

OFFERING CIRCULAR

\$984,000,000

Tennessee Valley Authority
OFFER TO EXCHANGE

Tennessee Valley Authority ("TVA") hereby offers, upon the terms and subject to the conditions set forth in this Offering Circular (the "Offering Circular") and in the accompanying Letter of Transmittal (the "Letter of Transmittal"), to exchange up to \$984,000,000 aggregate principal amount of its newly issued 6.79% Power Bonds 2002 Series A Due May 23, 2012 (the "New Bonds") for any and all of the \$984,000,000 aggregate principal amount of its 7.14% Power Bonds 2000 Series F Due May 23, 2012 (the "Old Bonds") (such offer is referred to as the "Exchange Offer").

The terms of the New Bonds will be substantially the same in all material respects as the terms of the Old Bonds except that (i) the New Bonds will be repayable at the option of the beneficial owner, together with the Holder (as defined in "Description of New Bonds" — "Book-Entry System") thereof, on May 24, 2004 (rather than May 23, 2002), and (ii) the interest rate on the New Bonds will be 6.79% (rather than 7.14%). See "Description of New Bonds".

Upon the terms and subject to the conditions of the Exchange Offer (including, if the Exchange Offer is extended or amended, the terms and conditions of any such extension or amendment) and applicable law, TVA will accept for exchange Old Bonds validly tendered pursuant to the Exchange Offer and will acquire such Old Bonds by issuing New Bonds therefor on Thursday, May 2, 2002 (the "Exchange Date"). Interest on the Old Bonds exchanged in the Exchange Offer will continue to accrue up to, but excluding, the Exchange Date and will be paid in cash in immediately available same-day funds to exchanging Holders on the Exchange Date concurrently with the delivery of the New Bonds. Interest on the New Bonds issued in exchange for the Old Bonds will accrue from, and including, the Exchange Date as described herein. See "Description of New Bonds" — "Payment of Principal and Interest". TVA will deliver such New Bonds and accrued interest to the exchanging Holders of Old Bonds on the Exchange Date.

To accept the Exchange Offer, Holders of Old Bonds should contact Computershare Trust Company of New York, which is acting as Exchange Agent for the Exchange Offer (the "Exchange Agent"). Requests for copies of the Exchange Offer materials should be directed to D. F. King & Co., Inc. (the "Information Agent") at the telephone numbers set forth on the back cover of this Offering Circular. Neither TVA, the Information Agent, the Exchange Agent nor Morgan Stanley & Co. Incorporated ("Morgan Stanley" or the "Dealer Manager") makes any recommendation as to whether the beneficial owners, together with the Holders, should exchange their Old Bonds pursuant to the Exchange Offer.

TVA expressly reserves the right, in its sole discretion, subject to applicable law, at any time and from time to time, to (i) waive any condition to the Exchange Offer and accept all Old Bonds previously tendered for exchange pursuant to the Exchange Offer, (ii) extend the expiration of the Exchange Offer and retain all Old Bonds tendered for exchange pursuant thereto, and/or (iii) amend the terms of the Exchange Offer. Any amendment of the Exchange Offer will apply to all Old Bonds tendered for exchange pursuant to the Exchange Offer, subject, however, to the withdrawal rights of Holders described under "The Exchange Offer" — "Withdrawal Rights". TVA currently has no intention to amend the Exchange Offer. See "The Exchange Offer" — "Expiration Time; Extensions; Amendments".

Tenders of the Old Bonds may not be withdrawn. Notwithstanding the foregoing, any Holders that had previously tendered Old Bonds may withdraw such Old Bonds if TVA amends the Exchange Offer and such amendment, in the opinion of the Board of Directors of TVA, adversely affects such Holders or the respective beneficial owners of the Old Bonds so tendered. See "The Exchange Offer" — "Withdrawal Rights".

Information regarding the Exchange Offer will be available on MCM "Corporate Watch" Service on Telerate — page 64163 and on Bloomberg on page MCM 7888.

THE EXCHANGE OFFER WILL EXPIRE AT 5:00 P.M., NEW YORK CITY TIME, ON THURSDAY, APRIL 25, 2002, UNLESS EXTENDED (THE "EXPIRATION TIME").

Application will be made to list the New Bonds on the New York Stock Exchange.

THE NEW BONDS WILL NOT BE OBLIGATIONS OF, NOR WILL PAYMENT OF THE PRINCIPAL THEREOF OR THE INTEREST THEREON BE GUARANTEED BY, THE UNITED STATES OF AMERICA. THE NEW BONDS ARE NOT REQUIRED TO BE REGISTERED UNDER THE SECURITIES ACT OF 1933. ACCORDINGLY, NO REGISTRATION STATEMENT HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. TVA IS NOT SUBJECT TO THE PERIODIC REPORTING REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934.

The Dealer Manager of the Exchange Offer is
MORGAN STANLEY

April 23, 2002

No dealer, salesperson or any other person has been authorized to give any information or to make any representations other than those contained in this Offering Circular or the current Information Statement contained herein and, if given or made, such information or representations must not be relied upon as having been authorized by TVA, the Dealer Manager, the Exchange Agent, or the Information Agent. Neither the delivery of this Offering Circular or the current Information Statement nor any distribution of securities hereunder shall under any circumstances create an implication that the information provided herein is correct at any time subsequent to their date or that there has been no change in the information set forth herein or in the affairs of TVA since such date.

This Offering Circular should be read in conjunction with TVA's current Information Statement, dated April 19, 2002 (the "current Information Statement"), which is attached hereto and incorporated herein by this reference. Any statement contained in the current Information Statement shall be deemed to be modified or superseded for all purposes of the current Information Statement and this Offering Circular to the extent that a statement contained in this Offering Circular modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified, to constitute a part of the current Information Statement. Additional copies (in reasonable quantities) of this Offering Circular and of the current Information Statement may be obtained upon written request directed to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902-1401, Attention: Investor Relations, or by calling 1-888-882-4975. The then-current Information Statement and other information concerning TVA may be inspected at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

THE EXCHANGE OFFER IS NOT BEING MADE TO (NOR WILL THE SURRENDER OF OLD BONDS FOR EXCHANGE BE ACCEPTED FROM OR ON BEHALF OF) BENEFICIAL OWNERS AND HOLDERS OF OLD BONDS IN ANY JURISDICTION IN WHICH THE MAKING OR ACCEPTANCE OF THE EXCHANGE OFFER WOULD NOT BE IN COMPLIANCE WITH THE LAWS OF SUCH JURISDICTION.

FORWARD-LOOKING STATEMENTS

This Offering Circular and the current Information Statement contain forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, predictions, estimates, objectives, intentions, or assumptions or otherwise relating to future events or performance may be forward-looking.

In certain cases, forward-looking statements can be identified by the use of words such as "may", "will", "should", "expect", "anticipate", "believe", "intend", "project", "plan", "predict", "assume", "estimate", "objective", "possible", "potential" or other similar expressions. Some examples of forward-looking statements include statements regarding TVA's projections of future power and energy requirements; future costs related to environmental compliance; impacts of potential legislation on TVA and the likelihood of enactment of such legislation; targets for TVA's debt reduction and future competitive position; anticipated availability of nuclear waste storage facilities; projections of nuclear decommissioning costs; and impacts of pending litigation and various administrative orders which have been or may be issued.

Although TVA believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws, regulations, and administrative orders, especially those related to the restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA's generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; changes in accounting standards; and unforeseeable events. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA's business or cause results to differ from those contained in any forward-looking statement.

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

TABLE OF CONTENTS

Offering Circular

	<u>Page</u>
Summary of Offer	C-5
Tennessee Valley Authority	C-9
Recent Developments	C-10
The Exchange Offer	C-13
Description of New Bonds	C-16
Legality of Investment	C-19
Taxes	C-20
Validity of New Bonds	C-25
Election Form	C-26
Instructions for Completing Election Form and Exercising Repayment Option for May 24, 2004	C-27

Information Statement

	<u>Page</u>
Tennessee Valley Authority	1
Selected Financial Data	2
Comparative Five-Year Data	3
Management's Discussion and Analysis of Financial Condition and Results of Operations	4
The Area Supplied by TVA	8
Rates, Customers and Market	8
Competition	10
Power and Energy Requirements	11
Power System	11
Nuclear Power Program	13
Environmental Matters	16
Insurance	19
Pending Litigation	19
Management	20
Employees	21
Certain Provisions of the Tennessee Valley Authority Act	21
The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness	22
Public Law No. 105-62	26
Independent Accountants	27
Financial Statements	F-1
Report of Independent Accountants	F-21
Report of Management	F-22

SUMMARY OF OFFER

TVA has announced its offer to exchange the New Bonds for any and all of the Old Bonds upon the terms and subject to the conditions set forth herein. Morgan Stanley has been named exclusive Dealer Manager for the Exchange Offer. For your convenience, a description of the Exchange Offer is summarized below. The following summary is not intended to be complete and is qualified in its entirety by reference to the more detailed information included in the Information Statement (and any supplement thereto) and elsewhere in this Offering Circular. Beneficial owners and Holders of Old Bonds are urged to read carefully this Offering Circular and the documents incorporated by reference in their entirety. Capitalized terms used and not defined herein have the meaning defined in such Information Statement and elsewhere in this Offering Circular.

The Exchange Offer

Issuer TVA is a wholly owned corporate agency and instrumentality of the United States of America established by the Tennessee Valley Authority Act of 1933, as amended.

Exchange Offer TVA is offering to exchange up to \$984,000,000 aggregate principal amount of the New Bonds described below for any and all of the \$984,000,000 aggregate principal amount of the Old Bonds described below. For each \$1,000 principal amount of the following Old Bonds, the exchanging Holders will receive \$1,000 principal amount of the following New Bonds.

New Bonds	Old Bonds
6.79% Power Bonds 2002 Series A due May 23, 2012 CUSIP No. 880591 DT6	7.14% Power Bonds 2000 Series F due May 23, 2012 CUSIP No. 880591 DL3

* The CUSIP number is provided solely as a convenience to Holders. No representation is made as to the correctness or accuracy of the CUSIP number set forth herein, and the terms of the Exchange Offer shall not be affected by any defect in such CUSIP number.

The terms of the New Bonds will be substantially the same in all material respects as the terms of the Old Bonds, except that (i) the New Bonds will be repayable at the option of the beneficial owner, together with the Holder thereof, on May 24, 2004 (rather than May 23, 2002) and (ii) the interest rate on the New Bonds will be 6.79% (rather than 7.14%). See “Description of New Bonds”.

Expiration Time The Exchange Offer shall expire at 5:00 p.m., New York City time, on Thursday, April 25, 2002, unless extended by TVA in its sole discretion (such date and time or the latest date and time to which the Exchange Offer is extended being referred to herein as the “Expiration Time” for the Exchange Offer). See “The Exchange Offer” — “Expiration Time; Extensions; Amendments”.

Exchange Date Upon the terms and subject to the conditions of the Exchange Offer (including, if the Exchange Offer is extended, the terms and conditions of any such extension), TVA will accept for exchange Old Bonds validly tendered at or prior to the Expiration Time pursuant to the Exchange Offer and thereafter will acquire such Old Bonds by issuing New Bonds in exchange therefor. Such New

Bonds will be delivered to the Holders of tendered and accepted Old Bonds on Thursday, May 2, 2002 (the "Exchange Date"). See "The Exchange Offer".

Interest on New Bonds Interest on the New Bonds issued in exchange for the Old Bonds will accrue from, and including, the Exchange Date at the rate set forth on the cover page hereof.

Interest on Old Bonds Interest on Old Bonds exchanged in the Exchange Offer will continue to accrue up to, but excluding, the Exchange Date and will be paid in cash in immediately available same-day funds concurrently with the delivery of New Bonds. See "The Exchange Offer" — "Terms of the Exchange Offer".

Procedures for Exchanging Old

Bonds To tender Old Bonds pursuant to the Exchange Offer, Holders must complete, sign and deliver (via facsimile to the number indicated in the Letter of Transmittal) to the Exchange Agent the Letter of Transmittal, and any other documents required therein, in accordance with the instructions therein at or prior to the Expiration Time.

By submitting the Letter of Transmittal, the Holder agrees to deliver such Old Bonds as are identified therein to the Exchange Agent in accordance with the Exchange Offer and such Letter of Transmittal.

All tendered Old Bonds must be delivered prior to 9:30 a.m., New York City time on Thursday, May 2, 2002 through the Federal Reserve Banks book-entry system (as defined herein) to the account of the Exchange Agent. Old Bonds may only be wired to the Exchange Agent prior to 9:30 a.m., New York City time on Thursday, May 2, 2002 and only in accordance with the normal delivery procedures of the Federal Reserve Banks book-entry system.

Waivers; Extensions;

Amendments TVA expressly reserves the right, in its sole discretion, subject to applicable law, at any time or from time to time, to (i) waive any condition to the Exchange Offer and accept all Old Bonds previously tendered for exchange pursuant to the Exchange Offer, (ii) extend the Expiration Time of the Exchange Offer and retain all Old Bonds tendered for exchange pursuant thereto and/or (iii) amend the terms of the Exchange Offer. Any amendment to the Exchange Offer will apply to all Old Bonds tendered pursuant to the Exchange Offer; subject, however, to the withdrawal rights described under "The Exchange Offer" — "Withdrawal Rights". See "The Exchange Offer" — "Expiration Time; Extensions; Amendments". TVA currently has no intention to amend the Exchange Offer.

Withdrawal Rights Tenders of Old Bonds for exchange may not be withdrawn. Notwithstanding the foregoing, any Holders who had previously tendered Old Bonds may withdraw such Old Bonds if TVA amends the Exchange Offer and such amendment, in the opinion of the Board of Directors of TVA, adversely affects such Holders or the

respective beneficial owners of the Old Bonds so tendered. See “The Exchange Offer” — “Withdrawal Rights”.

Certain Effects of the Exchange

Offer	Old Bonds exchanged pursuant to the Exchange Offer will be cancelled through the Federal Reserve Banks, as Fiscal Agent. The exchange of Old Bonds pursuant to the Exchange Offer will reduce the aggregate principal amount of Old Bonds that otherwise might trade publicly, which could adversely affect the liquidity and market value of the remaining Old Bonds held by the public.
Dealer Manager	Morgan Stanley & Co. Incorporated
Exchange Agent	Computershare Trust Company of New York
Information Agent	D.F. King & Co., Inc.

Description of New Bonds Offered

New Bonds	Up to \$984,000,000 aggregate principal amount of 6.79% Power Bonds 2002 Series A Due May 23, 2012.
Interest	The New Bonds will bear interest from, and including, the Exchange Date, at the annual rate of 6.79%, payable semi-annually in arrears on each May 23 and November 23, commencing November 23, 2002.
Redemption	The New Bonds will not be subject to redemption prior to maturity.
Repayment	Each of the New Bonds will be repayable, at the option of the beneficial owner, together with the Holder thereof, on May 24, 2004, at 100 percent of its principal amount plus accrued interest thereon to the date of repayment. To exercise such an option, a beneficial owner, together with the Holder thereof, must deliver a timely notice to TVA. Such notice must be received by TVA at the office specified herein no earlier than April 23, 2004, and no later than May 7, 2004. Once received, such notice will be irrevocable. See “Description of New Bonds” — “Repayment”.
Fiscal Agent	Federal Reserve Banks.
Listing	Application will be made to list the New Bonds on the New York Stock Exchange.
Source of Payment	The interest and principal on the New Bonds are payable solely from Net Power Proceeds and are not obligations of, or guaranteed by, the United States of America. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” in the current Information Statement.
Form and Denomination of New Bonds	The New Bonds will be issued and maintained and may be transferred by Holders only on the book-entry system of the Federal Reserve Banks. See “Description of New Bonds” — “Book-Entry System”. The New Bonds will not be exchangeable for definitive securities. The New Bonds will be issued and must be maintained

and transferred in minimum denominations of \$1,000 and integral multiples thereof.

Legality of Investment Each person or entity is advised to consult with its own counsel with respect to the legality of investment in the New Bonds. Generally, Power Bonds:

- are acceptable as security for all fiduciary, trust, and public funds, the investment or deposit of which shall be under the authority or control of any officer or agency of the United States of America;
- are eligible as collateral for Treasury tax and loan accounts;
- are among those obligations which national banks may deal in, underwrite and purchase for their own accounts in an amount up to ten percent of unimpaired capital and surplus;
- are eligible as collateral for advances by Federal Reserve Banks to member banks;
- are legal investments for federal savings associations and federal savings banks to the extent specified in applicable regulations;
- are eligible as collateral for advances by Federal Home Loan Banks to members for which the Power Bonds are legal investments; and
- are legal investments for federal credit unions, subject to applicable regulations.

See “Legality of Investment”.

No Acceleration Right The New Bonds will not contain any provisions permitting the Holders to accelerate the maturity thereof on the occurrence of any default.

Taxation Those participating in the Exchange Offer will be subject to various tax consequences. See “Taxes”.

CUSIP Number for New Bonds . . . 880591 DT6

TENNESSEE VALLEY AUTHORITY

The Tennessee Valley Authority is one of the largest electric power systems in the United States, having produced over 156 billion kilowatt-hours of electricity in fiscal year 2001. The TVA system supplies electric power to a region containing more than eight million people located in parts of Tennessee, Kentucky, Mississippi, Alabama, Georgia, North Carolina and Virginia.

TVA is a wholly owned corporate agency and instrumentality of the United States of America established pursuant to the Tennessee Valley Authority Act of 1933, as amended (the "Act"), primarily to develop and manage the resources of the Tennessee Valley region. Historically, the programs at TVA have consisted of power and nonpower programs. The Act requires TVA's electric system operations to be self-supporting from power system revenues, which were almost \$7.0 billion in fiscal year 2001. Congress does not appropriate funds to TVA for its power program. The Act authorizes TVA to issue Evidences of Indebtedness (as defined in "Description of New Bonds"), the proceeds of which TVA may only use to finance its power program. TVA's nonpower activities have included responsibilities associated with operation of the Tennessee River system, land management, economic development and the environment. While Congress historically has appropriated amounts to fund TVA's nonpower programs, Congress passed legislation in 1997 providing for the funding of these programs with revenues from TVA's power program and other TVA revenue sources when appropriations are insufficient. In fiscal year 1999, the last year TVA received appropriated funds, it spent a total of approximately \$70 million on essential stewardship activities, \$30 million of which amount was power funds. In fiscal years 2000 and 2001, TVA spent a total of approximately \$70 million on essential stewardship activities, virtually all of which was power funds, and TVA expects in fiscal year 2002 to spend approximately the same amount of power funds on such activities as it did in fiscal year 2001. For a further discussion of this matter, see "Public Law No. 105-62" in the current Information Statement.

For over six decades, TVA has been associated with bringing prosperity to a significant region of the United States. Its dams have averted an estimated \$4 billion in flood damage; its power program has brought electricity to a large undeveloped area of the country; and its economic development program has contributed to a vast increase in the number of jobs in the Tennessee Valley.

RECENT DEVELOPMENTS

Financial Results

The condensed financial statements for TVA's power program for the three months ended December 31, 2001 and 2000, are unaudited, but in the opinion of management of TVA include all adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of results for such periods. You should read the following information together with the audited financial statements and notes thereto in the current Information Statement. Results for the three months ended December 31, 2001, and for past years are not necessarily indicative of future results.

BALANCE SHEETS

	<u>December 31,</u> <u>2001 (unaudited)</u>	<u>September 30,</u> <u>2001 (audited)</u>
	(Millions)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 11	\$ 339
Accounts receivable	511	720
Inventories (at average cost) and other		
Fuel	191	170
Other	274	272
Total current assets	987	1,501
Property, plant, and equipment		
Completed plant	30,555	30,467
Less accumulated depreciation	(10,583)	(10,344)
Net completed plant	19,972	20,123
Construction in progress	1,169	923
Deferred nuclear generating units	4,094	4,110
Nuclear fuel and capital lease assets	552	487
Total property, plant, and equipment	25,787	25,643
Investment funds	812	725
Deferred charges and other assets		
Loans and other long-term receivables	123	124
Debt issue and reacquisition costs	183	140
Other deferred charges	1,400	1,566
Total deferred charges and other assets	1,706	1,830
Total assets	<u>\$ 29,292</u>	<u>\$ 29,699</u>
LIABILITIES AND PROPRIETARY CAPITAL		
Current liabilities		
Accounts payable	\$ 509	\$ 710
Accrued liabilities	157	235
Accrued interest	312	389
Short-term debt	2,519	3,016
Current maturities of long-term debt	1,984	1,984
Total current liabilities	5,481	6,334
Other liabilities	2,929	2,806
Long-term debt		
Public bonds — senior	20,649	20,375
Unamortized discount and other	(529)	(524)
Total long-term debt	20,120	19,851
Proprietary capital		
Appropriation investment	503	508
Retained earnings	302	306
Accumulated other comprehensive loss	(43)	(106)
Total proprietary capital	762	708
Total liabilities and proprietary capital	<u>\$ 29,292</u>	<u>\$ 29,699</u>

STATEMENTS OF CASH FLOWS (unaudited)

	Three Months Ended December 31,	
	2001	2000
	(Millions)	
Cash flows from operating activities		
Net income	\$ 3	\$ 47
Net items not requiring cash	297	355
Other changes, net	<u>(242)</u>	<u>(158)</u>
Net cash provided by operations	58	244
Cash flows from investing activities		
Construction expenditures	(349)	(209)
Allowance for funds used during construction	14	13
Other, net	<u>(104)</u>	<u>(29)</u>
Net cash used in investing activities	(439)	(225)
Cash flows from financing activities		
Borrowings, net	(224)	(337)
Proceeds from combustion turbine lease/leaseback	320	—
Other	<u>(43)</u>	<u>(15)</u>
Net cash provided by (used in) financing activities	53	(352)
Net change in cash and cash equivalents	<u>\$ (328)</u>	<u>\$ (333)</u>

STATEMENTS OF INCOME (unaudited)

	Three Months Ended December 31,	
	2001	2000
	(Millions)	
Operating revenues		
Sales of electricity		
Municipalities and cooperatives	\$1,301	\$1,456
Industries directly served	162	164
Federal agencies and other utilities	42	74
Other revenue	<u>16</u>	<u>21</u>
Total operating revenues	1,521	1,715
Operating expenses		
Fuel and purchased power	385	480
Operating and maintenance	425	361
Depreciation and amortization	269	327
Tax-equivalents	<u>82</u>	<u>78</u>
Total operating expenses	1,161	1,246
Operating income	360	469
Other income, net	<u>3</u>	<u>6</u>
Income before interest expense	363	475
Interest expense		
Interest on debt	368	420
Amortization of debt discount, issue, and reacquisition costs, net	6	21
Allowance for funds used during construction	<u>(14)</u>	<u>(13)</u>
Net interest expense	360	428
Net income	<u>\$ 3</u>	<u>\$ 47</u>

Results of Operations

TVA had net income of \$3 million for the first quarter of fiscal year 2002 compared with \$47 million for the same period last year.

Operating Revenues

Operating revenues for the three months ended December 31, 2001, were \$1,521 million, compared with \$1,715 million for the same period last year. The \$194 million decrease reflected a weather-related decline in energy sales of 4.3 billion kilowatt-hours (10.7 percent). The TVA service territory experienced unseasonably warm weather this past December as compared with unseasonably cold weather the previous year.

Operating Expenses

Operating expenses declined \$85 million, from \$1,246 million for the three months ended December 31, 2000, to \$1,161 million for the three months ended December 31, 2001. Fuel and purchased power expense decreased \$95 million in conjunction with the reduced sales and generation. Operating and maintenance expenses, on the other hand, increased \$64 million, primarily due to major maintenance projects and increased benefit costs. Depreciation and amortization expense decreased \$58 million, primarily as a result of accelerated amortization in fiscal year 2001.

Interest Expense

Net interest expense declined \$68 million for the first quarter of fiscal year 2002, compared with the same period last year reflecting a lower level of total outstanding debt in addition to refinancing bonds at favorable interest rates. The decrease in amortization of debt discount, issue and reacquisition costs is a result of accelerated amortization in fiscal year 2001.

Liquidity and Capital Resources

Since January 1, 2002, TVA has offered 7 issues of electronotesSM totaling \$197 million. In addition, TVA is planning to issue another installment of electronotesSM on April 25, 2002 in the amount of \$14 million.

Other Matters

TVA and the Knoxville Utilities Board (“KUB”) have completed the negotiation of an amendment to their power contract which provides more flexibility for KUB in three areas: (1) KUB will have the authority to set retail rates for its customers. (In the past, TVA regulated these rates for KUB.) (2) TVA will not collect stranded costs from KUB after 2007. (3) KUB has the right to cancel its contract with TVA after five years’ notice beginning October 1, 2002 instead of after ten years’ notice. (TVA retained its right to cancel the contract on ten years’ notice.) KUB is one of the five largest distributors of TVA power, serving 390,000 customers in Knox County and parts of seven adjacent counties in Tennessee. The contract amendment is being prepared and will soon be processed for execution.

Financial Position

Net cash provided by operations decreased \$186 million from \$244 million to \$58 million, for the three months ended December 31, 2000 and 2001, respectively. Net income declined \$44 million, from \$47 million for the first quarter of fiscal year 2001 to \$3 million for the first quarter of fiscal year 2002. Items not requiring cash decreased by \$58 million, and working capital requirements increased by \$84 million, primarily as a result of a decrease in accounts payable and other accrued expenses.

Net cash used in investing activities increased by \$214 million, for the first quarter of fiscal year 2002. Cash used for construction expenditures increased \$140 million for the reporting period, and cash paid for nuclear enrichment and fabrication services increased \$73 million due to the timing of services received.

Cash flows provided by financing activities increased \$405 million, from a net use of funds of \$352 million for the three months ended December 31, 2000, to funds of \$53 million provided by financing activities for the three months ended December 31, 2001. Borrowings decreased \$224 million in the first quarter of fiscal year 2002 as compared with \$337 million in the first quarter of fiscal year 2001. Proceeds received from combustion turbine financing in the current year were \$320 million, and the associated liability is included on the Balance Sheet in Other Liabilities. The increase in other financing costs of \$28 million is due to a valuation adjustment on a currency swap contract.

THE EXCHANGE OFFER

TVA hereby offers, upon the terms and subject to the conditions set forth in this Offering Circular and in the Letter of Transmittal, to exchange New Bonds for any and all of the Old Bonds that are validly tendered at or prior to the Expiration Time. TVA will accept tenders of Old Bonds only in principal amounts of \$1,000 or integral multiples of \$1,000. The Exchange Offer will commence on Tuesday, April 23, 2002, and will expire at 5:00 p.m., New York City time, on Thursday, April 25, 2002, unless extended by TVA in its sole discretion.

Holder and beneficial owners of Old Bonds may choose to participate in the Exchange Offer by following the procedures described herein.

Terms of the Exchange Offer

Subject to the terms and conditions set forth in this Offering Circular and in the Letter of Transmittal, TVA is offering to exchange up to \$984,000,000 aggregate principal amount of New Bonds described below in exchange for any and all of the \$984,000,000 aggregate principal amount of the Old Bonds described below.

