UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)
x QUARTERLY REPORT PURSUANT TO SECTION 13, 15(d), OR 37 OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-52313

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

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

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

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

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

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

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

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

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

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## GLOSSARY OF COMMON ACRONYMS

Following are definitions of terms or acronyms frequently used in this Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 (the "Quarterly Report"):

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

| | |
|---|---|
| OCI | Other Comprehensive Income (Loss) |
| PM | Particulate matter |

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

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FORWARD-LOOKING INFORMATION

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

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

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

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

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

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

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

## GENERAL INFORMATION

### Fiscal Year

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

### Notes

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

### Available Information

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

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | Three Months Ended March 31 | | Six Months Ended March 31 | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Operating revenues | | | | |
| Sales of electricity | $2,901 | $2,709 | $5,251 | $5,258 |
| Other revenue | 37 | 32 | 69 | 62 |
| Total operating revenues | 2,938 | 2,741 | 5,320 | 5,320 |
| Operating expenses | | | | |
| Fuel | 663 | 672 | 1,206 | 1,466 |
| Purchased power | 313 | 288 | 564 | 533 |
| Operating and maintenance | 793 | 876 | 1,600 | 1,795 |
| Depreciation and amortization | 453 | 408 | 894 | 836 |
| Tax equivalents | 140 | 136 | 262 | 273 |
| Total operating expenses | 2,362 | 2,380 | 4,526 | 4,903 |
| Operating income | 576 | 361 | 794 | 417 |
| Other income (expense), net | 13 | 11 | 27 | 26 |
| Interest expense | | | | |
| Interest expense | 336 | 359 | 675 | 714 |
| Allowance for funds used during construction and nuclear fuel expenditures | (42) | (41) | (82) | (80) |
| Net interest expense | 294 | 318 | 593 | 634 |
| Net income (loss) | $295 | $54 | $228 | $(191) |

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

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

| | Three Months Ended March 31 | | Six Months Ended March 31 | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net income (loss) | $295 | $54 | $228 | $(191) |
| Other comprehensive income (loss) | | | | |
| Net unrealized gain (loss) on cash flow hedges | 2 | (49) | 22 | (16) |
| Reclassification to earnings from cash flow hedges | (7) | 63 | (29) | 58 |
| Total other comprehensive income (loss) | $(5) | $14 | $(7) | $42 |
| Total comprehensive income (loss) | $290 | $68 | $221 | $(149) |

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED BALANCE SHEETS
(in millions)
ASSETS

| | March 31, 2014 | September 30, 2013 |
|---|---|---|
| Current assets | (Unaudited) | |
| Cash and cash equivalents | $506 | $1,602 |
| Restricted cash and investments | 11 | 33 |
| Accounts receivable, net | 1,449 | 1,567 |
| Inventories, net | 1,047 | 1,091 |
| Regulatory assets | 635 | 561 |
| Other current assets | 69 | 52 |
| Total current assets | 3,717 | 4,906 |
| | | |
| Property, plant, and equipment | | |
| Completed plant | 47,541 | 47,073 |
| Less accumulated depreciation | (23,845) | (23,157) |
| Net completed plant | 23,696 | 23,916 |
| Construction in progress | 5,245 | 4,704 |
| Nuclear fuel | 1,305 | 1,256 |
| Capital leases | 62 | 47 |
| Total property, plant, and equipment, net | 30,308 | 29,923 |
| | | |
| Investment funds | 1,827 | 1,701 |
| | | |
| Regulatory and other long-term assets | | |
| Regulatory assets | 8,663 | 9,131 |
| Other long-term assets | 508 | 445 |
| Total regulatory and other long-term assets | 9,171 | 9,576 |
| | | |
| Total assets | $45,023 | $46,106 |

