual	Normal[1]	Percent Variation	2013 Actual	Normal[1]	Percent Variation	2014 Actual	2013 Actual	Percent Change
Heating Degree Days									
Three Months Ended June 30	199	228	(12.7)%	261	228	14.5 %	199	261	(23.8)%
Nine Months Ended June 30	3,697	3,343	10.6 %	3,332	3,343	(0.3)%	3,697	3,332	11.0 %
Cooling Degree Days									
Three Months Ended June 30	651	586	11.1 %	598	586	2.0 %	651	598	8.9 %
Nine Months Ended June 30	743	666	11.6 %	637	666	(4.4)%	743	637	16.6 %

Note

(1) This calculation is updated every five years in order to incorporate the then most recent 30 years. It was last updated in 2011.

Sales of electricity decreased 2.1 billion kilowatt hours ("kWh") for the three months ended June 30, 2014, compared to the three months ended June 30, 2013, primarily due to a decrease in demand from industries directly served. The reduced demand was largely the result of a decrease in demand by USEC, which began ceasing operations during the third quarter of 2013.

Sales of electricity decreased 3.8 billion kWh for the nine months ended June 30, 2014, compared to the nine months ended June 30, 2013, primarily due to a decrease in demand from industries directly served. The reduced demand was largely the result of a decrease in demand by USEC, which began ceasing operations during the third quarter of 2013. Partially offsetting this decrease in sales to industries directly served was an increase in sales to LPCs due primarily to 11 percent more heating degree days and 17 percent more cooling degree days than the same period of the prior year.

Financial Results

The following table compares operating results for the three and nine months ended June 30, 2014, and 2013:

Summary Consolidated Statements of Operations

	Three Months Ended June 30			Nine Months Ended June 30		
	2014	2013	Percent Change	2014	2013	Percent Change
Operating revenues	$2,651	$2,602	1.9 %	$7,971	$7,922	0.6 %
Operating expenses	2,453	2,324	5.6 %	6,979	7,228	(3.4)%
Operating income	198	278	(28.8)%	992	694	42.9 %
Other income, net	10	10	— %	37	36	2.8 %
Interest expense, net	289	300	(3.7)%	882	933	(5.5)%
Net income (loss)	$(81)	$(12)	(575.0)%	$147	$(203)	172.4 %

Operating Revenues. Operating revenues for the three and nine months ended June 30, 2014, and 2013, consisted of the following:

Operating Revenues

	Three Months Ended June 30			Nine Months Ended June 30		
	2014	2013	Percent Change	2014	2013	Percent Change
Electricity sales						
Local power companies	$2,383	$2,227	7.0 %	$7,217	$6,766	6.7 %
Industries directly served	197	302	(34.8)%	539	946	(43.0)%
Federal agencies and other	38	43	(11.6)%	113	118	(4.2)%

Electricity sales	2,618	2,572	1.8	%	7,869	7,830	0.5	%
Other revenue	33	30	10.0	%	102	92	10.9	%
Total operating revenues	$2,651	$2,602	1.9	%	$7,971	$7,922	0.6	%

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Operating revenues increased $49 million in the three and nine months ended June 30, 2014, compared to the three and nine months ended June 30, 2013, due to the following:

	Three Month Change	Nine Month Change
Fuel cost recovery	$94	$(127)
Base revenue	(41)	178
Other	(4)	(2)
Total	$49	$49

Operating revenues increased by $49 million for the three months ended June 30, 2014, compared to the three months ended June 30, 2013, primarily due to a $94 million increase in fuel cost recovery. The increase in fuel cost recovery was primarily attributable to higher fuel rates, which resulted from the use of more expensive generation resources during the previous quarter. Due to the design of the fuel cost recovery mechanism, these costs were recovered during the quarter ended June 30, 2014. This was partially offset by a $41 million decrease in base revenue, which was largely the result of the decrease in demand by USEC.

Operating revenues increased $49 million for the nine months ended June 30, 2014, compared to the nine months ended June 30, 2013, primarily due to a $178 million increase in base revenue. The increase in base revenue was attributable to higher sales volume to LPCs and the non-fuel base rate increase that became effective October 1, 2013. This was partially offset by a $127 million decrease in fuel cost recovery which resulted from the use of less expensive nuclear generation resources and from the decrease in sales to industries directly served due to the reduction in demand by USEC.