For each \$1,000 Principal Amount of the Following Old Bonds	The Exchanging Holders will Receive \$1,000 Principal Amount of the Following New Bonds
7.14% Power Bonds 2000 Series F due May 23, 2012 CUSIP No. 880591 DL3*	6.79% Power Bonds 2002 Series A due May 23, 2012 CUSIP No. 880591 DT6*

* The CUSIP number is provided solely as a convenience to Holders. No representation is made as to the correctness or accuracy of the CUSIP number set forth herein, and the terms of the Exchange Offer shall not be affected by any defect in such CUSIP number.

Accrued but unpaid interest on the Old Bonds to, but excluding, the Exchange Date will be paid to the Holders of the Old Bonds exchanged pursuant to the Exchange Offer on the Exchange Date (rather than on the regularly scheduled interest payment date). Interest will cease to accrue on and after the Exchange Date for Old Bonds exchanged pursuant to the Exchange Offer. The accrued interest for the Old Bonds validly tendered and accepted for exchange will be paid to such Holders in immediately available (same-day) funds on the Exchange Date.

Upon consummation of the Exchange Offer, TVA will cause the Old Bonds accepted by TVA for exchange pursuant to the Exchange Offer to be cancelled through the Federal Reserve Banks, as Fiscal Agent.

The terms of the New Bonds will be substantially the same in all material respects as the terms of the Old Bonds except that (i) the New Bonds will be repayable at the option of the beneficial owner, together with the Holder thereof, on May 24, 2004 (rather than May 23, 2002), and (ii) the interest rate on the New Bonds will be 6.79% (rather than 7.14%). See "Description of New Bonds".

Expiration Time; Extensions; Amendments

The Exchange Offer will expire at 5:00 p.m., New York City time, on Thursday, April 25, 2002, subject to extension by TVA as herein provided (the "Expiration Time").

TVA expressly reserves the right, in its sole discretion, subject to applicable law, at any time or from time to time, to (i) waive any condition to the Exchange Offer and accept all Old Bonds previously tendered for exchange pursuant to the Exchange Offer, (ii) extend the Expiration Time of the Exchange Offer and retain all Old Bonds tendered pursuant thereto, and/or (iii) amend the Exchange Offer in any respect until the Old Bonds are accepted for exchange. Currently, TVA has no intention of amending the Exchange Offer.

Any extension or amendment of the Exchange Offer may be made by TVA giving written or oral notice thereof to the Information Agent, to be followed as promptly as practicable by a public announcement thereof. In the case of an extension, a public announcement will be issued prior to 8:45 a.m., New York City time on the next business day after the previously scheduled Expiration Time of the Exchange Offer. Without limiting the manner in which TVA may choose to make any public announcement, TVA shall have no obligation to publish, advertise or otherwise communicate any such public announcement other than by making a release to the Dow Jones News Service or otherwise as required by law. All Old Bonds tendered pursuant to the Exchange Offer prior to any extension will remain subject to the Exchange Offer.

The terms of any amendment of the Exchange Offer may vary from the original Exchange Offer depending on such factors as the principal amount of Old Bonds previously tendered. Any amendment of the Exchange Offer will apply to all Old Bonds tendered for exchange pursuant to the Exchange Offer.

If TVA makes a change to the Exchange Offer which in the opinion of the Board of Directors of TVA adversely affects the Holders or the respective beneficial owners of the Old Bonds so tendered, TVA will provide a supplement to the Offering Circular or other additional exchange offer materials describing such amendment and will extend the Exchange Offer for a period sufficient for the Holders and beneficial owners to review such material; provided, however, that TVA shall not be required to extend the Exchange Offer for a period greater than the period of the original Exchange Offer. See “Withdrawal Rights”.

Effect of Tender

By submitting the Letter of Transmittal, the Holder agrees to deliver such Old Bonds as are identified therein to the Exchange Agent free and clear of all liens, charges, claims, encumbrances, interest and restrictions of any kind in accordance with the Exchange Offer and the Letter of Transmittal. Upon tender of Old Bonds pursuant to the Letter of Transmittal, TVA will, subject to the conditions of the Exchange Offer and the Letter of Transmittal, become obligated to issue the corresponding principle amount of New Bonds to such Holder on the Exchange Date.

Procedures for Exchanging Old Bonds

Holders and beneficial owners of Old Bonds wishing to participate in the Exchange Offer must deliver the Letter of Transmittal and tender Old Bonds in accordance with the procedures set forth herein and in the Letter of Transmittal. The delivery of the Letter of Transmittal, Old Bonds through the Federal Reserve Banks, and all other required documents is at the risk of the tendering beneficial owners and Holders, and delivery with respect to each item will be deemed made when actually received by the Exchange Agent. To tender Old Bonds pursuant to the Exchange Offer, Holders must complete, sign and deliver to the Exchange Agent, via facsimile to the number indicated in the Letter of Transmittal, the Letter of Transmittal and any other documents required therein, in accordance with the instructions therein at or prior to the Expiration Time. The Letter of Transmittal must be signed by the Holder of Old Bonds tendered thereby.

Delivery of Old Bonds. All tendered Old Bonds must be delivered no later than 9:30 a.m., New York City time on Thursday, May 2, 2002 through the Federal Reserve Banks book-entry system (as defined herein) to the account of the Exchange Agent. Old Bonds may only be wired to the Exchange Agent no later than 9:30 a.m., New York City time on Thursday, May 2, 2002 in accordance with the normal delivery procedures of the Federal Reserve Banks book-entry system.

Tender of Old Bonds Held Through a Nominee. Any beneficial owner of Old Bonds who wishes to tender Old Bonds that are held of record by a custodian bank, depository, broker, trust company or other nominee should contact such entity promptly and instruct such entity to tender the Old Bonds on such

beneficial owner's behalf according to the procedures described herein and in the Letter of Transmittal. An instruction letter is contained in the solicitation materials provided along with this Offering Circular which may be used by a beneficial owner to instruct the Holder to tender Old Bonds.

No alternative, conditional, irregular or contingent tenders will be accepted. By executing the Letter of Transmittal (or facsimile thereof), the tendering Holders of Old Bonds waive any right to receive any notice of the acceptance for exchange of their Old Bonds.

Tendering Holders should indicate in the applicable box in the Letter of Transmittal the account and other information necessary to enable the Exchange Agent to deliver the New Bonds together with the accrued interest on the Old Bonds. In the case of issuance in a different name, the employer identification or social security number of such different named person also must be indicated and an Internal Revenue Service Substitute Form W-9 for such recipient must be completed (or, if the different named person is not a U.S. Person, an Internal Revenue Service Form W-8BEN or other appropriate W-8 form must be completed for such person). If no such instructions are given, such payments, New Bonds, or Old Bonds not accepted for exchange will be delivered or returned, as the case may be, to the Holder of the Old Bonds tendered through the Federal Reserve Banks book-entry system to the account from which such Old Bonds were delivered.

Determination of Validity. All questions as to the validity, form, eligibility (including time of receipt) and acceptance of tendered Old Bonds pursuant to the procedures described above will be determined by TVA in its sole discretion, which will be final and binding. TVA reserves the absolute right to reject any or all tenders of Old Bonds determined by it not to be in proper form or the acceptance of which may, in the opinion of counsel for TVA, be unlawful. TVA also reserves the absolute right, in its sole discretion, subject to applicable law, to waive any of the conditions of the Exchange Offer or any defects or irregularities of any tender as to Old Bonds, whether or not similar defects or irregularities are waived in the case of other tendered Old Bonds. TVA's interpretation of the terms and conditions of the Exchange Offer (including the instructions in the Letter of Transmittal) will be final and binding. Unless waived by TVA, any irregularities in connection with tenders must be cured within such time as TVA shall determine. None of TVA, the Exchange Agent, the Information Agent, the Federal Reserve Banks and the Dealer Manager shall be under any duty to give notification of defects in any tenders or shall incur liabilities for failure to give such notification. Tenders of Old Bonds will not be deemed to have been made until such irregularities have been cured or waived. Any Old Bonds received by the Exchange Agent that are not validly tendered and as to which the irregularities have not been cured or waived will be returned by the Exchange Agent to the tendering Holder, unless otherwise provided in the Letter of Transmittal, as soon as practicable following the Expiration Time.

Transfer Taxes. TVA will pay all transfer taxes, if any, applicable to the transfer of Old Bonds to it pursuant to the Exchange Offer where the legal incidence of the taxes is on the beneficial owner. If, however, New Bonds are to be delivered to, or are to be registered or issued in the name of, any person other than the Holder of Old Bonds tendered, or if tendered Old Bonds are registered in the name of any person other than the person signing the Letter of Transmittal, or if a transfer tax is imposed for any reason other than the transfer or sale of Old Bonds to TVA pursuant to the Exchange Offer, the amount of any such transfer taxes (whether imposed on the Holder or any other persons) will be payable by the beneficial owners. If satisfactory evidence of payment of such taxes or exemption therefrom is not submitted with the Letter of Transmittal, the amount of such transfer taxes will be billed directly to such beneficial owners.

Withdrawal Rights

Tenders of Old Bonds are irrevocable and may not be withdrawn at any time. Notwithstanding the foregoing, any Holders who had previously tendered Old Bonds may withdraw such Old Bonds if TVA amends the Exchange Offer and such amendment, in the opinion of the Board of Directors of TVA, adversely affects such Holders or the respective beneficial owners of the Old Bonds so tendered.

Certain Effects of the Exchange Offer

Old Bonds exchanged pursuant to the Exchange Offer will be cancelled through the Federal Reserve Banks, as Fiscal Agent. The exchange of Old Bonds pursuant to the Exchange Offer will reduce the aggregate

principal amount of Old Bonds that otherwise might trade publicly which could adversely affect the liquidity and market value of the remaining Old Bonds held by the public.

Dealer Manager

TVA has engaged Morgan Stanley to act as exclusive Dealer Manager in connection with the Exchange Offer and to provide certain financial advisory services to TVA in connection therewith. Any Holder or beneficial owner who has questions concerning the terms of the Exchange Offer may contact the Dealer Manager at the address and telephone number set forth on the back cover page of this Offering Circular.

TVA has agreed to pay Morgan Stanley predetermined compensation for its Dealer Manager services and to reimburse Morgan Stanley for its reasonable fees and expenses of outside legal counsel. TVA has agreed to indemnify Morgan Stanley against certain liabilities, including certain liabilities under the federal securities laws. Morgan Stanley has provided in the past, and currently is providing, other investment banking and financial advisory services to TVA.

Exchange Agent

Computershare Trust Company of New York has been appointed as Exchange Agent for the Exchange Offer. Transmittal letters must be faxed to the Exchange Agent at the number set forth on the back cover page of this Offering Circular to constitute a valid delivery. In addition, all tendered Old Bonds must be delivered through the Federal Reserve Banks book-entry system to the account of the Exchange Agent. See “Procedures for Exchanging Old Bonds”.

Information Agent

D.F. King & Co., Inc. has been appointed as Information Agent for the Exchange Offer. Requests for assistance or additional copies of this Offering Circular or the Letter of Transmittal may be directed to the Information Agent at the address and telephone numbers set forth on the back cover page of this Offering Circular. Beneficial owners of Old Bonds may also contact their broker, dealer, commercial bank or trust company for assistance concerning the Exchange Offer. TVA will pay the Information Agent reasonable and customary fees for its services and will reimburse it for its reasonable out-of-pocket expenses in connection with reimbursement of reasonable expenses incurred by brokerages houses and other custodians and handling Exchange Offer documents and forwarding tenders.

DESCRIPTION OF NEW BONDS

General

The New Bonds are to be issued pursuant to authority vested in TVA by the Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution adopted on October 6, 1960, as amended on September 28, 1976, October 17, 1989 and March 25, 1992 (the “Basic Resolution”), and the Supplemental Resolution authorizing the New Bonds adopted as of February 17, 1999 (the “Supplemental Resolution” and together with the Basic Resolution, the “Resolutions”). TVA has entered into a Fiscal Agency Agreement dated as of October 17, 1989 (the “Fiscal Agency Agreement”) with the Federal Reserve Banks, as fiscal agents (together, the “Fiscal Agent”). The Secretary of the Treasury has approved the time of issuance of, and the maximum rate of interest to be borne by, the New Bonds in compliance with Section 15d(c) of the Act. The New Bonds represent obligations of TVA payable solely from TVA’s Net Power Proceeds and are not obligations of, or guaranteed by, the United States of America.

The Act authorizes TVA to issue and sell bonds, notes and other evidences of indebtedness (hereinafter collectively referred to as “Evidences of Indebtedness”) to assist in financing its power program and to refund such Evidences of Indebtedness. Evidences of Indebtedness issued pursuant to Section 2.2 of the Basic Resolution designated as Tennessee Valley Authority Power Bonds are herein referred to as “Power Bonds”. The aggregate amount of Evidences of Indebtedness at any one time outstanding is limited to \$30 billion. As

of December 31, 2001, TVA had approximately U.S. \$23.5 billion, DM 1.5 billion (issued in September 1996) and £450 million (issued in December 1998 and July 2001) of Evidences of Indebtedness outstanding. When TVA issued its DM and British pound sterling Evidences of Indebtedness, TVA entered into currency swap agreements to hedge against fluctuations in the exchange rates of these currencies. For information with respect to TVA's Power Bonds and the Basic Resolution, see "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Issuance of Additional Bonds and Other Evidences of Indebtedness" in the current Information Statement.

The summaries herein of certain provisions of the Act, the Resolutions and the Fiscal Agency Agreement do not purport to be complete and are qualified in their entirety by reference to all the provisions of the Act, the Resolutions and the Fiscal Agency Agreement, copies of which (in reasonable quantities) may be obtained upon written request directed to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902-1401, Attention: Investor Relations, or by calling 1-888-882-4975.

The New Bonds will be Power Bonds as defined above and will be payable as to both principal and interest solely from TVA's Net Power Proceeds, which are defined as the remainder of TVA's Gross Power Revenues (as defined in the Basic Resolution) after deducting the costs of operating, maintaining, and administering its power properties (including multiple-purpose properties in the proportion that multiple-purpose costs are allocated to power) and payments to states and counties in lieu of taxes, but before deducting depreciation accruals or other charges representing the amortization of capital expenditures, plus the net proceeds of the sale or other disposition of any Power Facility (as defined in the Basic Resolution) or interest therein. The Act also requires TVA to make certain payments to the Treasury each year from Net Power Proceeds in excess of those required for debt service as a return on and reduction of the Appropriation Investment (as defined in the Basic Resolution). See "Certain Provisions of the Tennessee Valley Authority Act" — "Payments to the Treasury" in the current Information Statement.

The New Bonds rank equally as to the application of Net Power Proceeds with all other Power Bonds. As to the application of Net Power Proceeds, Power Bonds presently rank on parity with other Evidences of Indebtedness as to principal and interest. See "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Fourth Amendatory Resolution to the Basic Resolution" in the current Information Statement. For a further discussion of the application of Net Power Proceeds, see "Certain Provisions of the Tennessee Valley Authority Act" and "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Application of Net Power Proceeds" in the current Information Statement.

There is no limit on other indebtedness or securities which may be issued by TVA and no financial or similar restrictions on TVA, except as provided under the Act, the Basic Resolution and the Supplemental Resolution. TVA issues its Discount Notes pursuant to Section 15d of the Act and in accordance with Section 2.5 of the Basic Resolution. TVA may also issue Other Indebtedness in addition to Power Bonds and Discount Notes. Other Indebtedness are issued pursuant to Section 15d of the Act and under appropriate authorizing resolutions. See "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" in the current Information Statement.

In accordance with Public Law No. 105-62, enacted in 1997, TVA is required, in the absence of sufficient appropriations, to fund nonpower programs that constitute "essential stewardship activities" with revenues derived from one or more of various sources, including power program revenues, notwithstanding provisions of the Act and Resolutions to the contrary. See the discussion of Public Law No. 105-62 in "Public Law No. 105-62" in the current Information Statement. Under the Supplemental Resolution, actions taken pursuant to Public Law No. 105-62 shall not be considered an event of default or breach under the Resolutions.

Possible Future Issuances

The Supplemental Resolution provides that, at the option of TVA, additional New Bonds may be issued in one or more future installments pursuant to an amendment to the Supplemental Resolution not requiring the consent of Holders of New Bonds. Additional New Bonds so issued shall be identical in all respects to the

New Bonds offered hereby (with any related changes, including changes in the issue date, issue price, and interest commencement date).

Payment of Principal and Interest

The New Bonds will consist of up to \$984,000,000 aggregate principal amount of 6.79% Power Bonds 2002 Series A Due May 23, 2012 (the "Maturity Date"). The New Bonds will be issued in minimum denominations of \$1,000 and integral multiples thereof in book-entry form only through the Federal Reserve Banks as described below under "Book-Entry System". Interest will be payable semi-annually in arrears on May 23 and November 23 (each an "Interest Payment Date") commencing November 23, 2002. Such interest payments will include any interest accrued from, and including, the Exchange Date or the preceding Interest Payment Date, as the case may be, to but excluding the relevant Interest Payment Date. Interest shall be computed on the basis of a 360-day year of twelve 30-day months. The principal amount of all New Bonds, together with the interest accrued and unpaid thereon, is due in full on the Maturity Date. Payments of principal and interest on the New Bonds will be made on the applicable payment dates to Holders of the New Bonds which are Holders as of the close of business on the Business Day preceding such payment dates, by credit of the payment amount to the Holders' accounts at the Federal Reserve Banks. The Holder and each other financial intermediary in the chain to the beneficial owner will have the responsibility of remitting payments for the accounts of their customers.

In any case in which an Interest Payment Date, the repayment date, or the Maturity Date is not a Business Day, payment of principal or interest, as the case may be, shall be made on the next succeeding Business Day with the same force and effect as if made on such Interest Payment Date, the repayment date, or the Maturity Date. The term "Business Day" shall mean any day other than a Saturday or Sunday or a day on which banking institutions in New York City are authorized or required by law or executive order to be closed.

Redemption

The New Bonds will not be subject to redemption prior to maturity.

Repayment

Each of the New Bonds will be repayable on May 24, 2004 at the option of the beneficial owner, together with the Holder thereof, at 100 percent of its principal amount plus accrued interest thereon to the day of repayment. To be repaid, the beneficial owner of a New Bond, together with the Holder of such New Bond, must notify TVA of such election and must return such Bond to TVA, as described below.

Notification of election. A beneficial owner that has elected to have a New Bond owned by it repaid must, together with its Holder, complete the applicable Option to Elect Repayment form, substantially in the form contained herein and in accordance with the instructions contained herein, and which form and instructions will be provided at the Holder's request by TVA. The Holder must then submit such form to TVA. To elect to have a New Bond repaid on May 24, 2004, such form must be received by TVA at the office specified in the instructions for completing the applicable election form no earlier than April 23, 2004 and no later than May 7, 2004. As described under "Book-Entry System" below, a beneficial owner of a New Bond will ordinarily hold the New Bond through a Holder. Therefore, a beneficial owner of a New Bond should determine from the relevant Holder the amount of notice that each such institution will need to comply with the notice provisions for repayment described above. Notice of the exercise of this repayment option by any Holder of a New Bond shall be irrevocable. After receipt of timely notice, TVA will assign a number ("Election Number") to such notice.

Return of New Bond. Any Holder that has submitted to TVA a completed Option to Elect Repayment form for a New Bond, as described above, must also return such New Bond to TVA. If such Holder has elected to have a New Bond repaid on May 24, 2004, such New Bond must be returned to TVA by close of business (for securities transfers on the book-entry system of the Federal Reserve Banks) on May 17, 2004. Such delivery shall be effected by free delivery, without simultaneous payment in exchange therefor, no later than the close of the securities wire on the book-entry system of the Federal Reserve Banks on such day to

TVA's account on the book-entry system of the Federal Reserve Banks. Thereafter, the Holder delivering such New Bond will not be listed on the book-entry system of the Federal Reserve Banks as the Holder or owner of such New Bond. A delivery of a New Bond for repayment that is not accompanied, in the related instructions transmitted on the book-entry system of the Federal Reserve Banks, by the correct corresponding Election Number assigned by TVA may be returned and will not be eligible for repayment on such repayment date.

Book-Entry System

The New Bonds will be issued and maintained and may be transferred only on the book-entry system of the Federal Reserve Banks in minimum principal amounts of \$1,000 and additional integral multiples thereof. The Federal Reserve Banks will maintain book-entry accounts with respect to the New Bonds and will make payments, on behalf of TVA, of interest on and principal of the New Bonds on the applicable payment dates by crediting Holders' accounts at the Federal Reserve Banks. The New Bonds will not be exchangeable for definitive securities.

The foregoing paragraph is a summary of certain provisions of the Fiscal Agency Agreement and does not purport to be a complete statement of all the provisions of such agreement.

Regulations governing the use of the book-entry system for the New Bonds are contained in 18 C.F.R. Part 1314. These regulations and procedures relate primarily to the registration, transfer, exchange and pledge of such obligations. The accounts of Holders on the Federal Reserve Banks' book-entry system are governed by applicable operating circulars of the Federal Reserve Banks. The Federal Reserve Banks' handling of, and rights, duties and obligations with respect to, the New Bonds will be governed exclusively by the applicable operating circulars of the Federal Reserve Banks, TVA's book-entry regulations and such other Federal book-entry regulations as may be applicable, notwithstanding any inconsistent procedures or requirements of any depository or organized exchange.

The New Bonds may be held of record only by entities eligible to maintain book-entry accounts with the Federal Reserve Banks. Such entities whose names appear on the book-entry records of a Federal Reserve Bank as the entities for whose accounts the New Bonds or Old Bonds (collectively, the "Bonds") have been deposited are herein referred to as "Holders". A Holder is not necessarily the beneficial owner of a Bond. Beneficial owners will ordinarily hold Bonds through one or more financial intermediaries, such as banks, brokerage firms and securities clearing organizations. A Holder that is not the beneficial owner of a Bond, and each other financial intermediary in the chain to the beneficial owner, will have the responsibility of establishing and maintaining accounts for their respective customers. The rights of the beneficial owner of a Bond with respect to TVA and the Federal Reserve Banks may be exercised only through the Holder thereof. TVA and the Federal Reserve Banks will have no direct obligation to a beneficial owner of a Bond that is not also the Holder of such Bond. The Federal Reserve Banks will act only upon the instructions of Holders in recording transfers of the Bonds.

Governing Law

The Fiscal Agency Agreement and the New Bonds shall be governed by and construed in accordance with the laws of the State of New York, to the extent such law is not inconsistent with federal law.

Listing

Application will be made to list the New Bonds on the New York Stock Exchange.

LEGALITY OF INVESTMENT

Each person or entity is advised to consult with its own counsel with respect to the legality of investment in the New Bonds. Generally, the following describes the legality of investment in Power Bonds.

Power Bonds are lawful investments and may be accepted as security for all fiduciary, trust and public funds, the investment or deposit of which shall be under the authority or control of any officer or agency of the United States of America. 16 U.S.C. § 831n-4(d).

Power Bonds are acceptable as collateral for Treasury tax and loan accounts pursuant to 31 C.F.R. § 203.24(e) and 31 C.F.R. § 380.3.

National banks may deal in, underwrite and purchase Power Bonds for their own accounts in an amount not to exceed ten percent of unimpaired capital and surplus. 12 U.S.C. § 24, seventh paragraph.

Federal Reserve Banks may accept Power Bonds as eligible collateral for advances to member banks. 12 U.S.C. § 347 and 12 C.F.R. § 201.108(b)(13).

Federal savings associations and federal savings banks may, to the extent specified in applicable regulations, invest in Power Bonds without regard to limitations generally applicable to investments. 12 U.S.C. § 1464(c)(1)(F).

Power Bonds are eligible as collateral for advances by Federal Home Loan Banks to members for which Power Bonds are legal investments. 12 U.S.C. § 1430(a) and 12 C.F.R. § 935.9(a)(2).

Federal credit unions may purchase Power Bonds, subject to applicable regulations. 12 U.S.C. § 1757(7)(E) and 12 C.F.R. Part 703.

Power Bonds are “obligations of a corporation which is an instrumentality of the United States” within the meaning of Section 7701(a)(19)(C)(ii) of the Internal Revenue Code for purposes of the 60 percent of assets limitation applicable to building and loan associations.

TAXES

The following tax discussion has been prepared by Orrick, Herrington & Sutcliffe LLP, as special tax counsel to TVA. This discussion of the United States federal income tax consequences of the Exchange Offer and the United States federal income and certain other tax consequences of the ownership and disposition of the New Bonds is based upon laws, regulations, rulings and decisions in effect on the date hereof, which are subject to change. This discussion does not address all aspects of United States federal income taxation that may be relevant to a particular investor in light of its personal investment circumstances or to certain types of investors subject to special treatment under the United States federal income tax laws (for example, banks, brokers, dealers, life insurance companies, tax-exempt organizations and, with limited exceptions, foreign investors) and generally does not address state and local taxation. Further, this discussion is limited to persons who acquire New Bonds pursuant to the Exchange Offer and who held the Old Bonds and who will hold the New Bonds as capital assets, and does not deal with United States federal income tax consequences applicable to persons who held the Old Bonds or will hold the New Bonds in the ordinary course or as an integral part of their trade or business, or as part of a hedging, integrated, conversion or straddle transaction or persons whose functional currency is not the U.S. dollar. Further, this discussion does not address alternative minimum tax consequences or the effects on holders of equity interests in a holder of an Old Bond or of a New Bond.

Each person or entity participating in the Exchange Offer is urged to consult with its own tax advisor with respect to the United States federal, state and local tax consequences associated with its participation in the Exchange Offer and its acquisition, ownership and disposition of a New Bond, as well as the tax consequences arising under the laws of any other taxing jurisdiction, and may not construe the following discussion as legal advice. In this regard, it should be noted that neither the Old Bonds nor the New Bonds are subject to redemption by reason of the imposition of withholding or other tax by any jurisdiction, and that TVA has no obligation to pay additional interest or other amounts if any withholding or other tax is imposed on payments on the Old Bonds or New Bonds (including any withholding tax that may be imposed as the result of a failure to provide an applicable United States Internal Revenue Service (“IRS”) form).

For purposes of this section (“Taxes”), “U.S. Person” means a citizen or resident of the United States, or a corporation or (except as may be provided in Treasury Regulations) partnership organized in or under the

laws of the United States or any political subdivision thereof, an estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source or a trust if a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust. The term “U.S. beneficial owner” includes any U.S. Person which is a beneficial owner of an Old Bond or a New Bond and any person which is a beneficial owner of such a Bond that is otherwise subject to United States federal income taxation on a net income basis in respect of income attributable to the Old Bonds or New Bonds.

Tax Considerations Applicable To Beneficial Owners Of Old Bonds

Set forth below in a discussion of the primary United States federal income tax considerations applicable to beneficial owners of Old Bonds who participate in the Exchange Offer. Persons participating in the Exchange Offer should also review the section entitled “Tax Considerations Applicable To Beneficial Owners Of New Bonds” for a description of the primary United States federal income and certain other tax consequences applicable to the ownership and disposition of the New Bonds.