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

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

| | March 31, 2014 | September 30, 2013 |
|---|---|---|
| Current liabilities | (Unaudited) | |
| Accounts payable and accrued liabilities | $1,499 | $1,627 |
| Environmental cleanup costs - Kingston ash spill | 118 | 102 |
| Accrued interest | 397 | 378 |
| Current portion of leaseback obligations | 75 | 69 |
| Current portion of energy prepayment obligations | 100 | 100 |
| Regulatory liabilities | 180 | 212 |
| Short-term debt, net | 1,691 | 2,432 |
| Current maturities of power bonds | 32 | 32 |
| Current maturities of long-term debt of variable interest entities | 31 | 30 |
| Total current liabilities | 4,123 | 4,982 |
| | | |
| Other liabilities | | |
| Post-retirement and post-employment benefit obligations | 5,319 | 5,348 |
| Asset retirement obligations | 3,535 | 3,472 |
| Other long-term liabilities | 1,877 | 1,861 |
| Leaseback obligations | 637 | 692 |
| Energy prepayment obligations | 360 | 410 |
| Environmental cleanup costs - Kingston ash spill | — | 67 |
| Regulatory liabilities | 2 | 1 |
| Total other liabilities | 11,730 | 11,851 |
| | | |
| Long-term debt, net | | |
| Long-term power bonds, net | 22,014 | 22,315 |
| Long-term debt of variable interest entities | 1,295 | 1,311 |
| Total long-term debt, net | 23,309 | 23,626 |
| | | |
| Total liabilities | 39,162 | 40,459 |
| | | |
| Proprietary capital | | |
| Power program appropriation investment | 263 | 268 |
| Power program retained earnings | 4,997 | 4,767 |
| Total power program proprietary capital | 5,260 | 5,035 |
| Nonpower programs appropriation investment, net | 605 | 609 |
| Accumulated other comprehensive income (loss) | (4) | 3 |
| Total proprietary capital | 5,861 | 5,647 |
| | | |
| Total liabilities and proprietary capital | $45,023 | $46,106 |

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
For the six months ended March 31
(in millions)

| | 2014 | 2013 |
|---|---|---|
| Cash flows from operating activities | | |
| Net income (loss) | $228 | $(191) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities | | |
| Depreciation and amortization (including amortization of debt issuance costs and premiums/discounts) | 917 | 857 |
| Amortization of nuclear fuel cost | 143 | 117 |
| Non-cash retirement benefit expense | 286 | 311 |
| Prepayment credits applied to revenue | (50) | (52) |
| Fuel cost adjustment deferral | (162) | 55 |
| Fuel cost tax equivalents | (3) | 3 |
| Environmental cleanup costs – Kingston ash spill – non cash | 34 | 36 |
| Changes in current assets and liabilities | | |
| Accounts receivable, net | 116 | 312 |
| Inventories and other, net | 62 | (54) |
| Accounts payable and accrued liabilities | (96) | (171) |
| Accrued interest | 19 | 22 |
| Regulatory assets costs | (39) | (5) |
| Pension contributions | (132) | (6) |
| Environmental cleanup costs – Kingston ash spill | (43) | (51) |
| Insurance recoveries | 161 | — |
| Other, net | (15) | (35) |
| Net cash provided by operating activities | 1,426 | 1,148 |
| Cash flows from investing activities | | |
| Construction expenditures | (1,141) | (996) |
| Nuclear fuel expenditures | (239) | (213) |
| Loans and other receivables | | |
| Advances | (1) | (4) |
| Repayments | 4 | 5 |
| Other, net | 3 | 4 |
| Net cash used in investing activities | (1,374) | (1,204) |
| Cash flows from financing activities | | |
| Long-term debt | | |
| Issues of power bonds | — | 1,067 |
| Redemptions and repurchases of power bonds | (333) | (1,387) |
| Redemptions of variable interest entities | (15) | (6) |
| Short-term debt issues (redemptions), net | (741) | 537 |
| Payments on leases and leasebacks | (50) | (55) |
| Financing costs, net | — | (7) |
| Payments to U.S. Treasury | (7) | (13) |
| Other, net | (2) | (29) |
| Net cash (used in) provided by financing activities | (1,148) | 107 |
| Net change in cash and cash equivalents | (1,096) | 51 |
| Cash and cash equivalents at beginning of period | 1,602 | 868 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $506 | $919 |