TVA's wholesale rate structure provides price signals intended to encourage LPCs and end-use customers to shift energy usage from high-cost generation periods to less expensive generation periods. Under the revised wholesale structure, weather can positively or negatively impact both volume and effective rates, while only volume was impacted under the former wholesale structure. This is because the wholesale structure includes two components: a demand charge and an energy charge. The demand charge is based on the customer's peak monthly usage and increases as the peak increases. The energy charge is based on the kWhs used by the customer. The rate structure also establishes a separate fuel rate that includes the costs of natural gas, fuel oil, purchased power, coal, emission allowances, nuclear fuel, and other fuel-related commodities; realized gains and losses on derivatives purchased to hedge the costs of such commodities; and tax equivalents associated with the fuel cost adjustments.

Operating Expenses. Operating expenses for the three and nine months ended June 30, 2014, and 2013, consisted of the following:

Operating Expenses

	Three Months Ended June 30			Nine Months Ended June 30		
	2014	2013	Percent Change	2014	2013	Percent Change
Fuel	$698	$652	7.1 %	$1,904	$2,118	(10.1)%
Purchased power	279	263	6.1 %	843	796	5.9 %
Operating and maintenance	880	866	1.6 %	2,480	2,662	(6.8)%
Depreciation and amortization	463	412	12.4 %	1,357	1,248	8.7 %
Tax equivalents	133	131	1.5 %	395	404	(2.2)%
Total operating expenses	$2,453	$2,324	5.6 %	$6,979	$7,228	(3.4)%

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The following table summarizes TVA's net generation and purchased power in millions of kWh by generating source and the percentage of all electric power generated and purchased for the periods indicated:
Power Supply from TVA-Operated Generation Facilities and Purchased Power

	Three Months Ended June 30						Nine Months Ended June 30					
	2014			2013			2014			2013		
	kWh (in millions)	Percent of Total Power Supply		kWh (in millions)	Percent of Total Power Supply		kWh (in millions)	Percent of Total Power Supply		kWh (in millions)	Percent of Total Power Supply	
Coal-fired	15,624	42	%	14,501	36	%	44,916	38	%	46,801	38	%
Nuclear	12,451	33	%	13,755	35	%	39,669	33	%	37,495	31	%
Hydroelectric	1,868	5	%	4,671	12	%	10,609	9	%	13,690	11	%
Natural gas and/or oil-fired	3,198	9	%	2,234	6	%	8,961	8	%	9,916	8	%
Renewable resources (non-hydro)	3	—	%	1	—	%	5	—	%	5	—	%
Total TVA-operated generation facilities	33,144	89	%	35,162	89	%	104,160	88	%	107,907	88	%
Purchased power	4,303	11	%	4,411	11	%	14,493	12	%	14,482	12	%
Total power supply	37,447	100	%	39,573	100	%	118,653	100	%	122,389	100	%

Fuel expense increased $46 million for the three months ended June 30, 2014, as compared to the same period of the prior year, primarily due the use of more expensive generation resources. Hydroelectric and nuclear generation, TVA's least expensive types of generation, were down 60 percent and nine percent, respectively, as compared to the same period of the prior year, while natural gas fired and coal-fired generation increased by 43 percent and eight percent, respectively, as compared to the same period of the prior year. The increased consumption of these more expensive types of generation resulted in a $62 million increase to fuel expense. Additionally, for the three months ended June 30, 2014, the fuel cost recovery mechanism increased fuel expense by $20 million, as compared to the same period of the prior year. The fuel cost recovery mechanism provides a means to regularly adjust rates in order to reflect changing fuel and purchased power costs, including realized gains and losses relating to fuel commodity hedging transactions under TVA's financial trading program ("FTP"). See Note 14 — Derivatives Not Receiving Hedge Accounting Treatment — Derivatives Under FTP. There is typically a lag between the occurrence of a change in fuel and purchased power costs and the reflection of the change in rates due to the operation of the fuel cost recovery mechanism. This difference is recorded as a regulatory asset or liability and represents over-collected revenues (regulatory liabilities) or under-collected revenues (regulatory assets). As a result of this treatment, eligible fuel expenses are correctly matched to the related revenue on the statements of operations. Offsetting the increases in fuel expense, a reduction in sales volume of five percent contributed to a $36 million decrease in fuel expense.