U.S. Beneficial Owners Who Tender Old Bonds in the Exchange Offer

Assuming (as is likely) that the Exchange Offer does not constitute a “recapitalization” for United States federal income tax purposes and subject to the discussion set forth below relating to “significant modifications”, a U.S. beneficial owner who participates in the Exchange Offer will recognize capital gain or (subject to the “wash sale” rules described below) loss in an amount equal to the difference between the issue price of the New Bonds (other than the amount, if any, in respect of accrued interest) and the U.S. beneficial owner’s adjusted tax basis of the Old Bonds surrendered. The “issue price” of the New Bonds will equal (i) if the New Bonds are traded on an established securities market at anytime during the sixty-day period ending thirty days after the Exchange Date, the fair market value of the New Bonds on the Exchange Date; (ii) if the New Bonds are not so traded but the Old Bonds are traded on an established securities market anytime during such sixty-day period, the fair market value of the Old Bonds on the Exchange Date; or (iii) if neither the Old Bonds nor the New Bonds are traded on an established securities market within such sixty-day period, the stated principal amount of the New Bonds.

An exception to the capital gain or loss treatment described above applies to a U.S. beneficial owner who holds Old Bonds with “market discount”. Market discount is the amount by which the U.S. beneficial owner’s basis in its Old Bonds immediately after their acquisition is exceeded by the stated redemption price at maturity of the Old Bonds. If, however, such excess is less than $\frac{1}{4}$ of 1% of the stated redemption price at maturity of the Old Bonds multiplied by the number of complete years from the U.S. beneficial owner’s acquisition date of the Old Bonds to their maturity date, the Old Bonds will generally have no market discount. The gain, if any, realized on the exchange of Old Bonds for New Bonds pursuant to the Exchange Offer by a U.S. beneficial owner of market discount Old Bonds will be treated as ordinary income to the extent of the market discount that has accrued from the U.S. beneficial owner’s acquisition date to the Exchange Date, unless the U.S. beneficial owner has elected to include market discount in income currently as it accrues. Any gain in excess of such accrued market discount will be subject to the capital gains rules described above. Generally, market discount obligations do not include debt obligations that are acquired at their original issue. If a U.S. beneficial owner had interest expense attributable to market discount Old Bonds which interest expense was not allowed as a deduction under Section 1277(a) of the Internal Revenue Code (the “Code”), such interest expense may be allowable in whole or in part upon such beneficial owner’s disposition of the Old Bonds. U.S. beneficial owners of Old Bonds having market discount should consult their own tax advisors as to the effect to them of the market discount rules on the exchange of Old Bonds for New Bonds pursuant to the Exchange Offer.

The cash received on the Exchange Date by a U.S. beneficial owner participating in the Exchange Offer which is attributable to interest accrued on the Old Bonds up to (but excluding) the Exchange Date will be taxable as ordinary income in accordance with the U.S. beneficial owner’s method of accounting for U.S. federal income tax purposes.

It should be noted that the ability of a U.S. beneficial owner to recognize a loss in connection with the exchange of Old Bonds for New Bonds pursuant to the Exchange Offer might be limited by the “wash sale” rules, which apply to exchanges of “substantially identical” securities. Thus, if the New Bonds were viewed as substantially identical to the Old Bonds, a U.S. beneficial owner would not be permitted to recognize a loss on the Exchange Offer, and the amount of the disallowed loss would be added to the U.S. beneficial owner’s basis in the New Bonds.

U.S. beneficial owners that tender their Old Bonds in the Exchange Offer may also wish to consider the possibility that the exchange of Old Bonds for New Bonds does not constitute an “exchange” for United States federal income tax purposes but, rather, constitutes a modification of the Old Bonds that is not a “significant modification”. Under this characterization of the Exchange Offer, neither gain nor loss would be recognized in the exchange; the New Bonds would not be considered newly issued for tax purposes and each U.S. beneficial owner’s basis and holding period in the New Bonds immediately after the exchange would equal the owner’s basis and holding period in the Old Bonds immediately before the exchange. U.S. beneficial owners participating in the Exchange Offer are urged to consult their own tax advisors as to whether the exchange of Old Bonds for New Bonds is properly characterized as other than an exchange for United States federal income tax purposes.

Non-U.S. Beneficial Owners Who Tender Old Bonds in the Exchange Offer

Generally, any amount which constitutes capital gain to a non-U.S. beneficial owner of an Old Bond (that is, a beneficial owner that is not a U.S. Person and that has no connection with the United States other than holding an Old Bond) who tenders its Old Bonds in the Exchange Offer will not be subject to United States federal income tax. However, an individual non-U.S. beneficial owner will be subject to Federal income tax on any gain recognized in the Exchange Offer if the individual is present in the United States for 183 days or more during the taxable year that includes the Exchange Date.

Beneficial Owners Who Do Not Tender Old Bonds in the Exchange Offer

A beneficial owner (whether a U.S. beneficial owner or not) whose Old Bonds are not exchanged in the Exchange Offer will not recognize any gain or loss for United States federal income tax purposes as a result of the Exchange Offer.

Backup Withholding

A beneficial owner participating in the Exchange Offer may be subject to United States federal income tax backup withholding at the rate of 30 percent with respect to interest and the proceeds (including the New Bonds) realized in connection with the Exchange Offer unless such beneficial owner: (i) is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact, (ii) in the case of a U.S. beneficial owner, provides a correct taxpayer identification number to the Exchange Agent, certifies as to no loss of exemption from backup withholding, and otherwise complies with the applicable requirements of the backup withholding rules or (iii) in the case of a non-U.S. beneficial owner, certifies as to its foreign status to the Exchange Agent under penalties of perjury. Any amount withheld under these rules (which will generally be effected by withholding New Bonds from the exchange) will be credited against the beneficial owner’s United States federal income tax liability. To prevent backup withholding each beneficial owner should complete and sign a substitute Form W-9 or an Internal Revenue Service Form W-8BEN (as appropriate) which are included as part of the Letter of Transmittal, and return one of the forms to the Exchange Agent. If withholding results in an overpayment of taxes, a refund may generally be obtained by such beneficial owner from the United States Internal Revenue Service.

Tax Considerations Applicable to Beneficial Owners of New Bonds

U.S. Beneficial Owners

A U.S. beneficial owner is subject to United States federal income taxation on income on a New Bond, and there is no special exemption for such a New Bond from United States federal estate and gift tax. The Act, however, provides that the New Bonds are exempt both as to principal and interest from all taxation now

or hereafter imposed by any state or local taxing authority except estate, inheritance and gift taxes. This exemption might not extend to franchise or other non-property taxes in lieu thereof imposed on corporations or to gain or loss realized upon the sale or exchange of a New Bond notwithstanding that such gain might in some cases be treated as interest income for United States federal income tax purposes.

Upon a sale or exchange of a New Bond, a U.S. beneficial owner generally will recognize capital gain or loss equal to the difference between the amount realized on the sale or exchange and the beneficial owner's adjusted basis for the New Bond.

If either the Old Bonds or the New Bonds are traded on an established market within the sixty-day period ending thirty days after the Exchange Date, the New Bonds may have original issue discount ("OID") or bond premium in an amount equal to the difference between their issue price (determined as described above under "Tax Considerations Applicable to Beneficial Owners of Old Bonds" — "U.S. Beneficial Owners Who Tender Old Bonds in the Exchange Offer") and their stated principal amount (unless the exchange of Old Bonds for New Bonds does not constitute an "exchange" for United States federal income tax purposes, as discussed above). If any loss realized in the Exchange Offer is disallowed under the wash sale rules discussed above under "Tax Considerations Applicable To Beneficial Owners Of Old Bonds" — "U.S. Beneficial Owners Who Tender Old Bonds in the Exchange Offer", the amount of OID will generally be offset, or the amount of bond premium will generally be increased, by the amount of the disallowed loss. If the New Bonds are issued with OID (in excess of a statutorily defined de minimis amount), U.S. beneficial owners will be required to include this OID in income on an accrual basis (and on the basis of a constant yield) over the period beginning on the Exchange Date and ending on May 24, 2004, and thus would be required to include amounts in income prior to the date such income is actually paid in cash. If the New Bonds are issued with bond premium, U.S. beneficial owners may elect to amortize this bond premium, using a constant yield method, over the remaining term of the New Bonds. Such an election, if made, would apply to all taxable debt obligations then owned or thereafter acquired by the U.S. beneficial owner and is irrevocable without the consent of the IRS.

Non-U.S. Beneficial Owners

Generally, a non-U.S. beneficial owner will not be subject to United States federal income taxation on interest on a New Bond. To qualify for the exemption from taxation, the last U.S. Person in the chain of payment prior to payment to a non-U.S. beneficial owner (the "Withholding Agent") must have received in the year in which such a payment occurs, or in either of the two preceding years, a statement that (i) is signed by the beneficial owner under penalties of perjury, (ii) certifies that such owner is not a U.S. beneficial owner, and (iii) provides, among other items, the name and address of the beneficial owner. The statement may be made on an Internal Revenue Service Form W-8BEN or substantially similar substitute form ("W-8"), and the beneficial owner must inform the Withholding Agent of any change in the information on the statement within 30 days of such change. In certain cases, the certification can be provided by a securities clearing organization or by certain other financial institutions and qualified intermediaries pursuant to recently finalized Treasury Regulations (the "New Regulations") provided that the non-U.S. beneficial owner has provided such entity with appropriate certification on documentation establishing its foreign status. Additionally, the New Regulations require, in the case of New Bonds held by a foreign partnership, that (a) the certification described above be provided by the partners rather than by the foreign partnership and (b) the partnership provide certain information, including a U.S. taxpayer identification number. A look-through rule applies in the case of tiered partnerships. Holders are urged to consult their own tax advisors regarding the effect and application of the New Regulations.

Generally, any amount which constitutes capital gain to a non-U.S. beneficial owner upon retirement or disposition of a New Bond will not be subject to United States federal income taxation. Certain exceptions may be applicable and individual non-U.S. beneficial owners are particularly urged to consult their own tax advisors. Generally, the New Bonds will not be includible in the federal estate of a non-U.S. beneficial owner.

Backup Withholding

Backup withholding of United States federal income tax at a rate of 30 percent (scheduled to be incrementally reduced to 28% over the next five years) may apply to payments made in respect of the New

Bonds to beneficial owners who are not exempt recipients and who fail to provide certain identifying information (such as the beneficial owner's taxpayer identification number) in the manner required. Generally, individuals are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients. Compliance with the identification procedures described under "Non-U.S. Beneficial Owners" above would establish an exemption from backup withholding for those non-U.S. beneficial owners who are not exempt recipients.

In addition, upon the sale of a New Bond to (or through) a broker, the broker must backup withhold unless either (i) the broker determines that the seller is a corporation or other exempt recipient or (ii) the seller provides, in the required manner, certain identifying information and, in the case of a non-U.S. beneficial owner, certifies that such seller is a non-U.S. beneficial owner (and certain other conditions are met). Such a sale must also be reported by the broker to the United States Internal Revenue Service, unless either (i) the broker determines that the seller is an exempt recipient or (ii) the seller certifies its non-U.S. status (and certain other conditions are met). Certification of the beneficial owner's non-U.S. status usually would be made on Internal Revenue Service Form W-8BEN under penalties of perjury, although in certain cases it may be possible to submit other documentary evidence. The term "broker" generally includes all persons who, in the ordinary course of a trade or business, stand ready to effect sales made by others, as well as brokers and dealers registered as such under the laws of the United States or a state. These requirements generally will apply to a United States office of a broker, and the information reporting requirement generally will apply to a foreign office of a United States broker, as well as to a foreign office of a foreign broker if the broker is (i) a controlled foreign corporation within the meaning of Section 957(a) of the Code, (ii) a foreign person 50 percent or more of whose gross income from all sources for the 3-year period ending with the close of its taxable year preceding the payment (or for such part of the period that the foreign broker has been in existence) was effectively connected with the conduct of a trade or business within the United States, or (iii) a foreign partnership if it is engaged in a trade or business in the U.S. or if 50 percent or more of its income or capital interests are held by U.S. Persons.

Generally, any amounts withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or a credit against such beneficial owner's United States federal income tax.

ELECTION FORM
TENNESSEE VALLEY AUTHORITY
6.79% POWER BONDS 2002 SERIES A DUE MAY 23, 2012
CUSIP NUMBER 880591 DT6
OPTION TO ELECT REPAYMENT
ON MAY 24, 2004

To: Tennessee Valley Authority

The undersigned beneficial owner of Tennessee Valley Authority (“TVA”) 6.79% Power Bonds 2002 Series A Due May 23, 2012 (the “Bonds”), together with the Holder (“Depository Institution”) thereof, hereby exercise an option for repayment of the principal amount of Bonds designated below on May 24, 2004 and agree to wire such Bonds to TVA’s account entitled: “TVA General NYC ABA 021038860” by close of business (for securities transfers on the book-entry system of the Federal Reserve Banks) on May 17, 2004, free of charge and bearing the Election Number assigned by TVA as a reference. To be valid, this Election Form must be received by TVA at the office specified in the instructions for completing this Election Form no earlier than April 23, 2004 and no later than May 7, 2004. The undersigned beneficial owner and Depository Institution acknowledge that this election shall have no effect if the Bonds are not timely wired as required above or if the amount of the Bonds wired to TVA for repayment does not correspond exactly to the principal amount designated on line (6) below.

(1) _____
Name of Beneficial Owner

(2) _____
Signature of Beneficial Owner

(3) _____
Name of Depository Institution (Holder)

(4) _____
ABA Account Number

(5) _____
Signature of Depository Institution Representative

(6) _____
Principal Amount to be Repaid

(7) _____
Date of Election

(8) Depository Institution Representative: (9) Wire instructions for payment of principal and interest:

Name:
Phone Number:
Fax Number:
Mailing Address (no P.O. Boxes);

Bank Name:
ABA Number:
Account Name:
Account Number:
Reference (optional):

Election Number* (to be completed by TVA):

* To be assigned by TVA upon receipt of this Election Form. An acknowledgment, in the form of a copy of this document with the assigned Election Number, will be returned to the party and location designated on line (8) above no later than May 14, 2004.

**INSTRUCTIONS FOR COMPLETING ELECTION FORM
AND EXERCISING REPAYMENT OPTION
FOR MAY 24, 2004**

1. Indicate name of beneficial owner on line (1).
2. Affix authorized signature of beneficial owner or its agent on line (2). Signature must be guaranteed by Depository Institution designated on line (3) or the appropriate financial intermediary.
3. Indicate name of Depository Institution holding the book-entry Bonds on the book-entry system of the Federal Reserve Banks on line (3).
4. Insert ABA Account Number of Depository Institution on line (4).
5. Affix authorized signature of Depository Institution's representative on line (5). Signature must be notarized.
6. Indicate the principal amount of Bonds to be repaid on line (6).
7. Indicate date the Election Form was completed on line (7).
8. Indicate name, mailing address (no P.O. boxes, please), telephone number and facsimile-transmission number of the party to whom confirmation of this election may be sent on line (8).
9. Indicate the wire instruction for payment of principal and interest on May 24, 2004 on line (9).
10. Mail or otherwise deliver original copy of the completed Election Form to:

Tennessee Valley Authority
ATTN: Treasurer
400 West Summit Hill Dr.
Knoxville, Tennessee 37902-1401

FACSIMILE TRANSMISSIONS WILL NOT BE ACCEPTED. To be valid, a properly completed Election Form must be received by TVA at the above specified office no earlier than April 23, 2004 and no later than the close of business on May 7, 2004.

11. If confirmation of TVA's receipt of the election, including the assigned Election Number, is not received by May 14, 2004, contact TVA at (865) 632-3366.
12. Arrange for the Depository Institution to wire the principal amount of the Bonds to be repaid to TVA's account entitled "TVA General NYC ABA 021038860", free of charge, by the close of business (for securities transfers on the book-entry system of the Federal Reserve Banks) on May 17, 2004. **THE ELECTION NUMBER MUST ACCOMPANY THE DELIVERY.**

For assistance with this form or any questions relating thereto,
please telephone TVA at (865) 632-3366.

INFORMATION STATEMENT

TENNESSEE VALLEY AUTHORITY

A Wholly Owned Corporate Agency and Instrumentality of the United States of America

The Tennessee Valley Authority (“TVA” or the “Corporation”) presents this Information Statement (this “Statement”) for the information of potential purchasers of (1) its Power Bonds (“Power Bonds”), (2) its Discount Notes (“Discount Notes”) and (3) any other evidences of indebtedness (“Other Indebtedness”) it may issue pursuant to the Tennessee Valley Authority Act of 1933, as amended (the “Act”). TVA issues Power Bonds pursuant to the Act and the Basic Tennessee Valley Authority Power Bond Resolution adopted by the Board of Directors of TVA (the “Board”) on October 6, 1960, as amended on September 28, 1976, October 17, 1989, and March 25, 1992 (the “Basic Resolution”). TVA issues Discount Notes and Other Indebtedness pursuant to the Act and their authorizing resolutions. Power Bonds, Discount Notes and Other Indebtedness are collectively referred to in this Statement as “Evidences of Indebtedness.”

TVA may offer Power Bonds and Other Indebtedness from time to time. TVA may offer Discount Notes for sale on a continuous basis by direct placement or through selected investment dealers, dealer banks, underwriters or underwriting syndicates. For each offering of Power Bonds, except for Power Bonds offered under a program on a continuous basis, TVA will prepare an offering circular describing the specific terms and conditions of the Power Bonds offered. For Power Bonds offered under a program on a continuous basis, TVA will prepare a single offering circular that describes the general terms and conditions common to all securities issued under the program. TVA will also prepare a single offering circular describing the general terms and conditions common to all Discount Notes offerings. For offerings of Other Indebtedness, TVA will either prepare an offering circular describing the specific terms and conditions of the particular offering or a more general offering circular, as TVA deems appropriate. For any offerings made through a program under which Other Indebtedness, Discount Notes or Power Bonds are offered on a continuous basis, the offering circular will describe how, if at all, the offering circular will be supplemented in order to reflect, among other things, the specific terms and conditions of the securities being offered. You should read this Statement, as it may be supplemented or amended, together with the appropriate offering circular, as it may be supplemented or amended, for each offering.

For each offering of an Evidence of Indebtedness, you should rely only on the information contained in (1) this Statement, (2) the relevant offering circular and (3) any supplements or amendments to these documents approved by TVA. TVA has not authorized anyone to provide you with any information that is different from that found in this Statement and each relevant offering circular. This Statement does not constitute an offer to sell or a solicitation of an offer to buy any Evidences of Indebtedness in any jurisdiction to any person to whom it is unlawful to make an offer or solicitation.

This Statement is accurate only as of its date. TVA may supplement, amend or replace this Statement from time to time, generally no more often than annually, to reflect its annual financial results or otherwise as TVA deems appropriate. However, TVA assumes no further duty to update this Statement. You should rely on the most recent supplements or amendments to or replacement of this Statement over different information in this Statement.

You may obtain additional copies of this Statement by writing to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902-1401, Attention: Investor Relations or by calling 1-888-882-4975.

Evidences of Indebtedness are not obligations of the United States of America, and the United States of America does not guarantee the payment of the principal of or interest on any Evidences of Indebtedness. TVA is not required to register Evidences of Indebtedness under the Securities Act of 1933 or to make periodic reports to the Securities and Exchange Commission under the Securities Exchange Act of 1934. TVA does not intend to register any of its Evidences of Indebtedness or file any reports with the Securities and Exchange Commission.

The date of this Information Statement is April 19, 2002.

FORWARD-LOOKING STATEMENTS

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

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

Some examples of forward-looking statements include statements regarding TVA’s projections of future power and energy requirements; future costs related to environmental compliance; impacts of potential legislation on TVA and the likelihood of enactment of such legislation; targets for TVA’s debt reduction and future competitive position; anticipated availability of nuclear waste storage facilities; projections of nuclear decommissioning costs; and impacts of pending litigation and various administrative orders which have been or may be issued.

Although TVA believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws, regulations, and administrative orders, especially those related to the restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA’s generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; changes in accounting standards; and unforeseeable events. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA’s business or cause results to differ materially from those contained in any forward-looking statement.

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

TABLE OF CONTENTS

Information Statement

	<u>Page</u>
Tennessee Valley Authority	1
Selected Financial Data	2
Comparative Five-Year Data	3
Management's Discussion and Analysis of Financial Condition and Results of Operations	4
The Area Supplied by TVA	8
Rates, Customers and Market	8
Competition	10
Power and Energy Requirements	11
Power System	11
Nuclear Power Program	13
Environmental Matters	16
Insurance	19
Pending Litigation	19
Management	20
Employees	21
Certain Provisions of the Tennessee Valley Authority Act	21
The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness	22
Public Law No. 105-62	26
Independent Accountants	27
Financial Statements	F-1
Report of Independent Accountants	F-21
Report of Management	F-22

TENNESSEE VALLEY AUTHORITY

TVA is one of the largest electric power systems in the United States, having produced over 156 billion kilowatt-hours (“kWh”) of electricity in fiscal 2001. TVA is a wholly owned corporate agency and instrumentality of the United States of America established by the Act to develop the resources of the Tennessee Valley region.

Historically, the programs at TVA have consisted of power and nonpower programs. Revenues and expenses of the power program are segregated from other revenues and expenses. Substantially all of TVA’s revenues and assets are attributable to its power program.

The Act requires the power program to be self-supporting from power system revenues and capital TVA raises through its power program financings. The Act authorizes TVA to issue Evidences of Indebtedness in an amount not exceeding \$30 billion outstanding at any one time, the proceeds of which may be used only for the power program. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness.”

Prior to fiscal 2000, congressional appropriations provided most of the funding for TVA’s nonpower programs. TVA has obtained additional funds from revenues and user fees from the nonpower programs. In 1997, Congress enacted appropriations legislation that anticipated no further appropriations for the nonpower programs and required TVA, in the absence of appropriations, to fund certain nonpower programs constituting essential stewardship activities from various sources, which may include power revenues. Because Congress has not provided appropriations for TVA’s nonpower programs since fiscal 1999, TVA primarily is using power funds (along with user fees, other forms of nonpower revenues and nonpower fund balances unused in prior years) for its essential stewardship activities in compliance with the 1997 appropriations legislation. In fiscal 1999, the last year TVA received appropriated funds, it spent a total of approximately \$70 million on essential stewardship activities, \$30 million of which amount was power funds. In fiscal years 2000 and 2001, TVA spent a total of approximately \$70 million on essential stewardship activities, virtually all of which was power funds (*see note 10 of the accompanying Financial Statements — Nonpower programs*), and TVA expects in fiscal 2002 to spend approximately the same amount of power funds on such activities as it did in fiscal 2001. For a further

discussion of this matter see “Public Law No. 105-62.”

Congress reserved the right in the Act to alter, amend or repeal the Act but provided that no amendment or repeal shall operate to impair the obligation of any contract made by TVA in the exercise of any power conferred by the Act. For a discussion of legislation relating to the Act, see “Public Law No. 105-62.”

TVA is administered by a board of three persons appointed by the President and confirmed by the United States Senate (the “Senate”). Appointments are for nine-year staggered terms, with one term expiring each three-year interval. The Board has the sole authority to determine the rates TVA charges for power. The Act requires the rates to be sufficient to cover certain costs. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Rate Covenant” and “Competition.”

The Act requires TVA to annually file a financial statement and complete report as to its business with the President and Congress. The Government Corporation Control Act authorizes the Comptroller General of the United States to periodically audit the transactions of TVA.

Under certain circumstances, the Act permits TVA to borrow up to \$150 million for a period of one year or less from the United States Treasury (the “Treasury”). The Act requires TVA to obtain the approval of the Secretary of the Treasury of the issue date and maximum interest rate for any issuance of an Evidence of Indebtedness with a term of one year or longer. The Office of Management and Budget (“OMB”) includes TVA’s finances as part of the budget of the United States.

Income on Evidences of Indebtedness issued by TVA is subject to United States federal income taxation and various other federal tax consequences. There is no special exemption for Evidences of Indebtedness from federal estate and gift taxes. Under the Act, Evidences of Indebtedness are exempt both as to principal and interest from all taxation now or hereafter imposed by any state or local taxing authority except estate, inheritance and gift taxes. This exemption might not extend to franchise or other nonproperty taxes imposed on corporations or to gain or loss realized upon the sale or exchange of an Evidence of Indebtedness even though such gain might in some cases be treated as interest income for federal income tax purposes.

SELECTED FINANCIAL DATA

The following selected financial data of TVA's power program for the fiscal years 1997 through 2001 have been derived from TVA's audited financial statements. These data should be read in conjunction with the audited financial statements and notes thereto (the "Financial Statements") presented herein.

Condensed Statements of Income (in millions)

	Fiscal Years Ended September 30,				
	2001	2000	1999	1998	1997
Operating revenues	\$ 6,999	\$6,762	\$6,595	\$6,729	\$ 5,934
Operating expenses	<u>5,506</u>	<u>5,019</u>	<u>4,926</u>	<u>4,549</u>	<u>4,080</u>
Operating income	1,493	1,743	1,669	2,180	1,854
Other income (expense), net.....	<u>248</u>	<u>17</u>	<u>10</u>	<u>12</u>	<u>157</u>
Income before interest expense and cumulative effect of change in accounting principle and loss on impairment of assets	1,741	1,760	1,679	2,192	2,011
Net interest expense	1,633	1,736	1,777	1,959	2,003
Cumulative effect of change in accounting principle	—	—	217	—	—
Loss on impairment of assets(a)	<u>(3,419)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net (loss) income	<u><u>\$ (3,311)</u></u>	<u><u>\$ 24</u></u>	<u><u>\$ 119</u></u>	<u><u>\$ 233</u></u>	<u><u>\$ 8</u></u>

Condensed Balance Sheets (in millions)

	September 30,				
	2001	2000	1999	1998	1997
Assets					
Current assets	\$ 1,501	\$ 1,426	\$ 1,318	\$ 1,656	\$ 1,399
Property, plant and equipment	25,643	28,314	28,417	28,891	29,298
Investment funds	725	840	731	578	561
Deferred charges and other assets.....	<u>1,830</u>	<u>2,601</u>	<u>2,920</u>	<u>2,490</u>	<u>2,426</u>
Total Assets	<u><u>\$29,699</u></u>	<u><u>\$33,181</u></u>	<u><u>\$33,386</u></u>	<u><u>\$33,615</u></u>	<u><u>\$33,684</u></u>
Liabilities and Proprietary Capital					
Current liabilities	\$ 6,334	\$ 4,793	\$ 3,117	\$ 4,440	\$ 3,853
Other liabilities	2,806	2,455	2,156	2,007	1,704
Long-term debt	19,851	21,753	23,903	23,020	24,152
Proprietary capital.....	<u>708</u>	<u>4,180</u>	<u>4,210</u>	<u>4,148</u>	<u>3,975</u>
Total Liabilities and Proprietary Capital	<u><u>\$29,699</u></u>	<u><u>\$33,181</u></u>	<u><u>\$33,386</u></u>	<u><u>\$33,615</u></u>	<u><u>\$33,684</u></u>

(a) Non-recurring charge due to the identification of certain assets for which the estimated future cash flows provided through future rates were likely to be less than recorded book values. (See note 1 of the accompanying Financial Statements — Impairment of assets.)