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (Unaudited)
For the three months ended March 31, 2014 and 2013
(in millions)

| | Power Program Appropriation Investment | Power Program Retained Earnings | Nonpower Programs Appropriation Investment, Net | Accumulated Other Comprehensive Income (Loss) from Net Gains (Losses) on Cash Flow Hedges | Total |
|---|---|---|---|---|---|
| Balance at December 31, 2012 (unaudited) | $283 | $4,249 | $617 | $(46) | $5,103 |
| Net income (loss) | — | 55 | (1) | — | 54 |
| Total other comprehensive income (loss) | — | — | — | 14 | 14 |
| Return on power program appropriation investment | — | (2) | — | — | (2) |
| Return of power program appropriation investment | (5) | $— | — | — | (5) |
| Balance at March 31, 2013 (unaudited) | $278 | $4,302 | $616 | $(32) | $5,164 |
| | | | | | |
| Balance at December 31, 2013 (unaudited) | $265 | $4,701 | $607 | $1 | $5,574 |
| Net income (loss) | — | 297 | (2) | — | 295 |
| Total other comprehensive income (loss) | — | — | — | (5) | (5) |
| Return on power program appropriation investment | — | (1) | — | — | (1) |
| Return of power program appropriation investment | (2) | — | — | — | (2) |
| Balance at March 31, 2014 (unaudited) | $263 | $4,997 | $605 | $(4) | $5,861 |

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

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (Unaudited)
For the six months ended March 31, 2014 and 2013
(in millions)

| | Power Program Appropriation Investment | Power Program Retained Earnings | Nonpower Programs Appropriation Investment, Net | Accumulated Other Comprehensive Income (Loss) from Net Gains (Losses) on Cash Flow | Total |
|---|---|---|---|---|---|

| | | | | Hedges | |
|---|---|---|---|---|---|
| Balance at September 30, 2012 | $288 | $4,492 | $620 | $(74) | $5,326 |
| Net income (loss) | — | (187) | (4) | — | (191) |
| Total other comprehensive income (loss) | — | — | — | 42 | 42 |
| Return on power program appropriation investment | — | (3) | — | — | (3) |
| Return of power program appropriation investment | (10) | $— | — | — | (10) |
| Balance at March 31, 2013 (unaudited) | $278 | $4,302 | $616 | $(32) | $5,164 |
| | | | | | |
| Balance at September 30, 2013 | $268 | $4,767 | $609 | $3 | $5,647 |
| Net income (loss) | — | 232 | (4) | — | 228 |
| Total other comprehensive income (loss) | — | — | — | (7) | (7) |
| Return on power program appropriation investment | — | (2) | — | — | (2) |
| Return of power program appropriation investment | (5) | — | — | — | (5) |
| Balance at March 31, 2014 (unaudited) | $263 | $4,997 | $605 | $(4) | $5,861 |

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

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


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## 1. Summary of Significant Accounting Policies

### General

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

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

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

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

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

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

Fiscal Year

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

Cost-Based Regulation

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

Basis of Presentation

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

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

Use of Estimates

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

Reclassifications

Certain reclassifications have been made to the Consolidated Statement of Cash Flows for the six months ended March 31, 2014 in the Cash flows from operating activities section as $(11) million previously reported as Other, net for the six months ended March 31, 2013, was reclassified to $(5) million Regulatory assets costs and $(6) million Pension contributions.

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Allowance for Uncollectible Accounts

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

The allowance for uncollectible accounts was $1 million at both March 31, 2014 and September 30, 2013 for accounts receivable. Additionally, loans receivable of $92 million and $73 million at March 31, 2014 and September 30, 2013, respectively, are included in Other long-term assets and reported net of allowances for uncollectible accounts of $10 million.

Depreciation

Depreciation expense was $382 million and $337 million for the three months ended March 31, 2014, and 2013, and $750 million and $694 million for the six months ended March 31, 2014, and 2013, respectively. On November 14, 2013, TVA determined that Paradise Fossil Plant ("Paradise") Units 1 and 2 will be idled on March 31, 2017, and depreciation expense is being accelerated over the remaining useful life. This resulted in additional depreciation expense of $13 million during the three and six months ended March 31, 2014. It is expected that the decision to idle Paradise Units 1 and 2 on March 31, 2017, will increase depreciation expense by approximately $40 million for the remainder of 2014.