Purchased power expense increased $16 million for the three months ended June 30, 2014, as compared to the same period of the prior year, primarily due to the timing fuel cost recovery mechanism. For the three months ended June 30, 2014, the fuel cost recovery mechanism increased purchased power expense by $13 million, as compared to the same period of the prior year. Additionally, higher market prices for natural gas increased purchased power expense by $9 million. As an indication of general market direction, the average Henry Hub natural gas spot price for the three months ended June 30, 2014 was approximately 14 percent higher than the same period of the prior year. Partially offsetting the increases in purchased power expense was a two percent decrease in the volume of power purchased for the three months ended June 30, 2014, as compared to the same period in the prior year. This change in volume decreased purchased power expense by $6 million.

Operating and maintenance expense increased $14 million for the three months ended June 30, 2014, compared with the same period of the prior year. This increase is primarily driven by an increase of $25 million due to more outages during the period partially offset by a $12 million decrease in pension and post-retirement costs, due to an increase in the discount rate, and decreases in expenses due to cost savings initiatives undertaken by management and fewer projects performed during the period.

Depreciation and amortization expense increased $51 million for the three months ended June 30, 2014, compared with the same period of the prior year, primarily due to an increase in the amount of accelerated depreciation recognized for certain coal-fired units to be idled.

Tax equivalents expense increased $2 million during the three months ended June 30, 2014, compared to the same period of the prior year. This increase primarily reflects an increase in the accrued tax equivalent expense related to the fuel cost adjustment. The accrued tax equivalent expense is equal to five percent of the fuel cost adjustment revenues and increased for the three months ended June 30, 2014, as compared to the same period of the prior year.

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Fuel expense decreased $214 million for the nine months ended June 30, 2014, as compared to the same period of the prior year, primarily due to a reduction in sales volume and the timing of the fuel cost recovery mechanism. For the nine months ended June 30, 2014, the fuel cost recovery mechanism decreased fuel expense by $132 million as compared to the same period of the prior year. Additionally, a reduction in sales volume of three percent contributed to a $71 million decrease in fuel expense. A change in the generation mix contributed to the remaining $11 million decrease in fuel expense.

Purchased power expense increased $47 million for the nine months ended June 30, 2014, as compared to the same period of the prior year, primarily due to higher market prices for natural gas, as TVA's primary source of purchased power is natural gas-fired generation. As an indication of general market direction, the average Henry Hub natural gas spot price for the nine months ended June 30, 2014 was $4.486 per mmBtu, which was 24 percent higher than the average price for the same period of the prior year. The higher prices contributed to a $95 million increase to purchased power expense. Offsetting the increase in purchased power expense was a $48 million decrease due to the timing of the fuel cost recovery mechanism.

Operating and maintenance expense decreased $182 million for the nine months ended June 30, 2014, compared with the same period of the prior year. This decrease was primarily driven by a $120 million decrease in expenses related to cost savings initiatives undertaken by management. See Key Initiatives and Challenges — Cost Reduction Initiatives. In addition, there was a $62 million decrease due to fewer projects undertaken during the period, a $37 million decrease in pension and post-retirement costs due to an increase in the discount rate, and a decrease of $18 million due to fewer outages during the period. These decreases were offset by a $56 million increase in employee-related expenses due to restructuring activities.

Depreciation and amortization expense increased $109 million for the nine months ended June 30, 2014, compared with the same period of the prior year, primarily due to an increase in the amount of accelerated depreciation recognized for certain coal-fired units to be idled.

Tax equivalents expense decreased $9 million during the nine months ended June 30, 2014, compared to the same period of the prior year. This change primarily reflects a decrease in gross revenues from the sale of power (excluding sales or deliveries to other federal agencies and off-system sales with other utilities) during 2013 compared to 2012.

Interest Expense. Interest expense and interest rates for the three and nine months ended June 30, 2014, and 2013, were as follows:

Interest Expense

	Three Months Ended June 30			Nine Months Ended June 30
	2014	2013	Percent Change	