**COMPARATIVE FIVE-YEAR DATA
STATISTICAL AND FINANCIAL SUMMARIES**

	Fiscal Years Ended September 30,				
	2001	2000	1999	1998	1997
Sales (millions of kWh)					
Municipalities and cooperatives	129,760	125,991	122,880	123,330	114,771
Industries directly served	23,306	22,204	22,885	18,514	17,359
Federal agencies and other(a)	8,355	11,376	10,190	21,293	27,198
Total sales	<u>161,421</u>	<u>159,571</u>	<u>155,955</u>	<u>163,137</u>	<u>159,328</u>
Operating revenues (millions of dollars)					
Electric					
Municipalities and cooperatives	\$5,908	\$5,676	\$5,510	\$5,554	\$4,811
Industries directly served	659	626	642	523	464
Federal agencies and other(a)	330	361	357	556	561
Other	102	99	86	96	98
Total revenues	<u>\$6,999</u>	<u>\$6,762</u>	<u>\$6,595</u>	<u>\$6,729</u>	<u>\$5,934</u>
Electric revenue per kWh (cents)	4.27	4.18	4.17	4.07	3.66
Winter net dependable generating capacity (megawatts)					
Hydro(b)	5,677	5,544	5,492	5,491	5,384
Fossil	15,050	15,042	15,049	15,003	15,014
Nuclear units in service	5,715	5,729	5,729	5,620	5,625
Combustion turbine	3,923	3,154	2,232	2,384	2,394
Total capacity	<u>30,365</u>	<u>29,469</u>	<u>28,502</u>	<u>28,498</u>	<u>28,417</u>
System peak load (megawatts) — summer	27,368	29,344	28,295	27,253	26,661
System peak load (megawatts) — winter	27,163	25,940	26,388	23,204	26,670
Percent net generation by fuel source					
Fossil and combustion turbine	65%	63%	63%	62%	61%
Hydro	6%	6%	7%	10%	11%
Nuclear	29%	31%	30%	28%	28%
Fuel cost per kWh (cents)					
Fossil and combustion turbine	1.32	1.27	1.28	1.25	1.23
Nuclear44	.49	.51	.71	.58
Aggregate fuel cost per kWh net thermal generation	1.08	1.05	1.05	1.10	1.04
Fuel data					
Net thermal generation (millions of kWh) ..	146,806	143,224	137,169	139,727	135,735
Billion Btu	1,505,504	1,470,452	1,403,110	1,426,151	1,381,837
Fuel expense (millions of dollars)	1,588	1,504	1,434	1,538	1,406
Cost per million Btu (cents)	105.47	102.29	102.21	107.81	101.73
Net heat rate, fossil only (average Btu per kWh)	10,255	10,267	10,229	10,207	10,180

(a) Sales and revenues have been adjusted to include sales to other utilities.

(b) Includes 405 megawatts of dependable capacity from the U.S. Army Corps of Engineers' projects on the Cumberland River System.

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

Results of Operations

FISCAL 2001 COMPARED TO FISCAL 2000

Net Income (Loss)

Net loss for fiscal 2001 was \$3,311 million, compared with net income of \$24 million for fiscal 2000. The reduction in earnings resulted primarily from a non-recurring charge for impairment of assets of \$3,419 million. Excluding this charge, net income would have been \$108 million, or \$84 million higher than fiscal 2000.

As of the end of fiscal 2001, the TVA Board determined that the book values of some of its existing assets were not appropriate in a competitive marketplace. Certain assets were identified as assets for which the estimated future cash flows provided through future rates were likely to be less than recorded book values. Consequently, TVA reduced the carrying amount of these assets by \$3,419 million and recognized an impairment loss (see note 1 of the accompanying Financial Statements — Impairment of assets).

Operating Revenues

Operating revenues were \$6,999 million in fiscal 2001, compared with \$6,762 million in fiscal 2000. The \$237 million increase was primarily due to an increase in energy sales to municipalities and cooperatives as a result of the colder winter weather during fiscal 2001. Total kWh sales increased 1.8 billion kWh, from 159.6 billion in 2000 to 161.4 billion in fiscal 2001.

Operating Expenses

Operating expenses increased \$487 million, or 10 percent, from \$5,019 million in fiscal 2000 to \$5,506 million in fiscal 2001. This increase was largely due to higher operating and maintenance expense of \$217 million in fiscal 2001, primarily as a result of system growth and outage activities, and greater depreciation and amortization expense of \$236 million, primarily due to depreciation on new combustion turbines and accelerated amortization of regulatory assets (see note 1 of the accompanying Financial Statements — Other deferred charges—Accelerated amortization).

Other Income

TVA had net other income of \$248 million in fiscal 2001, compared with net other income of \$17 million in fiscal 2000. The fiscal 2001 net other income resulted primarily from the settlement of litigation.

Interest Expense

Net interest expense declined \$103 million, from \$1,736 million in fiscal 2000 to \$1,633 million in fiscal 2001. Total outstanding indebtedness as of September 30, 2001, was \$25.4 billion, with an average interest rate of 6.57 percent. As of September 30, 2000, total outstanding indebtedness was \$26.0 billion, with an average interest rate of 6.83 percent.

FISCAL 2000 COMPARED TO FISCAL 1999

Operating Revenues

Operating revenues were \$6,762 million in fiscal 2000, compared with \$6,595 million in fiscal 1999. The \$167 million increase was primarily due to an increase in energy sales to municipalities and cooperatives as a result of the hot summer during fiscal 2000. Accordingly, total kWh sales increased 3.6 billion kWh, from 156.0 billion in fiscal 1999 to 159.6 billion in fiscal 2000.

Operating Expenses

Operating expenses increased \$93 million, or 2 percent, from \$4,926 million in fiscal 1999 to \$5,019 million in fiscal 2000. This increase was primarily due to higher fuel and purchased power expense of \$185 million in fiscal 2000 as a result of hotter summer weather and increased power demand, and establishment of a \$75 million inventory valuation reserve, partially offset by a \$140 million reduction in the amount of accelerated amortization recorded in fiscal 2000 (see note 1 of the accompanying Financial Statements — Other deferred charges — Accelerated amortization).

Interest Expense

Net interest expense declined \$41 million from \$1,777 million in fiscal 1999 to \$1,736 million in fiscal 2000. Total outstanding indebtedness as of September 30, 2000, was \$26.0 billion, with an average interest rate of 6.83 percent; as of September 30, 1999, this amount outstanding was \$26.4 billion, with an average interest rate of 6.83 percent.

Liquidity and Capital Resources

Capital Structure

The U.S. Government invested approximately \$1.4 billion in TVA's power system. The bulk of this investment occurred before 1959. In 1959, TVA received congressional approval to issue bonds to finance its growing power program. Since that time, TVA's power program has been required to be self-supporting. As a result, TVA funds its capital requirements through internal cash generation or through its power program financings (subject to a congressionally mandated \$30 billion limit on Evidences of Indebtedness).

A return on the U.S. Government's initial appropriation investment in TVA power facilities, plus a repayment of the initial investment, is specified by law. The payment for fiscal 2001 was \$55 million, and cumulative repayments and return on investment by TVA to the Treasury exceed \$3 billion.

Cash Flows

Net cash provided by power program operations for fiscal 2001, 2000 and 1999 was \$1,885 million, \$1,584 million and \$1,431 million, respectively. This positive trend reflects improvements made in TVA's operations during the three-year period.

Net cash used in investing activities for fiscal 2001, 2000 and 1999 was \$1,191 million, \$1,035 million and \$956 million, respectively. The \$156 million increase from fiscal 2000 to fiscal 2001 was primarily due to an increase in construction expenditures of \$148 million, reflecting the construction of natural-gas combustion turbines for peaking power and the purchase of investments of \$119 million, offset by a decrease in nuclear fuel enrichment and fabrication costs of \$90 million.

Net cash used in financing activities for fiscal 2001, 2000 and 1999 was \$703 million, \$304 million and \$763 million, respectively. For fiscal 2001, the cash used in financing activities reflects the aggregate net reduction of total outstanding debt of \$610 million, coupled with borrowing costs of \$29 million and payments to the Treasury of \$55 million.

Capital Resources

During fiscal 2001, 2000 and 1999, TVA accessed the capital markets through cost-effective

long-term financing structures and continued to expand its global and retail investor base. TVA offered global securities in January 2001 by issuing \$1 billion of 10-year Power Bonds to investors in Europe, Asia and the United States. In July 2001, TVA issued £250 million of sterling-denominated Power Bonds. In August 2001, TVA completed its third global offering by issuing \$1 billion of three-year Power Bonds, with over 70 percent of the Power Bonds distributed to international investors. TVA offered nine issues of Power Bonds in fiscal 2001 under its new retail targeted medium-term note program, *electronotes*sm. These issues ranged in size from \$21 million to \$63 million, for a total of \$356 million for the year.

In November 2001, TVA received approximately \$320 million in proceeds by entering into a lease-leaseback transaction for eight new peaking combustion turbine units. In December 2001, TVA issued in the public market \$600 million of global Power Bonds that mature in 2016 but can be put back to TVA in 2006. In November and December of 2001, TVA offered five issues of *electronotes*sm totalling \$92 million.

Market Risk

Risk Policies

TVA has established a Risk Management Committee, which is charged with the responsibility of reviewing and approving controls and procedures for TVA-wide risk management activities, including the oversight of models and assumptions used to measure risk, the review of counterparty exposure limits, and the establishment of formal procedures regarding the use of financial hedging instruments.

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

TVA is exposed to losses in the event of counterparties' nonperformance and accordingly has established controls to determine the creditworthiness of counterparties in order to mitigate exposure to credit risk.

With respect to hedging activities, TVA risk management policies provide for the use of derivative financial instruments to manage financial exposures but prohibit the use of these instruments for speculative or trading purposes. Prior to October 1, 2000, TVA accounted for hedging activities using the deferral method, and gains and losses were recognized in the financial statements when the related hedged transaction occurred. During 2001 TVA adopted Statement of Financial Accounting Standards (“SFAS”) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Derivative contracts to which TVA is a party that are covered by these standards include various purchased option contracts and certain currency and interest rate swap agreements. See further discussion related to TVA’s adoption of SFAS No. 133 and SFAS No. 138 at “New Accounting Pronouncements.”

Rating Triggers

As of September 30, 2001, TVA was a party to three swap contracts and three power purchase agreements that contained rating triggers. Under most of these rating triggers, the amount of collateral that TVA will have to post under certain circumstances will increase if TVA’s rated bonds are downgraded. The requirement to post collateral under any of these six contracts would not, if triggered, have a material effect on TVA’s financial condition.

Interest Rate and Foreign Currency Risk

TVA manages its daily cash needs through issuance of Discount Notes and other short-term borrowings. These borrowings expose TVA to fluctuations in short-term interest rates. TVA is not exposed to changes in interest rates on most of its long-term debt until such debt matures and may be refinanced at the then applicable rates. An interest rate swap is used to hedge TVA’s exposure related to its inflation-indexed accreting principal bonds, and currency swap contracts are used as hedges for foreign currency denominated debt issues (*see note 5 of the accompanying Financial Statements — Foreign currency and interest rate swaps*). Based on TVA’s overall interest rate exposure at September 30, 2001, including derivative and other interest rate sensitive instruments, a near-term one percentage point change in interest rates would

not have a material impact on TVA’s financial position or results of operations for fiscal 2001.

Commodity Price Risk

TVA is exposed to the impact of market fluctuations in the price and transportation costs of certain commodities and fuels including, but not limited to, coal, natural gas and electricity. TVA employs established policies and procedures to manage risks associated with these market fluctuations by using various commodity-based instruments, including forwards and option contracts. To monitor the risk of commodity trading activities, TVA employs several tools including a daily Value at Risk (“VaR”) model, a daily mark-to-market review, price risk analysis and forward market monitoring. Based on TVA’s overall commodity price risk exposure, management does not anticipate a materially adverse effect on TVA’s financial position or results of operations as a result of market fluctuations.

Equity Price Risk

TVA maintains trust funds, consistent with the United States Nuclear Regulatory Commission (“NRC”) requirements, to fund certain costs of decommissioning its nuclear generating units. These funds are managed by various money managers and are primarily invested in marketable equity securities, which are exposed to price fluctuations in equity markets. TVA actively monitors the trust funds’ portfolios by benchmarking the performance of their investment managers against certain market indices. Based on the expected performance of the portfolios, sufficient funds have been set aside to fully fund decommissioning obligations as estimated under guidelines established by the NRC. Therefore fluctuations in trust fund marketable security returns do not affect the earnings of TVA (*see notes 1 and 9 of the accompanying Financial Statements — Decommissioning costs and — Contingencies-Decommissioning costs*).

Forward Contracts

TVA enters into electricity forward contracts for the sole purpose of limiting or otherwise hedging its economic risks directly associated with meeting its power supply obligations in the Tennessee Valley region. These contracts qualify for normal purchase and normal sale accounting under SFAS No. 133, as interpreted by Derivative Implementation Group Issue C15. In addition, at September 30, 2001, management does not anticipate a

materially adverse effect on TVA's financial position or results of operations as a result of market fluctuations.

Accounting Standards

TVA accounts for the financial effects of regulation in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. As a result, TVA records certain regulatory assets and liabilities that would not be recorded on the balance sheet under generally accepted accounting principles for nonregulated entities.

TVA has approximately \$439 million of regulatory assets (*see note 1 of the accompanying Financial Statements — Other deferred charges, and Debt issue and reacquisition costs*), along with approximately \$4.1 billion of deferred nuclear units as of September 30, 2001 (*see notes 1 and 2 of the accompanying Financial Statements — Impairment of assets and Nuclear Power Program*). In the event that restructuring of the utility industry changed the application of SFAS No. 71, TVA would be required to evaluate such regulatory assets and deferred nuclear units under the provisions of SFAS No. 101, *Regulated Enterprises — Accounting for the Discontinuation of Application of SFAS No. 71*. SFAS No. 101 establishes reporting criteria for an enterprise that ceases to meet the criteria for application of SFAS No. 71.

New Accounting Pronouncements

Effective October 1, 2000, TVA adopted the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Derivative contracts subject to the application of this standard to which TVA is a party include various purchased option contracts and certain currency and interest rate swap agreements (*see note 5 of the accompanying Financial Statements — Foreign currency and interest rate swaps*). TVA determined the fair value of such contracts to be approximately \$51 million at October 1, 2000, by utilizing a variety of independent market sources. In accordance with SFAS No. 133, these contracts qualify for cash flow hedge treatment. Accordingly, the effective portion of gains and losses related to such contracts is reported in accumulated other comprehensive income, while the ineffective portion is recognized through the creation of a regulatory asset/liability. The amounts accumulated in other

comprehensive income and regulatory asset/liability are recognized in earnings upon settlement of the related contracts. Such treatment reflects TVA's ability and intent to account for these derivative instruments on a settlement basis for ratemaking purposes. At September 30, 2001, TVA reported other comprehensive loss of \$106 million, primarily related to foreign currency exchange fluctuation and an interest rate swap (*see note 5 of the accompanying Financial Statement — Foreign currency and interest rate swaps*). Due to the nature of the derivative instruments and related cash flows, the hedges are considered to be 100 percent effective.

In December 2000, the Derivatives Implementation Group of the Financial Accounting Standards Board ("FASB") discussed several issues related to the power generation industry, and in June 2001 the group issued final guidance requiring certain power and fuel agreements to be marked to fair market value for each reporting period. The new accounting treatment was applied on September 30, 2001.

In June 2001 the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. TVA is currently evaluating the nature and scope of plant site and other long-lived asset retirements. Upon completion of the evaluation, cost estimates will be developed and used in the determination of all related asset retirement obligations. The associated asset retirement costs will be capitalized as part of the carrying amount of the long-lived asset. The Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002.

In October 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which replaces SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. The objective of SFAS No. 144 was to develop one accounting model for long-lived assets to be disposed of by sale, based on the framework established in SFAS No. 121, and to address significant implementation issues. SFAS No. 144 requires that those long-lived assets be measured at the lower of their carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. The provisions

of SFAS No. 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001, and, generally, are to be applied prospectively.

At the present time, TVA is unable to predict whether the implementation of these standards will be material to its results of operations or financial position.

Decommissioning Costs

Provision for decommissioning costs of nuclear generating units is based on the estimated cost of dismantling and decontaminating the facilities to meet NRC criteria for license termination. Effective for fiscal 1998, TVA changed its method of accounting for nuclear decommissioning costs and related liabilities in order to comply with certain tentative conclusions reached by the FASB in its project regarding the accounting for closure and removal of long-lived assets, as well as certain rate-setting actions.

TVA recognizes as incurred all obligations related to closure and removal of its nuclear units. The liability for closure is measured as the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk-free rate of interest. The charge to recognize the additional obligation is effected by adjusting the corresponding regulatory asset. Earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. At September 30, 2001, the present value of the estimated future decommissioning cost of \$804 million was included in other liabilities, and the unamortized regulatory asset of \$439 million was included in deferred charges. The decommissioning cost estimates are based on prompt dismantlement and removal of a plant from service. The actual decommissioning costs may vary from the estimates because of changes in the assumed dates of decommissioning, changes in regulatory requirements, changes in technology and changes in the cost of labor, materials and equipment.

TVA maintains a decommissioning trust fund to provide funding for the decommissioning of nuclear power plants. As of September 30, 2001, the decommissioning trust fund investments totaled

\$600 million and were invested in securities designed to achieve a return in line with overall equity market performance.

TVA is currently evaluating the nature and scope of its decommissioning policy as it relates to all electric generating plants. The evaluation will be used to determine the need for recognition of additional asset retirement obligations as described in the recently issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 will be effective for TVA in fiscal 2003.

THE AREA SUPPLIED BY TVA

TVA supplies power in most of Tennessee, northern Alabama, northeastern Mississippi and southwestern Kentucky, and in small portions of Georgia, North Carolina and Virginia. TVA serves a population of about eight million people. Subject to certain minor exceptions, TVA may not without specific authorization by act of Congress enter into contracts which would have the effect of making it or the distributors of its power a source of power supply outside the area for which TVA or the distributors were the primary source of power supply on July 1, 1957.

TVA is primarily a wholesaler of power. Its customers are composed of three major groups: (1) distributors, consisting of municipal and cooperative systems; (2) industries that have large or unusual loads; and (3) federal agencies. Additionally, TVA has entered into exchange power arrangements with most of its surrounding electric systems.

RATES, CUSTOMERS AND MARKET

The Act gives the Board sole responsibility for establishing the rates that TVA charges for power and authorizes the Board to include in power contracts terms and conditions that it judges necessary or desirable for carrying out the purposes of the Act. The Act requires TVA to charge rates for power which, among other things, will produce gross revenues sufficient to provide funds for (1) operation, maintenance and administration of its power system; (2) payments to states and counties in lieu of taxes; (3) debt service on outstanding Evidences of Indebtedness; and (4) annual payments to the Treasury in repayment of and as a return on the Government's appropriation investment in TVA power facilities (the "Appropriation Investment"). See "Certain Provisions of the

Tennessee Valley Authority Act,” “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Rate Covenant,” and “Public Law No. 105-62.” Rates set by the Board are not subject to review or approval by any state or federal regulatory body. See “Competition.”

A summary of power program operating revenues by customer type for each of the last five fiscal years ended September 30 is shown in the Comparative Five-Year Data presented on page 3.

Municipal and Cooperative Distributors

Sales to municipal and cooperative distributors accounted for approximately 84 percent of TVA’s total revenues in fiscal 2001. TVA has long-term wholesale power contracts with 158 municipal and cooperative distributors. All of these contracts require distributors to purchase substantially all of their electric power and energy requirements from TVA.

All distributors purchase power under one of three basic arrangements. Fifty-seven distributors purchase power under contracts that require 10 years’ notice to terminate and further provide that on each anniversary beginning on the tenth anniversary, one additional year is automatically added to the term. Four distributors have contracts that require 15 years’ notice to terminate the contract. On each anniversary of these contracts, beginning on the fifth anniversary, one additional year is automatically added to the term. TVA has also offered distributors the option of moving from 10- or 15-year termination notice periods to a 5-year termination notice period, which notice may be given no sooner than October 2002. Ninety-seven distributors have entered into contractual arrangements of this type. TVA has agreed that all of these term arrangements are deemed to provide for adequate recovery by TVA of any investment in generation, transformation or transmission facilities for service to the distributor.

TVA’s wholesale power contracts contain standard provisions specifying the wholesale rates, resale rates and terms and conditions under which power is to be distributed. Under these contracts, TVA, on a quarterly basis, may determine and make adjustments in the wholesale rate schedule with corresponding adjustments in resale rate schedules necessary to enable TVA to meet all requirements of the Act and the financial covenants and provisions of its bond resolutions. The contracts provide

for agreement between the parties on general or major changes in both the wholesale and resale rate schedules. If, however, agreement is not reached, the contracts permit TVA to make changes in these schedules to carry out the objectives of the Act, to meet financial requirements and covenants and to comply with the provisions of its bond resolutions.

The power contracts between TVA and the distributors of TVA power specify the resale rates that distributors charge the ultimate power consumers. These rates are revised from time to time to reflect changes in costs, including changes in the wholesale cost of power. They are designed to promote the Act’s objective of providing an adequate supply of power at the lowest feasible rates.

A number of TVA distributors, including some with the largest loads, have expressed interest in further revising their wholesale power contracts to allow them more options respecting contract term and other matters, such as purchasing a portion of their power requirements from suppliers other than TVA. TVA agreed to work with distributors to develop additional contract flexibility and outlined a framework for additional contract options in June 2001. Distributors and the Tennessee Valley Public Power Association (“TVPPA”), an association which represents all distributors of TVA power, agreed to work with TVA to draft the new contract arrangements. Two working teams are working to develop proposals, one on long-term contract options and the other on partial requirement options that would permit distributors to buy up to 10 percent of their power from other suppliers or to generate a comparable amount themselves, following a two-year notice to TVA.

Other Sources of Revenues

Revenues from industries and federal agencies directly served and from exchange power arrangements with other power systems and other revenue accounted for approximately 16 percent of TVA’s total revenues in fiscal 2001. Contracts with industries directly served by TVA are normally for 10-year terms. These contracts are subject to termination by TVA or the customer upon a minimum notice period that varies according to the customer’s contract demand and the period of time service has been provided to the location where it is to be terminated. TVA establishes the rates it charges industries it directly serves. These rates normally

are the same as those charged by the distributors of TVA power to large industries (those with demand greater than 25,000 kilowatts). TVA generally sells power to federal agencies under the same contract terms and rates as directly served industries. TVA also has exchange power arrangements with 12 neighboring power systems.

COMPETITION

The electric utility industry has become increasingly competitive over the last decade. Competition is expected to continue to intensify, and restructuring legislation may dramatically change the way electric utilities do business in the future. Among the early initiatives that have begun to promote industry competition is the Energy Policy Act of 1992 (the "Energy Act"). The Energy Act, and related Federal Energy Regulatory Commission ("FERC") orders, already allow competitors of a utility to access that utility's transmission system to sell electricity to other electric power suppliers and wholesale customers. In TVA's case, some special provisions apply.

Under the TVA Act, subject to certain minor exceptions, TVA may not currently enter into contracts that would have the effect of making it or the distributors of its power a source of power supply outside a statutorily specified area. However, under a special provision of the Energy Act (the "anti-cherry-picking provision"), TVA is not required to provide its competitors access to its transmission system to transmit power for consumption within the area that TVA or the distributors of its power may serve. Thus, while TVA may not sell power outside its current service area, its competitors are not allowed to use its transmission system to sell power within TVA's service area.

In the future, it is likely that the current law that serves to limit competition between TVA and its competitors will change. In the past four years, numerous bills have been introduced in Congress designed to restructure the electric utility industry and mandate or promote competition in the industry. Within the context of restructuring legislation, some of the key issues for TVA are: (1) whether TVA rates will be regulated by FERC, (2) whether TVA and the distributors of TVA power will be able to sell power outside the TVA service area and whether TVA will be required to provide its competitors access to its transmission system to transmit power for consumption within the TVA service

area, (3) whether Congress will attempt to shorten the terms of TVA's present wholesale power contracts with the distributors of its power and (4) whether TVA will have the right to recover its power system investments that would no longer be economical under full and open market competition (stranded costs).

Since the early days of the federal electric power industry restructuring effort, TVA has been working closely with TVPPA and the Tennessee Valley Industrial Committee ("TVIC"), an organization representing industries that TVA directly serves, to develop a consensus position on industry restructuring. After a series of negotiations, TVA, TVPPA and TVIC agreed upon the key elements of legislation regarding TVA. This legislation would allow for: (1) simultaneous repeal on the effective date of the restructuring legislation of the anti-cherry-picking provision and the provision that limits the area in which TVA and the distributors of TVA power can be a source of power supply, (2) renegotiation of power contract terms with a minimum termination notice period of three years, and a distributor option to take partial requirements from other suppliers with advance notice to TVA, (3) new limitations on TVA retail sales in TVA's current service area, (4) stranded cost recovery, (5) FERC regulation of TVA's transmission system, (6) TVA subjection to antitrust laws (with the exception of civil damages and attorney's fees), (7) reduction of most of TVA's existing regulatory role with respect to distributors and (8) limitation on new TVA generation to that needed to meet demand within the current TVA service territory. No provisions were included with respect to TVA wholesale rate regulation. In December 2001, Representative Barton introduced a bill in the House of Representatives that incorporates this consensus position.

Other bills that would affect TVA have been introduced in this session and prior sessions of Congress as the federal restructuring debate has continued. One such bill, introduced in March 2001 by Senators Bunning and McConnell, is S. 608, the latest in a series of legislative proposals offered over the last few years that would make TVA a "public utility" for all purposes under the Federal Power Act. This bill would also, among other things, modify TVA's contractual relationships with distributors of TVA power, permitting them to meet their new power requirements from sources other than TVA. In light of current conditions in

the United States electrical power markets, TVA believes it is unlikely that any restructuring legislation will be enacted during the current session of Congress. TVA's management has developed and will continue to develop plans and strategies designed to position TVA for competitive success in a restructured industry.

The United States General Accounting Office ("GAO") issues reports on TVA from time to time. In February 2001, GAO issued a report entitled "TENNESSEE VALLEY AUTHORITY, Debt Reduction Efforts and Potential Stranded Costs." In this report GAO says that, although TVA has made progress in reducing its level of debt and in recovering the cost of deferred assets and although its financial condition has improved, in light of its levels of debt and deferred assets, TVA's financial flexibility to respond to financial and competitive challenges is less than that of its likely competitors, and as a result TVA could have stranded costs if Congress enacts legislation that requires TVA to compete with other electricity providers. TVA disagrees with this report, particularly with respect to its market price discussion, its conclusion regarding the comparative financial health of TVA versus that of its likely competitors and its analysis of TVA's exposure to and recovery of stranded costs. TVA continues to believe that its power prices, currently in the lowest quartile of the nation's prices, will remain competitive in the context of any industry restructuring.

POWER AND ENERGY REQUIREMENTS

TVA prepares annual forecasts of future power and energy requirements as part of its planning and budgeting process. TVA's forecast procedure involves producing a range of load forecasts for the explicit purpose of bounding the range of uncertainty associated with load growth. TVA produces the load forecasts probabilistically. TVA believes that there is a 90 percent probability that the actual load will be less than the high load forecast, a 50 percent probability that the actual load will be less than medium load forecast and a 10 percent probability that actual load will be less than the low load forecast. TVA's current load forecast through fiscal 2003 reflects an average annual peak growth rate of 3.1 percent, 2.3 percent and 0.5 percent for the high, medium and low load forecasts, respectively. TVA's total system energy requirements through fiscal 2003 reflect an average annual energy growth rate of 3.6 percent, 2.8 percent and 1.0 per-

cent for the high, medium and low load forecasts, respectively. Numerous factors, such as weather conditions and the health of the regional economy, could cause actual results to differ materially from TVA's forecasts.