Blended Low-Enriched Uranium Program

Under the blended low-enriched uranium ("BLEU") program, TVA, the Department of Energy ("DOE"), and certain nuclear fuel contractors have entered into agreements providing for the DOE's surplus of enriched uranium to be blended with other uranium down to a level that allows the blended uranium to be fabricated into fuel that can be used in nuclear power plants. Under the terms of an interagency agreement between TVA and the DOE, in exchange for supplying highly enriched uranium materials to the appropriate third-party fuel processors for processing into usable BLEU fuel for TVA, the DOE participates to a degree in the savings generated by TVA’s use of this blended nuclear fuel. Over the life of the program, TVA projects that the DOE’s share of savings generated by TVA’s use of this blended nuclear fuel could result in payments to the DOE of as much as $175 million. TVA accrues an obligation with each BLEU reload batch related to the portion of the ultimate future payments estimated to be attributable to the BLEU fuel currently in use. At March 31, 2014, TVA had paid out approximately $101 million for this program, and the obligation recorded was $16 million.

2. Impact of New Accounting Standards and Interpretations

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

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

Comprehensive Income. In February 2013, FASB issued guidance that requires public reporting companies under the Securities Act of 1933 to present information about reclassification adjustments from accumulated other comprehensive income (loss) ("AOCI") in their annual and interim financial statements in a single location. The guidance requires that companies present the effect of significant amounts reclassified from each component of AOCI based on its source and the income statement line items affected by the reclassification. This information may be disclosed either in a single note or parenthetically on the face of the financial statements. If a component is not required to be reclassified to net income in its entirety, companies must cross reference to the related footnote for additional information. These changes became effective for TVA on October 1, 2013, and have been applied on a prospective basis. TVA has chosen to disclose the required information in a single note. This guidance relates solely to enhanced disclosures and did not have an impact on TVA's financial condition, results of operations, or cash flows.

There are no FASB Accounting Standards Updates that have been issued but not yet adopted as March 31, 2014, that are expected to significantly impact TVA’s financial condition, results of operations, or cash flows.

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3. Restructuring

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

Severance Cost Liability Activity

| | Three Months Ended March 31, 2014 | Six Months Ended March 31, 2014 |
|---|---|---|
| Severance cost liability at beginning of period | $12 | $— |
| Liabilities incurred during the period | 17 | 29 |
| Actual costs paid during the period | (4) | (4) |
| Severance cost liability at end of period | $25 | $25 |

4. Accounts Receivable, Net

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

Accounts Receivable, Net

| | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| Power receivables | $1,385 | $1,495 |
| Other receivables | 65 | 73 |
| Allowance for uncollectible accounts | (1) | (1) |
| Accounts receivable, net | $1,449 | $1,567 |

5. Inventories, Net

The table below summarizes the types and amounts of TVA's inventories:

Inventories, Net

| | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| Materials and supplies inventory | $619 | $620 |
| Fuel inventory | 451 | 494 |
| Emission allowance inventory | 17 | 14 |
| Allowance for inventory obsolescence | (40) | (37) |
| Inventories, net | $1,047 | $1,091 |

6. Other Long-Term Assets

The table below summarizes the types and amounts of TVA's other long-term assets:

Other Long-Term Assets

| | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| EnergyRight® receivables | $118 | $117 |
| Unamortized debt issue cost of power bonds | 66 | 75 |
| Loans and other long-term receivables, net | 92 | 73 |
| Prepaid capacity payments | 58 | 62 |
| Restricted cash | 74 | — |

| | | |
|---|---|---|
| Currency swap asset, net | — | 28 |
| Coal contract derivative assets | 2 | 1 |
| Other | 98 | 89 |
| Other long-term assets | $508 | $445 |

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In association with the EnergyRight® Solutions program, local power company customers of TVA ("LPCs") offer financing to end-use customers for the purchase of energy-efficient equipment. TVA purchases the resulting loans receivable from its LPCs. The loans receivable are then transferred to a third-party bank with which TVA has agreed to repay in full any loan receivable that has been in default for 180 days or more or that TVA has determined is uncollectible. Given this continuing involvement, TVA accounts for the transfer of the loans receivable as secured borrowings. The current and long-term portions of the loans receivable are reported in Accounts receivable, net and Other long-term assets, respectively, on TVA's Consolidated Balance Sheets. As of March 31, 2014 and September 30, 2013, the carrying amount of the loans receivable, net of discount, reported in Accounts receivable, net was approximately $33 million. See Note 10 for information regarding the associated financing obligation.