POWER SYSTEM

TVA's power system is one of the largest in the United States in capacity and in energy production. Its size permitted the construction of large facilities which resulted in lower unit costs. Most of TVA's dams were completed years ago when construction costs were far below present-day levels.

TVA's power generating facilities at September 30, 2001, included 29 hydroelectric plants, 11 coal-fired plants, 3 nuclear plants, 1 pumped storage hydroelectric plant, 5 combustion turbine plants, 1 windpower site, 1 landfill gas site and 10 solar photovoltaic sites. Energy is delivered to TVA customers over a transmission system of approximately 17,000 miles of lines, including 2,400 miles of extra-high-voltage (500,000 volt) transmission lines. The system interconnects with neighboring power systems at numerous points. TVA has various types of interchange arrangements with these systems. The extent and types of interchange transactions depend upon the characteristics of the systems' loads, the management policies of the systems and other factors. Interchange arrangements are an essential part of TVA's efforts to minimize investment in electrical facilities, increase the reliability of service, effect operating economies and minimize the cost of electric energy.

While not subject to FERC jurisdiction, TVA is voluntarily seeking ways to meet FERC's objectives to improve regional transmission control in a manner consistent with TVA's responsibilities under the TVA Act. TVA is moving forward on two initiatives. First, TVA is working to create a coordination agreement with other public power providers to develop a regional grid that will allow its members to continue their public service mission and integrate with surrounding regional transmission organizations ("RTOs") for a seamless market. Second, TVA is working with neighboring utilities and RTOs — including Southern Company, Entergy Corporation, and the Midwest Independent System Operator — to create a contractual arrangement that would encourage a seamless wholesale power market for much of the eastern interconnection.

During the fiscal year ended September 30, 2001, 65 percent of the power generated by the TVA coordinated system was by fossil-fired plants and combustion turbines, 29 percent by nuclear and 6 percent by hydro. Coal consumption during this time was 41.9 million tons. Coal is purchased under contracts ranging from a single delivery to deliveries over several years. TVA coal inventory levels

vary from plant to plant based upon a simulated inventory model. As of December 31, 2001, TVA had approximately 25 days' coal supply in inventory at full burn. See "Nuclear Power Program" — "Nuclear Fuel" for a discussion of TVA's nuclear fuel supplies. Management believes the sources and availability of fuel materials essential to its business should be adequate for the foreseeable future.

Generating Resources

The following table summarizes the winter net dependable capacity ("NDC") in megawatts ("MW") on this coordinated system as of September 30, 2001:

	<u>Generating Units</u>	<u>Winter NDC MW(1)</u>
TVA Hydro Plants	109	3,376
TAPOCO, Inc. Hydro Plants		318(2)
U.S. Army Corps of Engineers Hydro Plants		405(3)
TVA Pumped Storage Facility	4	<u>1,578</u>
Total Hydro		5,677
Fossil	59	15,050
Nuclear	5	5,715
Combustion Turbine	64	<u>3,923(4)</u>
Total NDC		<u><u>30,365</u></u>

- (1) NDC as stated is the net power output which can be obtained for a period adequate to satisfy the daily load patterns under expected conditions of operation with equipment in an average state of maintenance. For planning purposes, TVA currently estimates summer dependable total hydro capacity of approximately 5,932 MW, coal-fired capacity of approximately 14,719 MW, nuclear power capacity of approximately 5,575 MW and combustion turbine capacity of approximately 3,179 MW, for a total summer NDC of approximately 29,405 MW.
- (2) Four hydro plants owned by TAPOCO, Inc., a subsidiary of the Aluminum Company of America ("Alcoa"), are operated as part of the TVA power system. Under contractual arrangements with TAPOCO, Inc., electric power generated at these facilities is supplied to TVA. In return, TVA supplies electric power for Alcoa's aluminum plant operations located in Tennessee.
- (3) The U.S. Army Corps of Engineers' plants on the Cumberland River system have a total installed capacity of 975 MW, of which 405 MW of NDC is available to TVA under a marketing agreement with the Southeastern Power Administration.
- (4) As of December 31, 2001, 16 of TVA's combustion turbine units were leased to private entities and leased back to TVA under long-term leases.

Under arrangements among TVA, the U.S. Army Corps of Engineers (the "CORPS") and the Southeastern Power Administration ("SEPA"), eight hydro plants of the CORPS on the Cumberland River system are operated in coordination with the TVA system. These arrangements further provide for capacity (405 MW) and energy from the Cumberland River system to be supplied to TVA by SEPA at the points of generation and the price paid for the power to be based on the operat-

ing and maintenance expenses and amortization of the power facilities. A portion of the output of the Cumberland River system is also made available to SEPA's customers outside the TVA region. The agreement with SEPA covering these arrangements for power from the Cumberland River system can be terminated upon three years' notice. This notice may be given beginning June 30, 2017.

TVA has contracted with Choctaw Generation, Inc., to purchase and take delivery of up to

440 MW of power over a 30-year term from a lignite power plant being constructed in Mississippi. Commercial operation of the plant commenced in April 2002. The owner of the facility bears the construction and operating risks. If the owner fails to deliver the required energy, the owner will be responsible for securing replacement power for TVA at the contractually agreed price.

TVA installed eight 85 MW natural-gas combustion turbines in time for the summer 2001 peak demands for power at its new Lagoon Creek site in West Tennessee. TVA is also installing eight additional 85 MW natural-gas combustion turbines in 2002. TVA recently decided not to proceed with its plans to build a gas-fired, combined-cycle plant that would have provided 510 MWs of power initially scheduled to begin operation in 2003. Current power projections indicate that in the near-term, ample power from generation sources within the

TVA service area should be available to meet TVA's near-term power needs at competitive prices. TVA's incurred costs are projected to total approximately \$175 million for equipment, engineering and other work, and TVA is currently analyzing whether the equipment that it purchased for the proposed plant can be used at its other plants or whether the equipment can be sold. The costs incurred to date for this project are accounted for on TVA's Balance Sheet as construction in progress under property, plant, and equipment. TVA is currently assessing the effect of the cancellation on its financial statements. TVA is uncertain at this time how much of its expenditures it will recover.

TVA has also supplemented its existing generation portfolio with additional renewable resource assets (wind, solar and landfill gas technologies). These assets account for about 5 MW of additional capacity at the present time.

NUCLEAR POWER PROGRAM

Overview

TVA has five operating nuclear units, three deferred nuclear units and one inoperative nuclear unit. Selected features of each of these units are described in the chart below.

<u>Nuclear Unit</u>	<u>Status</u>	<u>Installed Capacity (MW)</u>	<u>Net Capacity Factor for FY 2001</u>	<u>Date of Expiration of Operating License</u>	<u>Date of Expiration of Construction License</u>
Sequoyah Unit 1	Operating	1,221	87.7	2020	—
Sequoyah Unit 2	Operating	1,221	91.7	2021	—
Browns Ferry Unit 2	Operating	1,190	87.4	2014	—
Browns Ferry Unit 3	Operating	1,190	100.0	2016	—
Watts Bar Unit 1	Operating	1,270	94.0	2035	—
Watts Bar Unit 2	Deferred	—	—	—	2010
Bellefonte Unit 1	Deferred	—	—	—	2002(1)
Bellefonte Unit 2	Deferred	—	—	—	2004
Browns Ferry Unit 1	Inoperative	—	—	2013	—

(1) Bellefonte 1's construction license was due to expire on October 1, 2001, and Bellefonte 2's is due to expire on October 1, 2004. On July 11, 2001, TVA asked the NRC to extend the construction license for Bellefonte 1 until October 1, 2011 and for Bellefonte 2 until October 1, 2014. While the NRC considers TVA's request, Bellefonte 1's construction license is automatically extended on a day-by-day basis. Previously, Watts Bar 2's construction license was similarly extended on a day-by-day basis while the NRC considered TVA's request to extend its construction license until 2010. At this time, TVA is aware of no issue that would result in the NRC not granting TVA's request to extend the Bellefonte construction licenses.

Status of Certain Nuclear Units

Browns Ferry 1 was taken offline in 1985 for modifications and improvements and will remain in an inoperative status until its ultimate disposition is determined. The undepreciated cost of Browns

Ferry 1 of \$53 million is included in net completed plant and is being depreciated as part of the recoverable cost of the plant over the remaining license period. Reflecting the recent interest in the competitive cost of nuclear generation, the Board re-

quested in September 2001 a technical study regarding the feasibility of recovering and restarting Browns Ferry 1. In March 2002, TVA's nuclear staff reported to the Board the results of a detailed cost and planning study which concluded that TVA can return Browns Ferry 1 to service safely and economically. The Board is awaiting the results of an environmental review and an assessment of power and financial conditions before deciding whether to return Browns Ferry 1 to service. The Board could make its decision on return to service as early as May or June. TVA currently anticipates that restarting Browns Ferry 1 would take about five years and cost approximately \$1.8 billion.

TVA has three units in deferred status. In 1988 TVA suspended construction activities on Watts Bar 2, and the unit is currently in lay-up. Bellefonte 1 and 2 were deferred in 1988 and 1985, respectively. Estimated 2002 expenditures for the three deferred units are limited to lay-up, maintenance and ensuring that options for the use of the units remain viable.

In December 1994 TVA determined that it will not, by itself, complete Bellefonte 1 and 2 and Watts Bar 2 as nuclear units. TVA's integrated resources planning process identified as a viable option the conversion of the Bellefonte facility to a combined-cycle plant utilizing natural gas or gasified coal. In 1997 an independent team of technical and financial experts completed a feasibility study to evaluate options for the conversion of the Bellefonte Nuclear Plant to a fossil fuel fired plant. The feasibility study indicated that one of the most economic fossil conversion strategies would be to complete Bellefonte as a natural gas fired combined-cycle plant. TVA also issued an Environmental Impact Statement ("EIS") assessing the environmental impacts of various fossil conversion options. The EIS identified the natural gas fired combined-cycle plant alternative as the preferred option. Bellefonte remains in a deferred status; however, TVA is re-examining its nuclear and non-nuclear options for Bellefonte. This project is being undertaken by a TVA vice president who reports directly to the TVA Board.

While future decisions on TVA's deferred units will ultimately impact the method of cost recovery, the TVA Board determined as of the end of 2001 that the values of some of its existing assets were not appropriate in a competitive marketplace. Certain nuclear assets, portions of Bellefonte 1 and

2 and Watts Bar 2 in its entirety, were identified as assets for which the estimated future values were less than recorded book values. Consequently, for 2001 TVA revalued these assets downward by \$2,220 million and recognized an impairment loss. The Board will establish rate adjustments and operating policies to ensure full recovery of the remaining cost of the Bellefonte units and compliance with the requirements of the TVA Act (*see note 1 of the accompanying Financial Statements — Impairment of assets*).

Nuclear Fuel

TVA owns all nuclear fuel held for its operating and deferred nuclear units. The net book value of this fuel was \$315 million as of September 30, 2001. TVA will fill future uranium requirements by a combination of term and spot purchase contracts while maintaining diversity of supply source. TVA currently has approximately 90 percent of its forward five-year (2002-2006) uranium requirements either in inventory or under contract.

TVA's investment in the fuel being used in the Sequoyah, Watts Bar and Browns Ferry units is being amortized and accounted for as a fuel expense. The Bellefonte initial cores have been defabricated, and uranium from these cores has been used in the Sequoyah and Browns Ferry units with the net book value assigned accordingly.

Under an interagency agreement entered into in 2001, DOE will transfer to TVA approximately 33 metric tons of surplus highly enriched uranium ("HEU"). The HEU will be transferred at no cost to TVA. However, TVA will be responsible for the subsequent costs required to down blend and convert the HEU material to a form of material usable in the nuclear fuel assembly manufacturing process. In April 2001, TVA entered into a contract with Framatome ANP for down-blending and conversion services of the HEU material through Framatome's subcontractor Nuclear Fuel Services and fabricating the blended-down material into fuel assemblies to be used in TVA's nuclear plants. The estimated costs TVA will incur under this contract are not expected to exceed \$750 million. TVA will defer the HEU down-blending and fuel assembly fabrication costs until such time as sufficient fuel is available for reactor unit reload. Deferred costs will be allocated to the reload assemblies and amortized as fuel expense over the fuel burn period in accordance with TVA's current nuclear fuel accounting policy.

Nuclear Waste

Spent Nuclear Fuel

TVA has entered into a contract with DOE for the disposal of spent nuclear fuel. Payments are based on TVA's nuclear generation and charged to expense. The provisions of the contract called for DOE to begin accepting spent nuclear fuel from utilities on January 31, 1998, the date provided by the Nuclear Waste Policy Act of 1982. However, as of September 30, 2001, DOE has accepted no spent fuel. (As a result of this failure, in April 2001 TVA filed a breach of contract lawsuit against the United States in the Court of Federal Claims). TVA's spent nuclear fuel storage facilities will be sufficient to provide storage space for spent fuel generated in TVA's system through 2004 for its Sequoyah Nuclear Plant, 2005 for its Browns Ferry Nuclear Plant, and 2018 for its Watts Bar Nuclear Plant. TVA plans to extend storage capability through life-of-plant if necessary, by using dry spent fuel storage in independent installations located at the Browns Ferry and Sequoyah Nuclear Plants at an estimated cost of \$120 million. Such spent fuel arrangements require NRC approval. However, such arrangements have been approved by the NRC at other facilities throughout the United States.

Low-Level Radioactive Waste

Disposal costs for low-level radioactive waste that results from the normal operation of nuclear units have increased significantly in recent years. Pursuant to the Low-Level Radioactive Waste Policy Act, each state is responsible for the disposal of low-level radioactive waste generated in that state. States may form regional compacts to jointly fulfill their disposal responsibilities. The states of Tennessee and Alabama (where TVA's nuclear plants are located) have joined other southeastern states to form the Southeast Compact Commission for Low-Level Radioactive Waste Management. This commission regulates the siting of new disposal facilities and the disposal of low-level waste within the southeastern states.

Until July 1995, the low-level waste generators located in the southeastern states were required to dispose of their radwaste at the Barnwell, South Carolina, disposal facility. South Carolina, however, is no longer a member of the interstate compact serving the southeastern states and is now a member of the Atlantic Interstate Low-Level Radioactive Waste Compact. Recently South Carolina

announced volume caps that cannot be exceeded due to the acceptance of waste from states that are not members of the Atlantic Interstate Low-Level Radioactive Waste Compact. After June 2009 no waste will be accepted from such states, which include Tennessee and Alabama.

After reviewing its storage and disposal options for low-level radwaste management, TVA began in 1999 to store the type of low-level radwaste that has previously been sent to Barnwell at the storage facilities at two TVA plant sites. These facilities are sized to handle anticipated storage needs for the foreseeable life of TVA's operating plants. TVA continues to send some dry radioactive waste to the Envirocare of Utah disposal facility in Clive, Utah, when economic conditions permit.

Nuclear Insurance

In 1988 Congress extended the indemnification and limitation of liability plan afforded the United States nuclear industry by the Price-Anderson Act for an additional 15 years. Certain provisions of the Price-Anderson Act are due to expire on August 1, 2002. Should the extension of these provisions be delayed beyond the expiration date, or should these provisions not be extended for any reason, the existing indemnification and limitation of liability plan would continue to apply to TVA's nuclear plants. Under the Price-Anderson Act, the limit of liability from an accident at an NRC-licensed reactor is approximately \$9.3 billion (\$88 million for each of the NRC-licensed reactors in the United States), composed of primary and secondary layers of financial protection. This amount is periodically adjusted for inflation. For further information about this nuclear liability insurance and its deferred premium, see note 9 of the accompanying Financial Statements. In accordance with industry practice, TVA maintains certain liability insurance coverage for workers at its nuclear sites.

NRC regulations require nuclear power plant licensees to obtain \$1.06 billion onsite property damage insurance coverage, and TVA has acquired \$2.06 billion of such coverage per nuclear site. Some of the nuclear property insurance may require the payment of retrospective premiums of up to approximately \$28 million in the event that losses by another insured party or TVA exceed available funds. In accordance with NRC regulations, the proceeds of nuclear property insurance are first used to ensure that the reactor is in safe and

stable condition and that it can be maintained in a condition that prevents significant risk to the public. Next, the proceeds are used for decontamination or, if necessary, decommissioning the reactor. Any excess proceeds insure against casualties to property.

Decommissioning

Provision for decommissioning costs of nuclear generating units is based on the estimated cost of dismantling and decontaminating the facilities to meet NRC criteria for license termination. Effective for 1998, TVA changed its method of accounting for nuclear decommissioning costs and related liabilities in order to comply with certain tentative conclusions reached by the FASB in its project for closure and removal of long-lived assets, as well as certain rate-setting actions.

TVA recognizes, as incurred, all obligations related to closure and removal of its nuclear units. TVA measures the liability for closure at the present value of the estimated cash flows required to satisfy the related obligation, discounted at a determined risk-free rate of interest. The corresponding charge to recognize the additional obligation was effected through the creation of a regulatory asset. Earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation." The book value of TVA's decommissioning fund investments was \$688 million at December 31, 2001. See notes 1 and 9 of the accompanying Financial Statements.

TVA is currently evaluating the nature and scope of its decommissioning policy as it relates to all electric generating plants. The evaluation will be used to determine the need for recognition of additional asset retirement obligations as described in the recently issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 will be effective for TVA in fiscal 2003.

ENVIRONMENTAL MATTERS

TVA's activities are subject to various federal, state and local environmental statutes and regulations. Major areas of regulation affecting TVA's activities include air pollution control, water pollu-

tion control and management and disposal of solid and hazardous wastes.

TVA has incurred and continues to incur substantial capital expenditures and operating expenses in order to comply with environmental requirements. Because these requirements change frequently, the total amount of such costs in the future is not now determinable. It is anticipated that environmental requirements will become more stringent and that compliance costs will increase, perhaps by substantial amounts.

Clean Air Developments

Under the Clean Air Act, the U.S. Environmental Protection Agency (the "EPA") has promulgated national ambient air quality standards for certain air pollutants, including sulfur dioxide ("SO₂"), particulate matter and nitrogen oxide ("NO_x"). Coal-fired generating units such as TVA's are considered major sources of these pollutants, and TVA has implemented reduction strategies to reduce its emissions in order to comply with these national standards.

Title IV of the Clean Air Act Amendments of 1990 ("CAAA") requires coal-fired generation units to reduce their SO₂ and NO_x emissions in two phases in order to control acid rain. Compliance with these requirements has resulted in substantial expenditures for the reduction of emissions at TVA's coal-fired generating plants.

The EPA has been directed by the administration to develop legislation aimed at achieving substantial additional reductions of SO₂, NO_x, and particulates from utility units. A number of bills have been introduced in Congress that would result in significant decreases in these emissions as well as carbon dioxide. The timing and content of such legislation remains highly uncertain, and it is unlikely that such legislation would be enacted before 2003 or 2004.

TVA's strategy for complying with the CAAA has included the use of flue gas desulfurization systems, or scrubbers, at two fossil units in addition to existing scrubbers on four other units, and the use of lower-sulfur coal at other fossil units to reduce SO₂ emissions. TVA has completed these scrubbers and is on schedule to complete the changeover to lower-sulfur coal.

NO_x reductions were required under the CAAA for 58 of TVA's 59 coal-fired units. The only

TVA unit for which NO_x reductions are not required under the CAAA is the Atmospheric Fluidized Bed Unit 10 at TVA's Shawnee Fossil Plant. The NO_x reductions for the other 58 units were achieved through the installation of low-NO_x burners and/or overfire air at 40 units and boiler optimization at the remaining 18 units. In 1996 TVA selected an early election option for four of these 58 units, which allows the four units at John Sevier Steam Plant to be limited to Phase I NO_x levels through 2007. In 2008 these four units will have to meet lower Phase II NO_x levels. For the remaining 54 units, TVA has elected to average NO_x emissions to meet a 54-unit NO_x Averaging Plan. This option enables TVA to optimize the cost of NO_x reduction while fully complying with the CAAA Title IV NO_x requirements. In addition to its Title IV projects, TVA is in the process of installing selective catalytic reduction systems ("SCRs") to further control NO_x emissions at 25 of its coal-fired units. SCRs are state-of-the-art NO_x pollution technology. This follows up on a commitment TVA has made to further reduce NO_x emissions throughout its system. Installation of these SCRs will also comply with the EPA's State Implementation Plan NO_x Reduction rule issued in 1998.

In TVA's continuing efforts to improve air quality in the Tennessee Valley and to comply with the Clean Air Act, TVA plans to design, build and operate five more scrubbers to further reduce SO₂ emissions from 12 of its coal-fired units. Although design of these scrubbers is scheduled to start in 2003, substantial construction activities are not expected to begin until TVA completes its SCR installation program in 2005.

The EPA has finalized new, more stringent particulate matter standards and a rule designed to reduce regional haze. Both are currently in litigation. These actions may require TVA to make additional reductions of SO₂ emissions beyond those currently planned. TVA anticipates that compliance with the new regulations will be required after 2010. The EPA has also determined that mercury emissions from coal-fired plants should be reduced, but has yet to propose a rule to accomplish this. Depending on the severity of the mercury reductions required by the EPA, TVA could incur additional substantial capital costs for control of mercury. Mercury reductions are expected to be required around 2007.

Expenditures related to clean air projects during 2001 and 2000 were approximately \$200 million and \$125 million, respectively. The cost of the SCR strategy is now estimated to be \$1.2 billion, and the cost of the planned installation of five scrubbers is estimated to be \$1.5 billion. The total cost of future compliance with NO_x, SO₂, mercury and particulate matter requirements, however, cannot reasonably be determined at this time because of the uncertainties surrounding emerging EPA regulations, resultant compliance strategies, potential for the development of new emissions control technologies, court litigation, and future amendments to the Clean Air Act. However, total future costs could exceed \$3 billion, inclusive of the costs of the planned SCRs and scrubbers.

The EPA has instituted judicial and administrative actions against a number of utilities in the eastern U.S., including TVA, alleging that they have modified their coal-fired units without complying with new source review ("NSR") requirements. TVA contends that the EPA's enforcement action is based on a new interpretation of an old rule and that TVA has routinely maintained its power plants to ensure efficient, reliable power generation while complying with all requirements. The EPA issued TVA an administrative order directing TVA to put new source controls on 14 of its coal-fired units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order, and the Eleventh Circuit Court of Appeals has stayed the order pending its review. The outcome of this litigation and the EPA proceedings is uncertain.

It is not possible to predict with certainty what impact implementation of the EPA's order will have on TVA if TVA's challenge is unsuccessful. If the EPA substantially prevails, TVA could be required to incur capital costs in excess of \$3 billion by 2010 to 2012. Any additional controls that TVA could be required to install on units as a result of this matter, however, would also be sufficient to comply with reduction requirements that are anticipated under other air quality programs discussed above. Thus, because of the other environmental program requirements, TVA would in any event probably incur a substantial portion of the costs that might result from the EPA's enforcement action, although the schedule for the installation of controls could be somewhat accelerated by the EPA action. TVA fully supports the need to further reduce emissions from coal-fired plants and seeks a

resolution that will not put TVA customers and the region at a disadvantage.

The National Parks Conservation Association (“NPCA”) and the Sierra Club filed cases in federal district courts raising the same NSR allegations at TVA’s Bull Run Fossil Plant and Colbert Fossil Plant Unit 5 as were raised in the EPA proceedings. Both cases have been stayed pending a decision from the Eleventh Circuit. NPCA also sued TVA in federal district court over compliance with the opacity limitations established by the State of Tennessee for TVA’s John Sevier and Kingston Fossil Plants. This case was dismissed by the court, and the time to appeal the dismissal has now expired. In November 2001, two other organizations, the Sierra Club and Our Children’s Earth, sent TVA a notice of their intent to sue TVA over compliance with opacity limitations at the same two plants.

The Bush administration is reviewing the energy implications of the EPA’s new NSR interpretation. TVA has determined that if the EPA’s new interpretation becomes law, TVA could lose about 11 percent of the energy capabilities of its coal-fired system within three years through permit limits on use of its units. On February 14, 2002, the Bush Administration announced its “Clean Skies Initiative,” which outlines legislative requirements for the phased reduction of SO₂, NO_x, and mercury emissions from utilities during the period from 2008 to 2018.

Hazardous Substances

The release and cleanup of hazardous substances are regulated under the Comprehensive Environmental Response, Compensation, and Liability Act (“CERCLA”). In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances over the years. TVA is aware of hazardous-substance releases at four offsite areas for which it may have some liability. TVA’s potential liabilities for its share of cleanup costs at these sites are uncertain but are not expected to have significant impact on TVA’s financial position or results of operations.

Water Quality

Under the Clean Water Act (“CWA”), every point source which discharges pollutants into waters of the United States must obtain a National Pollutant Discharge Elimination System

(“NPDES”) permit specifying the allowable quantity and characteristics of the pollutants discharged. All of TVA’s various point sources operate under NPDES permits, including all of its major generating units. Compliance with NPDES requirements has necessitated substantial expenditures and may require additional expenditures in the future as NPDES permits come up for renewal and applicable requirements become more stringent.

The CWA allows the permitting authority to establish thermal limits less stringent than the water quality criteria if the discharger can demonstrate that the alternate limit will assure protection and propagation of a balanced, indigenous aquatic population. TVA has now been issued alternate limits at several of its facilities, and it is meeting these limits. The CWA also requires that the design, capacity, location and construction of cooling water intake structures reflect the best technology available for minimizing adverse environmental impacts. EPA has been engaged in rulemaking that addresses the design of water intake structures at new and existing facilities. The rulemaking for new facilities is expected to mandate more stringent controls for future facilities than have been used at some older power plants and other manufacturing facilities. The new rule may reduce environmental impact uncertainty and monetary requirements. The rulemaking for existing facilities, scheduled to be issued in August 2003, may require cooling water intake changes to be made at TVA facilities. The cost of such changes is uncertain.

Solid and Hazardous Waste Management

Under the Resource Conservation and Recovery Act (“RCRA”), the storage, transportation and disposal of hazardous wastes are regulated by EPA and the states. RCRA also allows EPA and the states to regulate solid wastes, and the states have detailed permitting programs for this. TVA has detailed procedures in place designed to ensure compliance with all applicable requirements for the management of hazardous wastes. Additionally, TVA has instituted an approved supplier list for hazardous waste disposal contractors under which such contractors’ financial status, compliance history and physical facilities and operations can be reviewed before they are allowed to treat or dispose of any of the hazardous wastes generated by TVA facilities. TVA does not itself operate any hazardous waste disposal or treatment facilities but does operate a permitted hazardous waste storage facility

in Muscle Shoals, Alabama. TVA maintains solid waste disposal permits for the solid waste disposal areas (e.g., fly ash, scrubber sludge, demolition materials and asbestos) it operates at some of its plant sites. TVA's costs in this area have not been substantial, but applicable requirements change frequently and are expected to become more stringent.

Under CERCLA, the release and cleanup of hazardous substances are regulated. Liability under CERCLA is generally viewed as joint and several, and TVA estimates its share of cleanup costs under CERCLA to be less than \$100,000.

Miscellaneous

Polychlorinated biphenyls ("PCBs") have been widely used as insulating fluids in electric equipment such as transformers and capacitors. Use of this equipment and the cleanup of released PCBs are regulated by EPA under the Toxic Substances Control Act. The TVA power system uses thousands of pieces of equipment that contain some level of PCBs. These pieces of equipment, when maintained properly, may continue to be operated under EPA's PCB regulations for the remainder of their useful lives. However, both international and domestic pressures are increasing to eliminate all use of PCBs. TVA has been phasing out much of this equipment as a matter of policy. The cost of phasing out the remainder of this equipment cannot be accurately determined at this time, but is not expected to be substantial. TVA has detailed procedures in place to continue operational compliance with EPA's PCB regulations and has not incurred substantial costs in this area.

There is public concern about whether there are adverse health effects from exposure to electric and magnetic fields ("EMF"). There are many sources of EMF, including electric transmission lines. Certain research, including a report by a National Academy of Sciences organization, has not found conclusive evidence that EMF causes adverse health effects. Other research, such as a report by the National Institute of Environmental Health Sciences, has found limited evidence that certain types of exposure to EMF are carcinogenic. Research in this area continues. Substantial costs could be incurred by electric systems, including TVA, if EMF levels from transmission lines have to be reduced, but this appears unlikely at this time.

INSURANCE

TVA does not generally carry property damage or public liability insurance except (1) as may be required or appropriate with respect to nuclear facilities, (2) to the extent it may do so as part of an owner-controlled insurance program it has implemented for some large contracts requiring on-site labor and (3) in other limited circumstances. The Federal Employees' Compensation Act governs liability for service-connected injuries to employees. See "Nuclear Power Program" — "Nuclear Insurance" herein and note 9 of the accompanying Financial Statements for additional information with respect to insurance.

PENDING LITIGATION

The EPA has issued TVA an administrative order directing TVA to put "new-source" controls on 14 of its units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order. See "Environmental Matters" — "Clean Air Developments" for a further discussion of this order and other air quality litigation.

On December 28, 2001, Bowater Incorporated and Bowater Newsprint South, Inc. (together, "Bowater") filed a lawsuit against TVA in federal court in Knoxville challenging TVA's charges for Economy Surplus Power ("ESP") and Testing and Restart Power ("TRP") for two Bowater plants. In its complaint, Bowater alleges that in violation of the contract provision which states that TVA will charge ESP and TRP customers based on TVA's actual hourly incremental cost of providing ESP (1) TVA included certain alleged non-incremental costs in the prices for ESP and TRP and (2) when calculating such prices TVA used the cost of providing the most expensive 100 megawatts of ESP sold during a given hour instead of the average cost in that hour of serving the entire ESP load. The complaint also alleges that TVA has been unjustly enriched as a result of these overcharges. The lawsuit seeks, among other things, compensatory damages in excess of \$25 million and interest of more than \$10 million. TVA believes that it will prevail in this lawsuit based on the information presently available.

TVA is a party to various other civil lawsuits and claims that have arisen in the ordinary course of its business. Although the outcome of these other civil lawsuits and claims cannot be predicted with

any certainty, it is the opinion of TVA counsel that their ultimate outcome should not have a material

adverse effect on TVA’s financial position or results of operations.

MANAGEMENT

TVA is administered by a board of directors composed of three persons appointed by the President and confirmed by the Senate. The Board and selected officers, their ages, their years of employment with TVA and principal occupations for recent years are as follows:

<u>Name and Title</u>	<u>Age</u>	<u>Year Commenced Employment</u>	<u>Year Term Expires</u>
Glenn L. McCullough, Jr. Chairman	47	1999	2005
Skila Harris Director	51	1999	2008
William W. Baxter Director	48	2001	2011
Oswald J. Zeringue President and Chief Operating Officer	56	1989	
John A. Scalice Chief Nuclear Officer & Executive Vice President, TVA Nuclear	54	1989	
David N. Smith Chief Financial Officer & Executive Vice President, Financial Services	58	1995	
Maureen H. Dunn Executive Vice President and General Counsel	52	1978	

Mr. McCullough was appointed to the Board in November 1999, and previously served as the mayor of Tupelo, Mississippi, beginning in 1997. Prior to his election as mayor of Tupelo, he was the director of the Mississippi office of the Appalachian Regional Commission. Chairman McCullough also worked in the family business, McCullough Steel Products, for 12 years.

Ms. Harris was appointed to the Board in November 1999. Prior to her current position, she served at DOE as Executive Director of the Secretary of Energy Advisory Board. From 1993 until 1997, she was a Special Assistant to Vice President Gore and Mrs. Gore’s Chief of Staff. She came to the White House from Steiner-Liff Iron and Metal Company in Nashville, Tennessee, where she was Vice President for Development and Compliance. Ms. Harris served as a project manager at the U.S. Synthetic Fuels Corporation, and she was with DOE during the Carter Administration. She has also held positions with management and engineering consulting firms specializing in energy-related work.

Mr. Baxter was appointed to the Board in November 2001. Prior to joining the Board, Mr. Baxter was Chairman and Chief Executive Officer of Holston Gases Inc. of Knoxville,

Tennessee. Before joining Holston Gases Inc. in 1981, Mr. Baxter was an attorney with Garrett, Coffee, McGee & Baxter in Knoxville. From December 1997 through December 2000, Mr. Baxter was Commissioner of the Department of Economic and Community Development for the State of Tennessee.

Mr. Zeringue was named President and Chief Operating Officer in April 1998. Prior to his current position, he served as Chief Nuclear Officer & Executive Vice President (1997-1998), as Senior Vice President, Nuclear Operations (1993-1997), as Browns Ferry Site Vice President (1989-1993) and as Plant Manager of Palo Verde Nuclear Station, Arizona Public Service Company (1987-1989).

Mr. Scalice was named Chief Nuclear Officer & Executive Vice President, TVA Nuclear in June 1998. Prior to his current position, he served as Acting Chief Nuclear Officer (beginning April 1998), as Senior Vice President of Nuclear Operations (1997-1998), as Watts Bar Site Vice President (1993-1997), as Plant Manager of Browns Ferry Nuclear Plant (1991-1993), as Plant Manager of Watts Bar Nuclear Plant (1989-1991) and as Plant Manager of Shoreham Nuclear Power Station, Long Island Lighting Company (1989).

Mr. Smith was named Chief Financial Officer in January 1995 and additionally was named Executive Vice President, Financial Services, in October 1996. Prior to his current position, he served as Executive Director of Odyssey Financial (1993-1994), as Vice President of Finance of LTV Corporation (1991-1993) and as Assistant Treasurer and Director of Corporate Finance of LTV Corporation (1986-1991).

Ms. Dunn joined TVA as an attorney in May 1978, assumed the position of Assistant General Counsel in September 1986, and assumed the position of Executive Vice President and General Counsel in January 2001.

EMPLOYEES

On September 30, 2001, TVA had about 13,430 employees, of which approximately 5,274 were trades and labor employees. Neither the federal labor relations laws covering most private sector employers nor those covering most federal agencies apply to TVA. However, the TVA Board has a long-standing policy of acknowledging and dealing with recognized representatives of its employees, which policy is reflected in long-term agreements to recognize trade and labor unions (or their successors) through 2012. Federal law prohibits TVA employees from engaging in strikes against TVA.

Salaries of regular TVA employees are limited by a federal pay cap (Executive Level IV, currently \$130,000). The federal pay cap makes it a challenge for TVA to recruit and retain top management talent. In response, TVA has developed and implemented supplementary compensation arrangements to reduce the impact of the pay cap and to enhance TVA's ability to attract and retain the caliber of executive talent required to manage one of the largest power systems in the country. TVA believes the implementation of these arrangements is within its legal authority. In the past, GAO has expressed the opinion that some of TVA's compensation arrangements are not within TVA's legal authority. However, GAO has no authority to issue binding legal opinions on this matter or to stop any TVA payments. Congress has been aware of TVA's supplemental compensation arrangements and has not taken any action that would undermine TVA's position that the arrangements are within its legal authority.

In October 1995, the President issued an Executive Order requiring government corporations, including TVA, to submit information to OMB on bonuses paid to its senior executives. TVA submits information on these bonuses annually to OMB and also publicly disseminates this information. OMB approval of TVA's bonuses is not required.

CERTAIN PROVISIONS OF THE TENNESSEE VALLEY AUTHORITY ACT

*The following summary of certain provisions of the Act is **not complete** and is qualified in its entirety by reference to the full text of the Act.*

Payments in Lieu of Taxes

TVA is not subject to federal income taxes or to taxation by states or their subdivisions. However, the Act requires TVA to make payments in lieu of taxes to states and counties in which the Corporation conducts power operations and in which the Corporation has acquired properties previously subject to state and local taxation. The basic amount of these payments is 5 percent of gross revenues from the sale of power to entities other than federal agencies during the preceding year, with a provision for minimum payments under certain circumstances.

Payments to the Treasury

The Act requires TVA to make certain payments to the Treasury each year from Net Power Proceeds in excess of those required for debt service, as a return on and reduction of the Appropriation Investment. The Appropriation Investment totaled \$503 million as of December 31, 2001. Net Power Proceeds are defined as the remainder of gross power revenues from TVA's power program

after deducting

- the costs of operating, maintaining and administering its power properties (including multiple-purpose properties in the proportion that multiple-purpose costs are allocated to power) and
- payments to states and counties in lieu of taxes,

but before deducting

- depreciation accruals or other charges representing the amortization of capital expenditures,

plus

- the net proceeds of the sale or other disposition of any interest in TVA's power properties that constitute an operating unit or system.

Acquisition of Real Estate

The Act empowers TVA to acquire real estate in the name of the United States of America by purchase or by exercise of the right of eminent domain, "and thereupon all such real estate shall be entrusted to the Corporation as the agent of the United States to accomplish the purposes of [the] Act." Thus, you should read and construe all references in this Statement to TVA properties, and to the amounts invested in TVA properties, in the light of this provision of the Act.

THE BASIC RESOLUTION; POWER BONDS, DISCOUNT NOTES AND OTHER INDEBTEDNESS

TVA issues Power Bonds pursuant to Section 15d of the Act and pursuant to the Basic Resolution. At December 31, 2001, TVA had U.S. \$20.9 billion, DM 1.5 billion (issued in September 1996) and £450 million (£200 issued in December 1998 and £250 million issued in July 2001) principal amount of Power Bonds outstanding. TVA may issue Power Bonds only to provide capital for TVA's power program (including refunding any Evidences of Indebtedness issued for like purposes) and only as authorized by law at the time of issuance. Power Bonds are payable as to both principal and interest solely from Net Power Proceeds, but TVA may, at its option, pay Power Bonds from the proceeds of refunding obligations or other funds legally available for such payment. Net Power Proceeds for fiscal 2001, 2000 and 1999 were \$3.3 billion, \$3.0 billion and \$3.1 billion, respectively. Power Bonds of each series must be further authorized by Supplemental Resolution. *Power Bonds are not obligations of, or guaranteed by, the United States of America.*

TVA intends from time to time to issue new Power Bonds with maturities and on terms deter-

mined in light of market conditions at the time of sale. TVA may sell new Power Bonds to dealers or underwriters, who may resell the new Power Bonds in public offerings or otherwise. Additionally, TVA may sell new Power Bonds directly or through other entities.

The offering circular, and any appropriate amendment or supplement to the offering circular, for each offering of new Power Bonds, except for new Power Bonds offered under a program on a continuous basis, will set forth the following information: (1) the aggregate principal amount, (2) maturity, (3) interest rate or method for determining such rate, (4) interest payment dates, if any, (5) purchase price to be paid to TVA, (6) any terms for redemption or other special terms, (7) form and denomination of new Power Bonds, (8) information as to any stock exchange listing, (9) the names of any dealers, underwriters or agents, (10) a description of any amendments or supplements to the Basic Resolution in connection with the sale of the new Power Bonds and (11) other terms of the new Power Bonds.

For Power Bonds offered under a program on a continuous basis, TVA will prepare a single offering circular that describes the general terms and conditions common to all Power Bonds issued under the program. The offering circular will describe how, if at all, the offering circular will be supplemented in order to reflect, among other things, the specific terms and conditions of the Power Bonds being offered. At the time of each sale, TVA will determine if the Power Bonds being sold will be subject to redemption prior to the maturity date and will establish the purchase price, principal amount, interest rate or interest rate formula, maturity date and certain other terms of such sale.

TVA also issues Discount Notes pursuant to Section 15d of the Act and in accord with Section 2.5 of the Basic Resolution. As of December 31, 2001, TVA had approximately \$2.5 billion in Discount Notes outstanding. Discount Notes are payable solely from Net Power Proceeds, but TVA may, at its option, pay Discount Notes from the proceeds of refunding obligations or other funds legally available for such payment. TVA intends to offer Discount Notes for sale on a continuous basis to a group of securities dealers selected by TVA, who will resell the notes. TVA will issue Discount Notes in a form and upon terms and conditions as it deems appropriate. Certain information respecting

Discount Notes will be set forth in a Discount Notes offering circular and any appropriate supplement to the offering circular. *Discount Notes are not obligations of, or guaranteed by, the United States of America.*

An offering circular, and any appropriate amendment or supplement to the offering circular, for each offering of Other Indebtedness will set forth the following information: (1) the aggregate principal amount, (2) maturity, (3) interest rate or method for determining such rate, (4) interest payment dates, if any, (5) purchase price to be paid to TVA, (6) any terms for redemption or other special terms, (7) form and denomination of Other Indebtedness, (8) information as to any stock exchange listing, (9) the names of any dealers, underwriters or agents and (10) other terms of Other Indebtedness. *Other Indebtedness will not be obligations of, or guaranteed by, the United States of America.*

*The following summary of certain provisions of the Basic Resolution is **not complete** and is qualified in its entirety by reference to the full text of the Basic Resolution. See also "Public Law No. 105-62."*

Application of Net Power Proceeds

Section 2.3 of the Basic Resolution provides as follows:

Net Power Proceeds shall be applied, and the Corporation hereby specifically pledges them for application, first to payments due as interest on Bonds, on Bond Anticipation Obligations, and on any Evidences of Indebtedness issued pursuant to Section 2.5 which rank on a parity with Bonds as to interest; to payments of the principal due on Bonds for the payment of which other provisions have not been made and on any Evidences of Indebtedness issued pursuant to Section 2.5 which rank on a parity with Bonds as to principal and for the payment of which other provisions have not been made; and to meeting requirements of sinking funds or other analogous funds under any Supplemental Resolutions. The remaining Net Power Proceeds shall be used only for:

(a) Required interest payments on any Evidences of Indebtedness issued pursuant to Section 2.5 which do not rank on a parity with Bonds as to interest.

(b) Required payments of or on account of principal of any Evidences of Indebtedness which do not rank on a parity with Bonds as to principal.

(c) Minimum payments into the United States Treasury required by the Act in repayment of and as a return on the Appropriation Investment.

(d) Investment in Power Assets, additional reductions of the Corporation's capital obligations, and other lawful purposes related to the Power Program; provided, however, that payments into the United States Treasury in any fiscal year in reduction of the Appropriation Investment in addition to the minimum amounts required for such purpose by the Act may be made only if there is a net reduction during such year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes, and only to such extent that the percentage of aggregate reduction in the Appropriation Investment during such year does not exceed the percentage of net reduction during the year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes.

Section 2.4 of the Basic Resolution provides as follows:

The Corporation, having first adopted a Supplemental Resolution authorizing the issuance of a series of Bonds and pending such issuance, may issue Bond Anticipation Obligations and renewals thereof (including Interim Obligations to the Secretary of the Treasury) to be paid from the proceeds of such series of Bonds when issued or from other funds that may be available for that purpose.

Section 2.5 of the Basic Resolution provides as follows:

To assist in financing its Power Program the Corporation may issue Evidences of Indebtedness other than Bonds and Bond Anticipation Obligations, which may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 hereof. Such other Evidences of Indebtedness may rank on a parity with but shall not rank ahead of the Bonds as to payments on account of the principal thereof or the interest thereon.

See “Public Law No. 105-62” for a discussion of legislation relating to appropriations for TVA’s nonpower programs and the funding of such programs, including the use of power revenues.

Rate Covenant

Section 3.2 of the Basic Resolution provides as follows:

The Corporation shall fix, maintain, and collect rates for power sufficient to meet in each fiscal year the requirements of that portion of the present subsection (f) of section 15d of the Act which reads as follows:

The Corporation shall charge rates for power which will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to States and counties in lieu of taxes; debt service on outstanding bonds, including provision and maintenance of reserve funds and other funds established in connection therewith; payments to the Treasury as a return on the appropriation investment pursuant to subsection (e) hereof; payment to the Treasury of the repayment sums specified in subsection (e) hereof; and such additional margin as the Board may consider desirable for investment in power system assets, retirement of outstanding bonds in advance of maturity, additional reduction of appropriation investment, and other purposes connected with the Corporation’s power business, having due regard for the primary objectives of the Act, including the objective that power shall be sold at rates as low as are feasible.

For purposes of this Resolution, “debt service on outstanding bonds,” as used in the above provision of the Act, shall mean for any fiscal year the sum of all amounts required to be (a) paid during such fiscal year as interest on Evidences of Indebtedness, (b) accumulated in such fiscal year in any sinking or other analogous fund provided for in connection with any Evidences of Indebtedness, and (c) paid in such fiscal year on account of the principal of any Evidences of Indebtedness for the payment of which funds will not be available from sinking or other analogous funds, from the proceeds of refunding issues, or from other sources; provided, however, that for purposes of clause (c) of this

definition Bond Anticipation Obligations and renewals thereof shall be deemed to mature in the proportions and at the times provided for paying or setting aside funds for the payment of the principal of the authorized Bonds in anticipation of the issuance of which such Bond Anticipation Obligations were issued.

The rates for power fixed by the Corporation shall also be sufficient so that they would cover all requirements of the above-quoted provision of subsection (f) of section 15d of the Act if, in such requirements, there were substituted for “debt service on outstanding bonds” for any fiscal year the amount which if applied annually for 35 years would retire, with interest at the rates applicable thereto, the originally issued amounts of all series of Bonds and other Evidences of Indebtedness, any part of which was outstanding on October 1 of such year.

Covenant for Protection of Bondholders’ Investment

Under the Act and Section 3.3 of the Basic Resolution, TVA must, in each successive five-year period beginning October 1, 1960, use an amount of Net Power Proceeds at least equal to the sum of (1) depreciation accruals and other charges representing the amortization of capital expenditures and (2) the net proceeds from any disposition of power facilities for either (a) the reduction of its capital obligations (including Evidences of Indebtedness and the Appropriation Investment) or (b) investment in Power Assets.

Issuance of Additional Bonds and Other Evidences of Indebtedness

The Act limits the issuance of Evidences of Indebtedness by TVA to a total of \$30 billion outstanding at any one time. At December 31, 2001, TVA had approximately U.S.\$23.5 billion, DM1.5 billion (issued in September 1996) and £450 million (£200 issued in December 1998 and £250 million issued in July 2001) of Evidences of Indebtedness outstanding. The Basic Resolution and the Act permit the issuance of Power Bonds only to provide capital for TVA’s power program, including the refunding of any Evidences of Indebtedness issued for that purpose.

Power Bonds, the terms and conditions of which may not be inconsistent with the Basic Reso-

lution, must also be authorized by Supplemental Resolution. The Basic Resolution provides that each Supplemental Resolution authorizing the issuance of Power Bonds must contain a finding by the Board that after the authorized Power Bonds have been issued, gross revenues from TVA's power program will be adequate to meet the requirements of the Basic Resolution with respect to rates and the application of depreciation accruals. These requirements are described under "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Rate Covenant" and "Covenant for Protection of Bondholders' Investment."

Pending the issuance of Power Bonds authorized by a Supplemental Resolution, TVA may issue Bond Anticipation Obligations and renewals of Bond Anticipation Obligations (including Interim Obligations to the Secretary of the Treasury), to be paid from the proceeds of such Power Bonds when issued or from other funds that may be available for that purpose.

TVA may also issue Evidences of Indebtedness other than Power Bonds and Bond Anticipation Obligations, such as Discount Notes, to assist in financing TVA's power program. They may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 of the Basic Resolution. They may not rank ahead of the Power Bonds as to principal or interest.

Mortgaging and Disposal of Power Properties

TVA may not mortgage any part of its power properties and may not dispose of all or any substantial portion of these properties unless it provides for a continuance of the interest, principal and sinking fund payments due and to become due on all outstanding Evidences of Indebtedness, or for the retirement of such Evidences of Indebtedness.

Modifications of Resolutions and Outstanding Bonds

The Basic Resolution provides for amendments to it, to any Supplemental Resolution and to any outstanding Power Bonds. Generally, TVA may make amendments to the respective rights and obligations of TVA and the bondholders with the written consent of the holders of at least 66 $\frac{2}{3}$ percent in principal amount of the outstanding Power Bonds to which the amendment applies. However, TVA may not make changes in the maturity, principal amount, redemption premium or rate of

interest or maturity of any interest installment, with respect to any Power Bond, or in the above percentage for any such consent, without the consent of the holder of such Power Bond.

Additionally, TVA may amend the Basic Resolution or any Supplemental Resolution without the consent of the bondholders in order (1) to close the Basic Resolution against the issuance of additional Power Bonds or to restrict such issuance by imposing additional conditions or restrictions; (2) to add other covenants and agreements to be observed by TVA or to eliminate any right, power or privilege conferred upon TVA by the Basic Resolution; (3) to modify any provisions to release TVA from any of its obligations, covenants, agreements, limitations, conditions or restrictions, provided that such modification or release shall not become effective with respect to any Power Bonds issued prior to the adoption of such amendment; (4) to correct any defect, ambiguity or inconsistency in, or to make provisions in regard to matters or questions arising under, the Basic Resolution or any Supplemental Resolution, so long as such amendments are not contrary to, or inconsistent with, the Basic Resolution or such Supplemental Resolution; or (5) to make any other modification or amendment which the Board by resolution determines will not materially and adversely affect the interests of holders of the Power Bonds.

Events of Default

Any of the following shall be deemed an Event of Default under the Basic Resolution: (1) default in the payment of the principal or redemption price of any Power Bond when due and payable at maturity, by call for redemption or otherwise; (2) default in the payment of any installment of interest on any Power Bond when due and payable for more than 30 days; or (3) failure of TVA to duly perform any other covenant, condition or agreement contained in the Power Bonds or in the Basic Resolution or any Supplemental Resolution for 90 days after written notice specifying such failure has been given to TVA by the holders of at least 5 percent in aggregate principal amount of the then-outstanding Power Bonds.

Upon any such Event of Default, the holders of the Power Bonds may proceed to protect and enforce their respective rights, subject to the restrictions described below. The holders of at least 5 percent in aggregate principal amount of Power

Bonds then outstanding shall, subject to certain restrictions, have the right and power to institute a proceeding (1) to enforce TVA's covenants and agreements, (2) to enjoin any acts in violation of the rights of holders of Power Bonds and (3) to protect and enforce the rights of holders of Power Bonds. Power Bonds do not provide for acceleration upon an Event of Default. Such holders have no right to bring any such action or proceeding against TVA unless they have given TVA written notice of an Event of Default and TVA has had a reasonable opportunity to take appropriate corrective action with respect thereto and has failed or refused to do so.

Holders of a majority in aggregate principal amount of the outstanding Power Bonds have the right to direct the time, method and place of conducting any proceeding for any remedy available and may waive any default and its consequences, except a default in the payment of the principal of or premium, if any, or interest on any Power Bonds.

Fourth Amendatory Resolution to the Basic Resolution

On March 25, 1992, TVA adopted a resolution amending the Basic Resolution, entitled "Fourth Amendatory Resolution to Basic Tennessee Valley Authority Power Bond Resolution" (the "Fourth Amendatory Resolution"), that (1) deleted from the Basic Resolution limitations on issuance of Power Bonds formerly set forth as Section 3.4 thereof and (2) amended the Basic Resolution to permit issuance of other Evidences of Indebtedness under Section 2.5 thereof that rank on a parity with Power Bonds as to principal and interest. With the deletion of Section 3.4 of the Basic Resolution, Sections 3.5 through 3.10 were renumbered as appropriate.

PUBLIC LAW NO. 105-62

In October 1997 Congress enacted the Energy and Water Development Appropriations Act, 1998, Pub. L. No. 105-62, 111 Stat. 1320, 1338 (1997). The paragraph captioned "TENNESSEE VALLEY AUTHORITY" in Title IV of this act (the "Appropriations Act paragraph") requires TVA, beginning with October 1, 1998, to fund nonpower programs that constitute "essential stewardship activities" with revenues derived from one or more of various sources, including power revenues, notwith-

standing provisions of the TVA Act and power bond covenants to the contrary.

The Appropriations Act paragraph states:

For the purpose of carrying out the provisions of the Tennessee Valley Authority Act of 1933, as amended (16 U.S.C. ch. 12A), including hire, maintenance, and operation of aircraft, and purchase and hire of passenger motor vehicles, \$70,000,000, to remain available until expended, of which \$6,900,000 shall be available for operation, maintenance, surveillance, and improvement of Land Between the Lakes; and for essential stewardship activities for which appropriations were provided to the Tennessee Valley Authority in Public Law 104-206, such sums as are necessary in fiscal year 1999 and thereafter, to be derived only from one or more of the following sources: nonpower fund balances and collections; investment returns of the nonpower program; applied programmatic savings in the power and nonpower programs; savings from the suspension of bonuses and awards; savings from reductions in memberships and contributions; increases in collections resulting from nonpower activities, including user fees; or increases in charges to private and public utilities both investor and cooperatively owned, as well as to direct load customers: *Provided*, That such funds are available to fund the stewardship activities under this paragraph, notwithstanding sections 11, 14, 15, 29, or other provisions of the Tennessee Valley Authority Act, as amended, or provisions of the TVA power bond covenants: *Provided further*, That the savings from, and revenue adjustments to, the TVA budget in fiscal year 1999 and thereafter shall be sufficient to fund the aforementioned stewardship activities such that the net spending authority and resulting outlays for these activities shall not exceed \$0 in fiscal year 1999 and thereafter.

Since fiscal 1999, Congress has provided no appropriations for TVA's nonpower programs. In compliance with the Appropriations Act, TVA is and will continue funding its essential stewardship activities with funds from its power program (and other available funds) to the extent that Congress does not make appropriations for these activities.

TENNESSEE VALLEY AUTHORITY
FINANCIAL STATEMENTS
CONTENTS

	Page
Balance Sheets	F-2
Statements of Income — Power Program	F-3
Statements of Cash Flows.....	F-4
Statements of Changes in Proprietary Capital — Power Program	F-5
Statements of Comprehensive Income (Loss) — Power Program	F-5
Statements of Net Expense and Comprehensive Loss — Nonpower Programs	F-5
Statements of Changes in Proprietary Capital — Nonpower Programs	F-5
Notes to Financial Statements	F-6
Report of Independent Accountants	F-21
Report of Management	F-22

FINANCIAL STATEMENTS

BALANCE SHEETS

At September 30

	Power program		All programs	
	2001	2000	2001	2000
	(in millions)			
ASSETS				
Current assets				
Cash and cash equivalents	\$ 339	\$ 348	\$ 343	\$ 361
Accounts receivable	720	688	720	688
Inventories at average cost and other				
Fuel	170	141	170	141
Other	272	249	272	249
Total current assets	1,501	1,426	1,505	1,439
Property, plant and equipment				
Completed plant	30,467	30,157	31,485	31,189
Less accumulated depreciation	(10,344)	(9,520)	(10,647)	(9,813)
Net completed plant	20,123	20,637	20,838	21,376
Construction in progress	923	793	923	793
Deferred nuclear generating units	4,110	6,325	4,110	6,325
Nuclear fuel and capital leases	487	559	487	559
Total property, plant, and equipment	25,643	28,314	26,358	29,053
Investment funds	725	840	725	840
Deferred charges and other assets				
Loans and other long-term receivables	124	144	149	176
Debt issue and reacquisition costs	140	1,302	140	1,302
Other deferred charges	1,566	1,155	1,566	1,155
Total deferred charges and other assets	1,830	2,601	1,855	2,633
Total assets	\$ 29,699	\$33,181	\$ 30,443	\$33,965
LIABILITIES AND PROPRIETARY CAPITAL				
Current liabilities				
Accounts payable	\$ 710	\$ 531	\$ 715	\$ 544
Accrued liabilities	235	200	235	200
Accrued interest	389	438	389	438
Discount notes	3,016	1,274	3,016	1,274
Current maturities of long-term debt	1,984	2,350	1,984	2,350
Total current liabilities	6,334	4,793	6,339	4,806
Other liabilities	2,806	2,455	2,806	2,455
Long-term debt				
Public bonds — senior	20,375	21,261	20,375	21,261
Public bonds — subordinated	—	1,100	—	1,100
Unamortized discount and other adjustments	(524)	(608)	(524)	(608)
Total long-term debt	19,851	21,753	19,851	21,753
Proprietary capital				
Appropriation investment	508	528	4,863	4,883
Retained earnings reinvested in power program	306	3,652	306	3,652
Accumulated other comprehensive loss	(106)	—	(106)	—
Accumulated net expense of nonpower programs	—	—	(3,616)	(3,584)
Total proprietary capital	708	4,180	1,447	4,951
Total liabilities and proprietary capital	\$ 29,699	\$33,181	\$ 30,443	\$33,965

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

FINANCIAL STATEMENTS
STATEMENTS OF INCOME — POWER PROGRAM
For the Years Ended September 30

	<u>2001</u>	<u>2000</u>	<u>1999</u>
	(in millions)		
Operating revenues			
Sales of electricity			
Municipalities and cooperatives	\$ 5,908	\$5,676	\$5,510
Industries directly served	659	626	642
Federal agencies and other	330	361	357
Other revenue	<u>102</u>	<u>99</u>	<u>86</u>
Total operating revenues	6,999	6,762	6,595
Operating expenses			
Fuel and purchased power	1,989	1,962	1,777
Operating and maintenance	1,660	1,443	1,403
Depreciation and amortization	1,312	1,185	1,181
Tax-equivalents	315	308	304
Accelerated amortization (notes 1 and 8)	<u>230</u>	<u>121</u>	<u>261</u>
Total operating expenses	<u>5,506</u>	<u>5,019</u>	<u>4,926</u>
Operating income	1,493	1,743	1,669
Other income, net	<u>248</u>	<u>17</u>	<u>10</u>
Income before interest expense, loss on impairment of assets, and cumulative effect of change in accounting principle	1,741	1,760	1,679
Interest expense			
Interest on debt	1,601	1,695	1,753
Amortization of debt discount, issue, and reacquisition costs, net	87	94	60
Allowance for funds used during construction	<u>(55)</u>	<u>(53)</u>	<u>(36)</u>
Net interest expense	1,633	1,736	1,777
Income (loss) before loss on impairment of assets and cumulative effect of change in accounting principle	108	24	(98)
Loss on impairment of assets (notes 1 and 2)	(3,419)	—	—
Cumulative effect of change in accounting principle (notes 1 and 8)	<u>—</u>	<u>—</u>	<u>217</u>
Net income (loss)	<u><u>\$(3,311)</u></u>	<u><u>\$ 24</u></u>	<u><u>\$ 119</u></u>

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

FINANCIAL STATEMENTS
STATEMENTS OF CASH FLOWS
For the Years Ended September 30

	Power program			All programs		
	2001	2000	1999	2001	2000	1999
	(in millions)					
Cash flows from operating activities						
Net power income (loss)	\$ (3,311)	\$ 24	\$ 119	\$ (3,311)	\$ 24	\$ 119
Net expense of nonpower programs	—	—	—	(32)	(28)	(96)
Items not requiring (providing) cash						
Depreciation and amortization	1,471	1,289	1,250	1,482	1,299	1,263
Accelerated amortization	230	121	261	230	121	261
Allowance for funds used during						
construction	(55)	(53)	(36)	(55)	(53)	(36)
Nuclear fuel amortization	158	177	177	158	177	177
Cumulative effect of change in accounting						
principle	—	—	(217)	—	—	(217)
Loss on impairment of assets	3,419	—	—	3,419	—	—
Other, net	(45)	25	(26)	(33)	25	—
Changes in current assets and liabilities						
Accounts receivable	(42)	42	65	(42)	42	65
Inventories and other	(60)	19	(35)	(60)	19	(35)
Accounts payable and accrued liabilities ..	205	61	(19)	197	42	(21)
Accrued interest	(49)	(26)	(23)	(49)	(26)	(23)
Other, net	(36)	(95)	(85)	(36)	(95)	(85)
Net cash provided by operating activities ...	1,885	1,584	1,431	1,868	1,547	1,372
Cash flows from investing activities						
Construction expenditures	(1,015)	(867)	(829)	(1,015)	(867)	(830)
Allowance for funds used during						
construction	55	53	36	55	53	36
Nuclear fuel	(94)	(184)	(135)	(94)	(184)	(135)
Other, net	(137)	(37)	(28)	(129)	(38)	(21)
Net cash used in investing activities	(1,191)	(1,035)	(956)	(1,183)	(1,036)	(950)
Cash flows from financing activities						
Long-term debt						
Issues	2,708	2,250	4,506	2,708	2,250	4,506
Redemptions	(5,069)	(2,944)	(4,046)	(5,069)	(2,944)	(4,046)
Short-term borrowings, net	1,742	292	(775)	1,742	292	(775)
Proceeds from combustion turbine financing	—	300	—	—	300	—
Financing costs, net	(29)	(148)	(391)	(29)	(148)	(391)
Congressional appropriations	—	—	—	—	—	50
Payments to U.S. Treasury	(55)	(54)	(57)	(55)	(54)	(57)
Other, net	—	—	—	—	(6)	—
Net cash used in financing activities	(703)	(304)	(763)	(703)	(310)	(713)
Net change in cash and cash equivalents	(9)	245	(288)	(18)	201	(291)
Cash and cash equivalents at beginning of						
period	348	103	391	361	160	451
Cash and cash equivalents at end of period ...	\$ 339	\$ 348	\$ 103	\$ 343	\$ 361	\$ 160

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

FINANCIAL STATEMENTS
POWER PROGRAM
STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL
For the years ended September 30
(in millions)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Retained earnings reinvested at beginning of period	\$ 3,652	\$3,662	\$3,580
Net income (loss)	(3,311)	24	119
Return on appropriation investment	<u>(35)</u>	<u>(34)</u>	<u>(37)</u>
Retained earnings reinvested at end of period	306	3,652	3,662
Accumulated other comprehensive loss	(106)	—	—
Appropriation investment at beginning of period	528	548	568
Return of appropriation investment	<u>(20)</u>	<u>(20)</u>	<u>(20)</u>
Appropriation investment at end of period	508	528	548
Proprietary capital at end of period	<u>\$ 708</u>	<u>\$4,180</u>	<u>\$4,210</u>

POWER PROGRAM
STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the years ended September 30
(in millions)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Net income (loss)	\$(3,311)	\$24	\$119
Accumulated other comprehensive loss	<u>(106)</u>	<u>—</u>	<u>—</u>
Comprehensive income (loss)	<u><u>\$(3,417)</u></u>	<u><u>\$24</u></u>	<u><u>\$119</u></u>

NONPOWER PROGRAMS
STATEMENTS OF NET EXPENSE AND COMPREHENSIVE LOSS
For the years ended September 30
(in millions)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Water and Land Stewardship	\$32	\$26	\$72
Land Between The Lakes	—	—	19
Economic Development	—	2	5
Net expense and comprehensive loss (note 10)	<u>\$32</u>	<u>\$28</u>	<u>\$96</u>

NONPOWER PROGRAMS
STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL
For the years ended September 30
(in millions)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Proprietary capital at beginning of period	\$771	\$860	\$908
Congressional appropriations	—	—	50
Net expense	(32)	(28)	(96)
Transfers to other federal agencies (note 10)	—	(56)	—
Other, net	<u>—</u>	<u>(5)</u>	<u>(2)</u>
Proprietary capital at end of period	<u>\$739</u>	<u>\$860</u>	<u>\$860</u>

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

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

TVA is a wholly owned corporate agency and instrumentality of the United States. It was established by the TVA Act with the objective of developing the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense by providing:

(1) an ample supply of power within the region, (2) navigable channels and flood control for the Tennessee River system, and (3) agricultural and industrial development and improved forestry in the region. TVA carries out these regional and national responsibilities in a service area that centers on Tennessee and includes parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina, and Virginia.

TVA's operations have historically been divided into two types of activities, the power program and the nonpower programs. Substantially all TVA revenues and assets are attributable to the power program. The power program has historically been separate and distinct from the nonpower programs and is required to be self-supporting from power revenues and proceeds from the issuance of debt. The power program receives no congressional appropriations and is required to make annual payments to the U.S. Treasury in repayment of, and as a return on, the government's appropriation investment in TVA power facilities. Until 2000, most of the funding for TVA's nonpower programs was provided by congressional appropriations. These programs are now funded largely with power funds. Certain nonpower activities are also funded with various revenues and user fees. See note 10 for a discussion relating to the future funding of TVA's nonpower programs.

Power rates are established by the TVA Board of Directors as authorized by the TVA Act. The TVA Act requires TVA to charge rates for power that, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes; and debt service on outstanding indebtedness.

Five municipal customers, which account for an aggregate of total power sales of 27 percent for

2001, 2000, and 1999, purchase power from TVA under long-term contracts that require 10 years' notice to terminate.

Fiscal year

Unless otherwise indicated, years (2001, 2000, etc.) refer to TVA's fiscal years ended September 30.

Revenue

Revenues from power sales are recorded as power is delivered to customers. TVA accrues estimated unbilled revenues for power sales provided to customers for the period of time from the end of the billing cycle to month's end.

Off-system sales are presented in the accompanying Statements of Income — Power Program as a component of Sales of electricity — Federal agencies and other.

Property, plant and equipment, and depreciation

Additions to plant are recorded at cost, which includes direct and indirect costs and an allowance for funds used during construction. The cost of current repairs and minor replacements is charged to operating expense. Nuclear fuel is valued at the lower of cost or market using the average cost method for raw materials and the specific identification method for nuclear fuel in reactor. Amortization of nuclear fuel is calculated on a units-of-production basis and is included in fuel expense. The TVA Act requires TVA's Board of Directors to allocate the cost of completed multipurpose projects between the power and nonpower programs, subject to the approval of the President of the United States. The original cost of property retired, together with removal costs less salvage value, is charged to accumulated depreciation. Depreciation is generally computed on a straight-line basis over the estimated service lives of the various classes of assets. Depreciation expense expressed as a percentage of the average annual depreciable completed plant was 3.28 percent for 2001, 3.27 percent for 2000, and 3.28 percent for 1999.

Decommissioning costs

TVA recognizes as incurred all obligations related to closure and removal of its nuclear units.

NOTES TO FINANCIAL STATEMENTS — (Continued)

Earnings from decommissioning investments, amortization of the decommissioning regulatory asset, and interest expense on the decommissioning liability are deferred (*see note 9 — Contingencies-Decommissioning costs*).

Allowance for funds used during construction

TVA capitalizes an allowance for funds used during construction. The allowance is applicable to construction in progress, excluding deferred nuclear generating units.

Other deferred charges

Other deferred charges primarily include pre-paid pension costs and regulatory assets capitalized under the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*.

Regulatory Assets

At September 30, 2001, other deferred charges included total unamortized regulatory assets of \$439 million, which represents certain charges related to the closure and removal of nuclear units (*see note 1 and note 9 — Contingencies-Decommissioning costs*). At September 30, 2000, the unamortized balances of regulatory assets of \$372 million consisted of \$228 million, representing a transition obligation for certain postemployment benefits, and \$144 million, representing certain charges related to the closure and removal of nuclear units (*see note 1 and note 9 — Contingencies-Decommissioning costs*). The \$228 million transition obligation for certain postemployment benefits was fully amortized during 2001. Effective for 1999, TVA reclassified an additional \$332 million from nuclear fuel inventory to deferred charges; this was subsequently charged against earnings in 1999 and 2000. The effect of this change was to increase 1999 expense by approximately \$111 million and to increase 2000 expense by approximately \$221 million.

Accelerated Amortization

Annual provisions for amortization of deferred charges are adjusted as necessary in order to achieve certain earnings levels. Such earnings levels are set forth in resolutions adopted annually by the

TVA Board of Directors in connection with the rate review process. The targeted earnings levels are based on the requirements of the TVA Act and the Basic TVA Power Bond Resolution (*see note 6 — Borrowing authority*). Such adjustments may result in either contraction or extension of the estimated amortization periods. The amortization of such assets is principally computed on a straight-line basis, over periods ranging from three to 15 years. As a result of surplus earnings levels in 2001, 2000, and 1999, TVA accelerated amortization of certain regulatory assets by \$230 million, \$121 million, and \$261 million, respectively, under the policy.

Nuclear refueling outage costs

Nuclear refueling outage maintenance costs are deferred and amortized on a straight-line basis over the estimated period until the next refueling outage. The amount of deferred outage costs at September 30, 2001, 2000, and 1999, was \$57 million, \$73 million, and \$63 million, respectively.

Investment funds

Investment funds consist primarily of trust funds designated to fund nuclear decommissioning requirements (*see note 9 — Contingencies-Decommissioning costs*). These funds are invested in portfolios of securities generally designed to earn returns in line with overall equity market performance. These investments are classified as trading securities and carried at fair value.

Debt issue and reacquisition costs

Debt issue and reacquisition expenses, call premiums, and other related costs are deferred and amortized (accreted) on a pooled straight-line basis over the weighted average life of TVA's debt portfolio.

TVA has incurred premiums related to certain advanced refundings and has also received and paid premiums in connection with the monetization of certain call provisions. In accordance with regulatory practices, TVA defers and amortizes such premiums on a pooled straight-line basis over the weighted average life of its public debt portfolio. In 2001, TVA charged deferred costs of \$789 million against earnings (*see note 1 — Impairment of assets*). The unamortized balances of such regula-

NOTES TO FINANCIAL STATEMENTS — (Continued)

tory assets at September 30, 2001 and 2000, were \$140 million and \$607 million, respectively.

Tax equivalents

The TVA Act requires TVA to make payments to states and local governments where the power operations of the corporation are conducted. The amount is 5 percent of gross receipts from the prior year's sale of power, excluding sales to other federal agencies and off-system sales with other utilities, with a provision for minimum payments under certain circumstances.

Impairment of assets

In conjunction with its periodic financial review, TVA identified certain assets for which the estimated future cash flows provided through future rates were likely to be less than recorded book values. Accordingly, TVA reduced the carrying amount of these assets by a total of \$3,419 million, of which \$2,220 million was attributable to deferred nuclear generating units, \$789 million was attributable to deferred debt refinancing costs, and \$410 million was attributable to plant held for future use. The ultimate disposition or use of these assets is unaffected by the asset value reductions (see note 1 — *Debt issue and reacquisition costs*, and notes 2 and 3) in accordance with SFAS No. 71. This nonrecurring charge will have no effect on TVA's statutory obligation to set rates at levels necessary to produce revenues sufficient to pay the service on its debt and other expenses specified in the TVA Act.

Cash and cash equivalents

Cash and cash equivalents include the cash available in commercial bank accounts and U.S. Treasury accounts, as well as short-term securities held for the primary purpose of general liquidity. Such securities mature within three months from the date of acquisition.

Insurance

TVA is primarily self-insured for property loss, workers' compensation, general liability, and automotive liability. TVA is also self-insured for health-care claims for eligible active and retired employees not covered by Medicare. Consulting

actuaries assist TVA in determining certain liabilities for self-insured claims. TVA maintains nuclear liability insurance and nuclear property, decommissioning, and decontamination insurance with an outside party (see note 9 — *Contingencies-Nuclear insurance*).

Impact of new accounting standards

Effective October 1, 2000, TVA adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, which requires that certain derivative instruments be recorded on the balance sheet as either an asset or a liability measured at fair value. Changes in the fair value of derivatives are recognized in either net income or other comprehensive income, depending on the designated purpose of the derivative. For 2001, accumulated other comprehensive loss primarily consists of mark-to-market bond swap valuation adjustments of \$106 million.

In June 2001 the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002.

In October 2001 the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which replaces SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. The objectives of these FASB standards were to develop one accounting model for long-lived assets to be disposed of by sale, based on the framework established in SFAS No. 121, and to address significant implementation issues. SFAS No. 144 requires that those long-lived assets be measured at the lower of the carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. The provisions of SFAS No. 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001, and, generally, are to be applied prospectively.

NOTES TO FINANCIAL STATEMENTS — (Continued)

At the present time, TVA is unable to determine whether the implementation of these standards will be material to its results of operations or financial position.

Management estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of

assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Other

Certain reclassifications have been made to the 1999 and 2000 financial statements to conform to the 2001 presentation.

2. NUCLEAR POWER PROGRAM

The nuclear power program at September 30, 2001, consists of nine units — five operating, three deferred, and one inoperative — at four locations, with investments in property, plant, and equipment as follows and in the status indicated:

	<u>Operating Units</u>	<u>Installed Capacity (Megawatts)</u>	<u>Completed Plant, Net</u>	<u>Construction in Progress</u>	<u>Deferred</u>	<u>Fuel Investment</u>
(dollars in millions)						
Browns Ferry*	2	2,380	\$ 2,800	\$ 39	\$ —	\$149
Sequoyah	2	2,442	1,846	77	—	102
Watts Bar	1	1,270	6,076	7	—	44
Bellefonte	—	—	—	—	4,110	—
Raw materials	—	—	—	—	—	20
Total	<u>5</u>	<u>6,092</u>	<u>\$10,722</u>	<u>\$123</u>	<u>\$4,110</u>	<u>\$315</u>

* Browns Ferry 1, an inoperative unit, is discussed below.

Browns Ferry 1 was taken offline in 1985 for modifications and improvements and will remain in an inoperative status until its ultimate disposition is determined. The undepreciated cost of Browns Ferry 1 of \$53 million is included in net completed plant and is being depreciated as part of the recoverable cost of the plant over the remaining license period.

TVA has three units in deferred status. In 1988 TVA suspended construction activities on Watts Bar 2, and the unit is currently in lay-up. Bellefonte 1 and 2 were deferred in 1988 and 1985, respectively. Estimated 2002 expenditures for the three deferred units are limited to lay-up, maintenance, and ensuring that options remain viable.

In December 1994 TVA determined that it will not, by itself, complete Bellefonte 1 and 2 and Watts Bar 2 as nuclear units. TVA's integrated resource planning process identified as a viable option the conversion of the Bellefonte facility to a

combined-cycle plant utilizing natural gas or gasified coal. In 1997 an independent team of technical and financial experts completed a feasibility study to evaluate options for the conversion of the Bellefonte Nuclear Plant to a fossil fuel fired plant. The feasibility study indicated that one of the most economical fossil conversion strategies would be to complete Bellefonte as a natural gas fired combined-cycle plant. TVA also issued an Environmental Impact Statement (EIS) assessing the environmental impacts of various fossil conversion options. The EIS identified the natural gas fired combined-cycle plant alternative as the preferred option. Bellefonte remains in a deferred status.

While future decisions on TVA's deferred units will ultimately impact the method of cost recovery, the TVA Board determined as of the end of 2001 that the values of some of its existing assets were not appropriate in a competitive marketplace. Certain assets, Bellefonte 1 and 2 and Watts Bar 2, were identified as assets for which the estimated

NOTES TO FINANCIAL STATEMENTS — (Continued)

future values are less than recorded book values. Consequently, for 2001 TVA revalued these assets downward by \$2,220 million and recognized an impairment loss. The Board will establish rate ad-

justments and operating policies to ensure full recovery of the remaining cost of the Bellefonte units and compliance with the requirements of the TVA Act (*see note 1 — Impairment of assets*).

3. COMPLETED PLANT — POWER PROGRAM

Completed plant of the power program consists of the following at September 30 after a downward revaluation of \$410 million to Other plant (*see note 1 — Impairment of assets*):

	2001			2000		
	Cost	Accumulated Depreciation	Net	Cost	Accumulated Depreciation	Net
	(in millions)					
Fossil	\$ 8,324	\$ 3,877	\$ 4,447	\$ 8,150	\$ 3,616	\$ 4,534
Combustion turbine	837	251	586	629	221	408
Nuclear	14,747	4,025	10,722	14,719	3,567	11,152
Transmission	3,672	1,211	2,461	3,473	1,154	2,319
Hydro	1,623	556	1,067	1,517	536	981
Other	1,264	424	840	1,669	426	1,243
Total.....	\$30,467	\$10,344	\$20,123	\$30,157	\$9,520	\$20,637

4. PROPRIETARY CAPITAL

Appropriation investment — power program

The TVA Act requires TVA to make annual payments to the U.S. Treasury from net power proceeds as a return on the appropriation investment in the power system and as a repayment of that investment. The payments required by the TVA Act may be deferred under certain circumstances for not more than two years. TVA paid \$20 million each year for 2001, 2000, and 1999 as a repayment of the appropriation investment. In addition, TVA paid the U.S. Treasury \$35 million in 2001, \$34 million in 2000, and \$37 million in 1999 as a return on the appropriation investment. The return is based on the appropriation investment as of the beginning of the year and on the computed average interest rate payable by the U.S. Treasury on its total marketable public obligations as of the same date (6.63 percent at September 30, 2000).

Accumulated other comprehensive loss

SFAS No. 130, *Reporting Comprehensive Income*, requires the disclosure of comprehensive income or loss to reflect changes in capital that result from transactions and economic events from nonowner sources. The amounts included in other comprehensive loss were \$106 million for 2001 and \$0 for 2000 and 1999. The loss of \$106 million for

2001 represents mark-to-market valuation adjustments for certain derivative instruments (*see note 1 — Impact of new accounting standards, and note 5 — Adoption of new accounting standard*).

5. RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS

TVA has established a Risk Management Committee, which is charged with the responsibility of reviewing and approving controls and procedures for TVA-wide risk management activities, including the oversight of models and assumptions used to measure risk, the review of counterparty exposure limits, and the establishment of formal procedures regarding the use of financial hedging instruments.

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

TVA is exposed to losses in the event of counterparties' nonperformance and accordingly has established controls to determine the creditworthi-

NOTES TO FINANCIAL STATEMENTS — (Continued)

ness of counterparties in order to mitigate exposure to credit risk.

With respect to hedging activities, TVA risk management policies provide for the use of derivative financial instruments to manage financial exposures but prohibit the use of these instruments for speculative or trading purposes. Prior to October 1, 2000, TVA accounted for hedging activities using the deferral method, and gains and losses were recognized in the financial statements when the related hedged transaction occurred. During 2001, TVA adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. See further discussion related to TVA's adoption of SFAS No. 133 at *Adoption of new accounting standard* (below).

Adoption of new accounting standard

During 2001, TVA adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In accordance with SFAS No. 133, certain commodity and interest rate swap contracts were marked to market and resulted in a \$106 million loss for 2001. Since such contracts represent cash flow hedges of certain commodity and debt transactions, the loss has been recognized in accumulated other comprehensive loss. As of September 30, 2001, less than \$1 million of deferred net losses on derivative instruments accumulated in other comprehensive loss is expected to be reclassified to earnings during the next 12 months. Because of the highly effective nature of its hedging transactions, TVA was not required to recognize losses in the Statements of Income due to the ineffectiveness of cash flow hedges. If any loss/(gain) were to be incurred as a result of the early termination of a swap contract, any resulting charge/(income) would be amortized over the remaining life of the bond as a component of interest expense.

Commodity contracts

TVA enters into contracts that hedge cash flow exposures to market fluctuations in the price and delivery of certain commodities. TVA expects to take or make delivery, as appropriate, under these forward contracts. Accordingly, these contracts qualify for normal purchase and normal sale accounting under SFAS No. 133, as interpreted by the

Derivative Implementation Group (DIG). DIG Issue C15 describes the criteria that must be met in order for such contracts to qualify for the use of normal purchase and normal sale accounting. DIG Issue C16 describes the circumstances under which certain contracts do not qualify for the use of normal purchase and normal sale accounting.

Gains and losses on cash flow hedges are deferred in other comprehensive income and recognized as adjustments to the carrying amount of the items hedged. Deferral of the gains and losses continues until the items hedged are recognized in income. Gains and losses on derivatives not qualifying for hedge accounting are deferred in accordance with SFAS No. 71.

Foreign currency and interest rate swaps

During 1996, TVA entered into a currency swap contract as a hedge for a foreign currency denominated debt transaction. TVA issued DM1.5 billion of bonds and entered into a currency swap to hedge fluctuations in the DM exchange rate. TVA also entered into currency swap contracts during 2001 and 1999 as hedges for sterling-denominated debt transactions in which TVA issued £250 million and £200 million of bonds, respectively. Any gains and losses on the debt instruments due to the foreign currency transactions are offset by losses or gains on the swap contracts. At September 30, 2001 and 2000, the currency transactions had resulted in net translation gains of \$322 million and \$360 million, respectively. However, the net translation gains were offset by corresponding losses on the swap contracts. Additionally, in 1997 TVA issued \$300 million of inflation-index accreting principal bonds. The 10-year bonds have a fixed coupon rate that is paid on the inflation-adjusted principal amount. TVA hedged its inflation exposure under the securities through a 10-year receive floating, pay fixed interest rate swap agreement.

6. DEBT

Borrowing authority

The TVA Act authorizes TVA to issue bonds, notes, and other evidences of indebtedness up to a total of \$30 billion outstanding at any one time. TVA must meet certain financial tests that are contained in the TVA Act and the Basic TVA

NOTES TO FINANCIAL STATEMENTS — (Continued)

Power Bond Resolution. Debt service on these obligations which is payable solely from TVA's net power proceeds, has precedence over payment to the U.S. Treasury (*see note 4 — Appropriation investment — power program*).

Short-term debt

The weighted average rates applicable to short-term debt outstanding in the public market as of September 30, 2001 and 2000, were 2.90 percent and 6.53 percent, respectively. During 2001, 2000, and 1999, the maximum outstanding balances of short-term borrowings held by the public were (in millions) \$3,459, \$3,943, and \$4,701, respectively. The average amounts (and weighted average interest rates) of short-term borrowings were approximately (in millions) \$1,994 (4.90 percent), \$2,628 (5.94 percent), and \$1,945 (5.01 percent), respectively.

Put and call options

Bond issues of \$4.7 billion held by the public are redeemable in whole or in part, at TVA's option, on call dates ranging from the present to July 2020 and at call prices ranging from 100 percent to 106.3 percent of the principal amount. Additionally, TVA has bond issues of \$2.6 billion held by the public that are redeemable in whole or in part at the option of the respective bondholders, as follows: One bond issue totaling \$121 million, which matures in April 2036, is redeemable in 2006 by the bondholders; a second issue totaling \$1.5 billion, which matures in April 2036, is redeemable in 2006 at the option of the bondholders; and a third issue

totaling \$984 million, which matures in May 2012, is redeemable in 2002 at the option of the bondholders. Each of these issues is reported in the debt schedule, with maturity dates corresponding to the earliest redeemable dates. Fifteen additional issues totaling \$849 million, with maturity dates ranging from 2005 to 2030, include a provision for right of redemption upon the death of a beneficial owner in certain specified circumstances.

Additionally, TVA has two issues of Puttable Automatic Rate Reset Securities (PARRS) outstanding. The bonds permit TVA, after a fixed-rate period of five years, to reset the coupon rate downward under certain market conditions. Investors have the option to redeem the bonds at par if and when the interest rate is reset. One PARRS issue totals \$575 million, matures in June 2028, and has its first potential reset date in June 2003. The second issue of PARRS totals \$525 million, matures in May 2029, and has its first potential reset date in May 2004.

Interest and capital costs

During 2001, 2000, and 1999, cash paid for interest on outstanding indebtedness (net of amount capitalized) was \$1,471 million, \$1,669 million, and \$1,740 million, respectively. In addition to paying interest on outstanding indebtedness, TVA is required by the TVA Act to make annual payments to the U.S. Treasury. The annual Treasury payments represent a repayment of the original appropriation investment, along with a return on the appropriation investment (*see note 4 — Appropriation investment — power program*).

NOTES TO FINANCIAL STATEMENTS — (Continued)

Debt outstanding at September 30, 2001 and 2000, consisted of the following:

	2001	2000
	(in millions)	
Short-term debt		
Discount notes (net of discount)	\$ 3,016	\$ 1,274
Current maturities of long-term debt — 5.00% to 7.14%	1,984	2,350
Total short-term debt	5,000	3,624
Long-term debt		
Senior		
Maturing in 2002 — 6.00% to 7.14%	—	2,000
Maturing in 2003 — 6.125%	—	1,250
Maturing in 2004 — 4.75% to 5.00%	1,400	400
Maturing in 2005 — 6.375% to 7.15%	2,065	2,065
Maturing in 2006 — 5.25% to 7.125%	2,670	2,621
Maturing in 2007 through 2045 — 5.375% to 8.25%	14,240	12,925
Subordinated		
Maturing in 2045 and 2046 — 7.50% to 8.00%	—	1,100
Total long-term debt	20,375	22,361
Total indebtedness	\$25,375	\$25,985

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

TVA uses the methods and assumptions described below to estimate the fair value of each significant class of financial instrument. The fair market value of the financial instruments held at September 30, 2001, may not be representative of the actual gains or losses that will be recorded when these instruments mature or if they are called or presented for early redemption.

Cash and cash equivalents and short-term debt

Because of the short-term maturity of these instruments, the carrying amount approximates fair value.

Investment funds

At September 30, 2001, these investments were classified as trading securities and carried at their fair value.

Loans and other long-term receivables

Fair values for these homogeneous categories of loans and receivables are estimated by determining the present value of future cash flows using a

discounted rate equal to lending rates for similar loans made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amount approximates fair value.

Long-term debt

Fair value of long-term debt traded in the public market is determined by multiplying the par value of the bonds by the quoted market price (asked price) nearest the balance sheet date. At September 30, 2001, the carrying amount of long-term debt was \$22,359 million compared with a fair value of \$23,139 million, and at September 30, 2000, the carrying amount of long-term debt was \$24,711 million compared with a fair value of \$23,840 million.

Other financing obligations

In 2000, TVA received approximately \$300 million in proceeds by entering into a lease-lease-back transaction for eight new peaking combustion turbine units. Due to the nature of the transaction, the carrying amount of the obligation and the fair market value are equal. At September 30, 2001 and 2000, the balance of the obligation was \$271 million and \$300 million, respectively.

NOTES TO FINANCIAL STATEMENTS — (Continued)

8. BENEFIT PLANS

Pension plan

TVA has a defined benefit plan for most of its full-time employees that provides two benefit structures: the Original Benefit Structure and the Cash Balance Benefit Structure. The plan is controlled and administered by a legal entity separate from TVA, the TVA Retirement System (TVARS), which is governed by its own independent board of directors. The plan assets are primarily stocks and bonds. TVA contributes to the plan such amounts as are agreed upon by the TVA and TVARS boards of directors, which in no event are less than the amounts necessary on an actuarial basis to provide assets sufficient to meet obligations for benefits. No TVA contribution is legally required when the plan's assets are sufficient to meet its accrued liabilities, as determined by an independent outside actuary.

The pension benefit for a member participating in the Original Benefit Structure is based on the member's years of creditable service, average base pay for the highest three consecutive years, and the pension rate for the member's age and years of service, less a Social Security offset.

The pension benefit for a member participating in the Cash Balance Benefit Structure is based on credits accumulated in the member's account and the member's age. A member's account receives credits each pay period equal to 6.0 percent of his or her straight-time earnings. The account also increases at an interest rate equal to the change in the Consumer Price Index (CPI) plus 3.0 percent, which amounted to 5.8 percent in 1998. During

1999, the plan was amended such that the rate may not be less than 6.0 percent or more than 10.0 percent. The actual change in the CPI for 2001 and 2000 was 3.2 percent and 2.0 percent, which resulted in interest rates of 6.2 percent and 6.0 percent, respectively.

TVARS also maintains a defined contribution plan, a 401(k) plan to which TVA makes matching contributions of 25 cents on the dollar (up to 1.5 percent of pay) for members participating in the Original Benefit Structure and of 75 cents on the dollar (up to 4.5 percent of pay) for members participating in the Cash Balance Benefit Structure.

During 1999, TVA changed its accounting policy for the purpose of determining the market-related value of pension assets, an action that resulted in a one-time gain of approximately \$217 million. This gain is presented in the Statements of Income under the caption "Cumulative effect of change in accounting principle."

The discount rate used to determine the actuarial present value of the projected benefit obligation was 7.5 percent in 2001, 8.0 percent in 2000, and 7.5 percent in 1999. The assumed annual rates of increase in future compensation levels for 2001, 2000, and 1999 ranged from 3.3 percent to 8.3 percent. The expected long-term rate of return on plan assets was 9.0 percent for 2001 and 10.0 percent for 2000 and 1999.

During 2000, plan amendments were effected that enhanced certain pension benefits, resulting in approximately \$250 million in additional pension-plan benefit obligations.

NOTES TO FINANCIAL STATEMENTS — (Continued)

The components of pension expense and other postretirement benefits expense for the years ended September 30 were:

	Pension Benefits		Other Postretirement Benefits	
	2001	2000	2001	2000
	(in millions)			
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 5,461	\$ 5,031	\$ 133	\$ 151
Service cost	79	76	2	5
Interest cost	424	367	10	11
Plan participants' contributions	28	32	43	36
Amendments, including special events	—	250	—	16
Actuarial (gain)/loss	268	20	93	(33)
Net transfers to variable fund/401(k) plan	9	(23)	—	—
Expenses paid	(4)	(3)	—	—
Benefits paid	(307)	(289)	(60)	(53)
Benefit obligation at end of year	<u>\$ 5,958</u>	<u>\$ 5,461</u>	<u>\$ 221</u>	<u>\$ 133</u>
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 7,312	\$ 6,842	\$ —	\$ —
Adjustment to reconcile to system asset value	(1)	(13)	—	—
Actual return on plan assets	(1,159)	764	—	—
Plan participants' contributions	28	32	43	36
Net transfers to variable fund/401(k) plan	9	(23)	—	—
Employer contributions	—	3	17	17
Expenses paid	(4)	(4)	—	—
Benefits paid	(307)	(289)	(60)	(53)
Fair value of plan assets at end of year	<u>\$ 5,878</u>	<u>\$ 7,312</u>	<u>\$ —</u>	<u>\$ —</u>
Funded status	\$ (80)	\$ 1,851	\$(221)	\$(133)
Unrecognized net actuarial (gain)/loss	418	(1,649)	62	(32)
Unrecognized prior service cost	456	492	(43)	(48)
Prepaid (accrued) benefit cost	<u>\$ 794</u>	<u>\$ 694</u>	<u>\$(202)</u>	<u>\$(213)</u>

	Pension Benefits			Other Postretirement Benefits		
	2001	2000	1999	2001	2000	1999
	(in millions)					
Components of net periodic benefit cost						
Service cost	\$ 78	\$ 76	\$ 94	\$ 2	\$ 5	\$ 5
Interest cost	424	367	374	10	11	14
Expected return on plan assets	(599)	(602)	(591)	n/a	n/a	n/a
Amortization of prior service cost	36	24	24	(4)	(6)	(2)
Amortization of transition obligation	—	—	—	—	—	—
Recognized net actuarial loss	(39)	(19)	—	(2)	—	—
Net periodic benefit cost	(100)	(154)	(99)	6	10	17
Special events	—	—	(217)	—	—	—
Total benefits cost/(income)	<u>\$(100)</u>	<u>\$(154)</u>	<u>\$(316)</u>	<u>\$ 6</u>	<u>\$ 10</u>	<u>\$ 17</u>

NOTES TO FINANCIAL STATEMENTS — (Continued)

Other postretirement benefits

TVA sponsors an unfunded postretirement plan that provides for non-vested contributions toward the cost of certain retirees' medical coverage. This plan formerly covered all retirees participating in the TVA medical plan, and TVA's contributions were a flat dollar amount based on the participants' ages and years of service and certain payments toward the plan costs. This plan now operates on a much more limited basis, covering only certain retirees and surviving dependents who do not qualify for TVARS benefits.

During 2000 these postretirement benefits were enhanced to help covered retirees offset the cost of medical coverage, which resulted in approximately \$16 million in additional postretirement benefit obligations.

The annual assumed cost trend for covered benefits was 8.5 percent in 2001, decreasing by 0.5 percent per year to a level of 5.0 percent in 2008 and thereafter. For 2000 and 1999, annual trend rates of 9.0 percent and 9.5 percent, respectively, were assumed. The effect of the change in assumptions of the cost basis was not significant. Increasing/(reducing) the assumed health-care cost trend rates by 1 percent would increase/(reduce) the accumulated postretirement benefit obligation (APBO) as of September 30, 2001, by \$17 million/(\$16 million) and the aggregated service and interest cost components of net periodic postretirement benefit cost for 2001 by \$1 million/(\$1 million).

The weighted average discount rate used in determining the APBO was 7.5 percent for 2001, 8.0 percent for 2000, and 7.5 percent for 1999. Any net unrecognized gain or loss resulting from experience different from that assumed or from changes in assumptions, and exceeding 10 percent of the APBO, is amortized over the average remaining service period of active plan participants.

Other postemployment benefits

Other postemployment benefits include workers' compensation provided to former or inactive employees and their beneficiaries and covered dependents for the period after employment but before retirement. Adoption of SFAS No. 112, *Employers' Accounting for Postemployment Benefits*, in

1995 changed TVA's method of accounting practice from recognizing costs as benefits are paid to accruing the expected costs of providing these benefits. In connection with the adoption of SFAS No. 112 and related approval by its Board of Directors, TVA recorded the transition obligation as a regulatory asset. The regulatory asset was being amortized over approximately 15 years, whereby the annual expense approximated the expense that would have been recorded on an as-paid basis. In 2000 TVA accelerated amortization of the regulatory asset by approximately \$80 million, and in 2001 it accelerated the amortization by \$194 million to complete the write-off of the regulatory asset. This acceleration was in accordance with TVA's accounting policy as previously described (*see note 1 — Other deferred charges-Accelerated amortization*).

9. COMMITMENTS AND CONTINGENCIES

Commitments

Leases

Certain property, plant, and equipment are leased under agreements with terms ranging from one to 30 years. Most of the agreements include purchase options or renewal options that cover substantially all the economic lives of the properties. Obligations under capital lease agreements in effect at September 30, 2001, total \$36 million annually through 2006 and an aggregate of \$157 million thereafter, for a total commitment of \$337 million. Of this amount, \$164 million is interest.

Construction Commitments

TVA has approximately \$1 billion in long-term construction commitments consisting primarily of the purchase of generating assets of approximately \$410 million and emission control equipment of \$540 million. Terms of the contracts extend into 2007.

Fuel Purchase Commitments

TVA has approximately \$4 billion in long-term fuel purchase commitments ranging in terms of up to five years for the purchase of coal, and approximately \$1.5 billion in long-term commitments ranging in terms of up to 14 years for the purchase of

NOTES TO FINANCIAL STATEMENTS — (Continued)

enriched uranium and the fabrication of nuclear fuel assemblies.

Purchased Power

TVA has agreements for the purchase of power from a 440-megawatt, lignite-fired electric generating plant and three smaller projects with a combined capacity of 62 megawatts. The agreement with the lignite-fired plant requires TVA to purchase the plant's output for a 30-year period beginning on the date of first generation, which is expected to occur in early 2002. Pricing of the contract includes fixed and variable components with minimum estimated power purchases approximating \$4 billion over the life of the contract. The remaining contracts are for a duration of 10 years beginning in 2001, with estimated payments of \$30 million over the lives of the contracts. Costs under these contracts are included in fuel and purchased power and expensed as incurred.

Other

TVA has a long-term Interagency Agreement with the Department of Energy (DOE) to utilize TVA's Sequoyah and Watts Bar Nuclear Plants to produce tritium. This agreement, ending in 2035, requires DOE to reimburse TVA for costs incurred.

Contingencies

Nuclear Insurance

The Price-Anderson Act sets forth an indemnification and limitation of liability plan for the U.S. nuclear industry. All Nuclear Regulatory Commission (NRC) licensees, including TVA, maintain nuclear liability insurance in the amount of \$200 million for each plant with an operating license. The second level of financial protection required is the industry's retrospective assessment plan, using deferred premium charges. The maximum amount of the deferred premium for each nuclear incident is approximately \$88 million per reactor, but not more than \$10 million per reactor may be charged in any one year for each incident. With its six licensed units, TVA could be required to pay a maximum of \$528 million per nuclear incident, but it would have to pay no more than \$60 million per incident in any one year.

TVA carries property and decontamination insurance of \$2.06 billion at each licensed nuclear plant to cover the cost of stabilizing or shutting down a reactor after an accident. Some of this insurance may require the payment of retrospective premiums up to a maximum of approximately \$28 million.

Clean Air Developments

Title IV of the Clean Air Act Amendments of 1990 (CAAA) requires coal-fired generation units to reduce their sulfur dioxide (SO₂) and nitrogen oxide (NO_x) emissions in two phases in order to control acid rain. Compliance with these requirements has resulted in substantial expenditures for the reduction of emissions at TVA's coal-fired generating plants.

The Environmental Protection Agency (EPA) has been directed by the new administration to develop legislation aimed at achieving substantial additional reductions of SO₂, NO_x, and particulates from utility units. A number of bills have been introduced in Congress that would result in significant decreases in these emissions as well as carbon dioxide. The timing and content of such legislation remains highly uncertain, and it is unlikely that such legislation would be enacted before 2003 or 2004.

TVA's strategy for complying with the CAAA has included the use of scrubbers at two fossil units and the use of lower-sulfur coal at other fossil units to reduce SO₂ emissions. TVA has completed these scrubbers and is on schedule to complete the changeover to lower-sulfur coal.

NO_x reductions were required under the CAAA for 58 of TVA's 59 coal-fired units. The only TVA unit for which NO_x reductions are not required under the CAAA is the Atmospheric Fluidized Bed Unit 10 at TVA's Shawnee Fossil Plant. The NO_x reductions for the other 58 units were achieved through the installation of low-nitrogen-oxide burners and/or overfire air at 40 units and boiler optimization at the remaining 18 units. In 1996 TVA selected an early election option for four of these 58 units, which allows the four units at John Sevier Steam Plant to be limited to Phase I NO_x levels through 2007. In 2008 these four units will have to meet lower Phase II NO_x levels. For the

NOTES TO FINANCIAL STATEMENTS — (Continued)

remaining 54 units, TVA has elected to average NO_x emissions to meet a 54-unit NO_x Averaging Plan. This option enables TVA to optimize the cost of NO_x reduction while fully complying with the CAAA Title IV NO_x requirements. In addition to its Title IV projects, TVA is in the process of installing selective catalytic reduction systems (SCRs) to further control NO_x emissions at 25 of its coal-fired units. SCRs are state-of-the-art NO_x pollution technology. This follows up on a commitment TVA has made to further reduce NO_x emissions throughout its system. Installation of these SCRs will also comply with the EPA's recent State Implementation Plan NO_x Reduction rule.

The EPA has finalized new, more stringent particulate matter standards and a rule designed to reduce regional haze. Both are currently in litigation. These actions may require TVA to make additional reductions of SO₂ emissions beyond those currently planned. TVA anticipates that compliance with the new regulations will be required after 2010. The EPA has also determined that mercury emissions from coal-fired plants should be reduced, but has yet to propose a rule to accomplish this. Depending on the severity of the mercury reductions required by the EPA, TVA could incur additional substantial capital costs for control of mercury. Mercury reductions are expected to be required around 2007.

Expenditures related to the Clean Air projects during 2001 and 2000 were approximately \$200 million and \$125 million, respectively. The cost of the SCR strategy is now estimated to be \$1.2 billion. The total cost of future compliance with NO_x, SO₂, and particulate matter requirements cannot reasonably be determined at this time because of the uncertainties surrounding emerging EPA regulations, resultant compliance strategies, potential for the development of new emission control technologies, court litigation, and future amendments to the Clean Air Act. However, total costs could exceed \$3 billion, inclusive of the costs of the planned SCRs.

The EPA has instituted judicial and administrative actions against a number of utilities in the eastern U.S., including TVA, alleging that they have modified their coal-fired units without complying with new source review (NSR) requirements. TVA contends that the EPA's enforcement action

is based on a new interpretation of an old rule and that TVA has routinely maintained its power plants to ensure efficient, reliable power generation while complying with all requirements. The EPA issued TVA an administrative order directing TVA to put new source controls on 14 of its coal-fired units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order, and the Eleventh Circuit Court of Appeals has stayed the order pending its review. The outcome of this litigation and the EPA proceedings is uncertain. It is not possible to predict with certainty what impact implementation of the EPA's order will have on TVA if TVA's challenge is unsuccessful. If the EPA substantially prevails, TVA could be required to incur capital costs in excess of \$3 billion by 2010 to 2012. Any additional controls that TVA could be required to install on units as a result of this matter, however, would also be sufficient to comply with reduction requirements that are anticipated under the other air quality programs discussed above. Thus, because of the other environmental program requirements, TVA would in any event probably incur a substantial portion of the costs that might result from the EPA's enforcement action, although the schedule for the installation of controls could be somewhat accelerated by the EPA action. TVA fully supports the need to further reduce emissions from coal-fired plants and seeks a resolution that will not put TVA customers and the region at a disadvantage.

The Bush administration is reviewing the energy implications of the EPA's new NSR interpretation and the legal merits of the EPA's enforcement cases. TVA has determined that if the EPA's new interpretation becomes law, TVA could lose about 11 percent of the energy capabilities of its coal-fired system within three years through permit limits on use of its units.

Hazardous Substances

The release and cleanup of hazardous substances are regulated under the Comprehensive Environmental Response, Compensation, and Liability Act. In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances over the years. TVA is aware of hazardous-substance releases at four off-

NOTES TO FINANCIAL STATEMENTS — (Continued)

site areas for which it may have some liability. TVA's potential liabilities for its share of cleanup costs at these sites are uncertain but are not expected to have a significant impact on TVA's financial position or results of operations.

Pending Litigation

The EPA issued TVA an administrative order directing TVA to put new source controls on 14 of its units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order. It is not possible to predict with certainty what impact implementation of the EPA's order will have on TVA if TVA's challenge is unsuccessful. If the EPA substantially prevails, TVA could be required to incur capital costs in excess of \$3 billion by 2010 to 2012 in order to implement the EPA's order (*see note 9 — Contingencies — Clean air developments*).

TVA is a party to various other civil lawsuits and claims that have arisen in the ordinary course of its business. Although the outcome of these other lawsuits and claims cannot be predicted with any certainty, it is the opinion of TVA counsel that the ultimate outcome should not have a materially adverse effect on TVA's financial position or results of operations.

Decommissioning Costs

Provision for decommissioning costs of nuclear generating units is based on the estimated cost of dismantling and decontaminating the facilities to meet NRC criteria for license termination. Effective for 1998, TVA changed its method of accounting for nuclear decommissioning costs and related liabilities in order to comply with certain tentative conclusions reached by the FASB in its project for closure and removal of long-lived assets, as well as certain rate-setting actions.

TVA recognizes as incurred all obligations related to closure and removal of its nuclear units. The liability for closure is measured as the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk-free rate of interest. The charge to recognize the additional obligation is effected by adjusting the corresponding regulatory asset. Earnings from decommissioning fund investments,

amortization expense of the decommissioning regulatory asset, and interest expense on the decommissioning liability are deferred in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. At September 30, 2001, the present value of the estimated future decommissioning cost of \$804 million was included in other liabilities, and the unamortized regulatory asset of \$439 million was included in deferred charges. The decommissioning cost estimates are based on prompt dismantlement and removal of a plant from service. The actual decommissioning costs may vary from the estimates because of changes in the assumed dates of decommissioning, changes in regulatory requirements, changes in technology, and changes in the cost of labor, materials, and equipment.

TVA maintains a decommissioning trust fund to provide funding for the decommissioning of nuclear power plants. As of September 30, 2001, the decommissioning trust fund investments totaled \$600 million and were invested in securities designed to achieve a return in line with overall equity market performance.

TVA is currently evaluating the nature and scope of its decommissioning policy as it relates to all electric generating plants. The evaluation will be used to determine the need for recognition of additional asset retirement obligations as described in the recently issued SFAS No. 143, *Accounting for Obligations Associated with Retirement of Long-Lived Assets*. SFAS No. 143 will be effective for TVA in 2003.

Cost-Based Regulation

As a regulated entity, TVA is subject to the provisions of SFAS 71, *Accounting for the Effects of Certain Types of Regulation*. Accordingly, TVA records certain assets and liabilities resulting from the effects of the ratemaking process that would not be recorded under generally accepted accounting principles for nonregulated entities. Currently, the electric utility industry is predominantly regulated on a basis designed to recover the cost of providing electric power to its customers. If cost-based regulation were to be discontinued in the industry for any reason, profits could be reduced and utilities might be required to reduce their asset balances to reflect a market basis less than cost.

NOTES TO FINANCIAL STATEMENTS — (Continued)

Discontinuance of cost-based regulation would also require affected utilities to write off their associated regulatory assets. Such regulatory assets for TVA total approximately \$439 million at September 30, 2001, along with approximately \$4.1 billion of deferred nuclear plant costs. Management cannot predict the potential impact, if any, of the change in the regulatory environment on TVA's future financial position and results of operations.

10. NONPOWER PROGRAMS

During 2001 TVA continued to conduct certain activities commonly referred to as "nonpower" programs, including managing navigable river channels, providing flood control, and overseeing certain recreation facilities. TVA's responsibilities include the general stewardship of land, water, and wildlife resources.

Historically, nonpower programs were primarily funded with federal appropriations. Certain nonpower program activities have also been funded with user fees and outside services revenues. In October 1997, Congress passed legislation that directed TVA to fund essential stewardship activities related to its management of the Tennessee River system and TVA properties with power funds in the event that there were insufficient appropriations or other available funds to pay for such activities in any year.

In 1999 TVA received federal appropriations of approximately \$50 million, of which \$43 million

was for essential stewardship activities and \$7 million was for the Land Between The Lakes National Recreation Area (LBL). Since that time, Congress has not provided any appropriations to TVA. Consequently, during 2001 and 2000, TVA paid \$71 million and \$72 million, respectively, for essential stewardship activities primarily with power revenues; the remainder was funded with user fees, other forms of nonpower revenues, and nonpower fund balances unused in prior years. In addition, administrative jurisdiction over LBL was transferred to the Secretary of Agriculture effective October 1, 1999. As part of the transfer, TVA assumed responsibility for certain transition costs associated with the transfer. As of September 30, 2001, TVA has paid \$7 million of transition expenses, with a remaining liability estimated to be approximately \$3 million at September 30, 2001. TVA retains responsibility for management of the remaining nonpower assets and settlement of nonpower obligations.

As of September 30, 2000, TVA had transferred \$56 million of property and equipment to the U.S. Forest Service. After this transfer, the completed plant of the nonpower programs consists of multipurpose dams and other plant. At September 30, 2001, the net completed plant balances for multipurpose dams and other plant were \$673 million and \$43 million, respectively. At September 30, 2000, the net completed plant balances for multipurpose dams and other plant were \$683 million and \$57 million, respectively.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of the Tennessee Valley Authority

In our opinion, the accompanying balance sheets (power program and all programs) and the related statements of income (power program), changes in proprietary capital (power program and nonpower programs), net expense (nonpower programs), and cash flows (power program and all programs) present fairly, in all material respects, the financial position of the power program and all programs of the Tennessee Valley Authority at September 30, 2001 and 2000, the results of operations of the power program and nonpower programs, and cash flows of the power program and all programs for each of the three years in the period ended September 30, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Tennessee Valley Authority's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2001 on our consideration of the Tennessee Valley Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations for the year ended September 30, 2001. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Knoxville, Tennessee
October 30, 2001

REPORT OF MANAGEMENT

Management is responsible for the preparation, integrity, and objectivity of the financial statements of the Tennessee Valley Authority as well as all other information contained in the annual report. The financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and, in some cases, reflect amounts based on the best estimates and judgments of management, giving due consideration to materiality. Financial information contained in the annual report is consistent with that in the financial statements.

The Tennessee Valley Authority maintains an adequate system of internal controls to provide reasonable assurance that transactions are executed in accordance with management's authorization, that financial statements are prepared in accordance with generally accepted accounting principles, and that the assets of the corporation are properly safeguarded. The system of internal controls is documented, evaluated, and tested on a continuing basis. No internal control system can provide absolute assurance that errors and irregularities will not occur due to the inherent limitations of the effectiveness of internal controls; however, management strives to maintain a balance, recognizing that the cost of such a system should not exceed the benefits derived. No material internal control weaknesses have been reported to management.

PricewaterhouseCoopers LLP was engaged to audit the financial statements of the Tennessee Valley Authority and issue reports thereon. Its audits were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Such standards require a review of internal controls and an examination of selected transactions and other procedures sufficient to provide reasonable assurance that the financial statements neither are misleading nor contain material errors. The Report of Independent Accountants does not limit the responsibility of management for information contained in the financial statements and elsewhere in the annual report.



David N. Smith
Chief Financial Officer
and Executive Vice President of Financial Services

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