## 7. Regulatory Assets and Liabilities

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

Regulatory Assets and Liabilities

| | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| Current regulatory assets | | |
| Deferred nuclear generating units | $237 | $237 |
| Unrealized losses on commodity derivatives | 122 | 183 |
| Environmental agreements | 83 | 73 |
| Environmental cleanup costs - Kingston ash spill | 60 | 68 |
| Fuel cost adjustment receivable | 133 | — |
| Total current regulatory assets | 635 | 561 |
| | | |
| Non-current regulatory assets | | |
| Deferred pension costs and other post-retirement benefits costs | 3,942 | 4,076 |
| Unrealized losses on interest rate derivatives | 833 | 808 |
| Nuclear decommissioning costs | 856 | 893 |
| Environmental cleanup costs - Kingston ash spill | 487 | 681 |
| Non-nuclear decommissioning costs | 582 | 571 |
| Deferred nuclear generating units | 1,358 | 1,438 |
| Environmental agreements | 153 | 189 |
| Unrealized losses on commodity derivatives | 127 | 139 |
| Other non-current regulatory assets | 325 | 336 |
| Total non-current regulatory assets | 8,663 | 9,131 |
| Total regulatory assets | $9,298 | $9,692 |
| | | |
| Current regulatory liabilities | | |
| Fuel cost adjustment tax equivalents | $173 | $176 |
| Fuel cost adjustment liability | — | 29 |
| Unrealized gains on commodity derivatives | 7 | 7 |
| Total current regulatory liabilities | 180 | 212 |
| | | |
| Non-current regulatory liabilities | | |
| Unrealized gains on commodity derivatives | 2 | 1 |
| Total non-current regulatory liabilities | 2 | 1 |
| Total regulatory liabilities | $182 | $213 |

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## 8. Variable Interest Entities

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

When TVA determines that it has a variable interest in a variable interest entity, a qualitative evaluation is performed to assess which interest holders have the power to direct the activities that most significantly impact the economic performance of the entity and have the obligation to absorb losses or receive benefits that could be significant to the entity. The evaluation considers the purpose and design of the business, the risks that the business was designed to create and pass along to other entities, the activities of the business that can be directed and which party can direct them, and the expected relative impact of those activities on the economic performance of the business through its life. TVA has the power to direct the activities of an entity when it has the ability to make key operating and financing decisions, including, but not limited to, capital investment and the issuance of debt.

### Southaven

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

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

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

John Sevier

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

The membership interests held by Holdco in JSCCG were purchased with proceeds from the issuance of $100 million of secured notes (the “Holdco notes") and are subject to mandatory redemption pursuant to scheduled amortizing, semi-annual payments due each January 15 and July 15, with a final payment due on January 15, 2042. The payment dates for the mandatorily redeemable membership interests are the same as those of the Holdco notes. The sale of the JSCCG notes, the membership interests in JSCCG, and the Holdco notes all closed on January 17, 2012. The JSCCG notes are secured by TVA’s

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lease payments, and the Holdco notes are secured by Holdco's investment in, and amounts receivable from, JSCCG. TVA's lease payments to JSCCG are equal to and payable on the same dates as JSCCG's and Holdco's semi-annual debt service payments. In addition to the lease payments, TVA pays administrative and miscellaneous expenses incurred by JSCCG and Holdco. Certain agreements related to this transaction contain default and acceleration provisions.

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

The financial statement items attributable to carrying amounts and classifications of JSCCG, Holdco, and SCCG as of March 31, 2014 and September 30, 2013, as reflected in the Consolidated Balance Sheets are as follows:

Summary of Impact of VIEs on Consolidated Balance Sheets

| | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| Current liabilities of VIE | | |
| Accrued interest of VIE | $12 | $12 |
| Current portion of membership interests of VIE subject to mandatory redemption | 2 | 2 |
| Current maturities of long-term debt of VIE | 31 | 30 |
| Total current liabilities of VIE | 45 | 44 |
| Other liabilities of VIE | | |
| Membership interests of VIE subject to mandatory redemption | 37 | 38 |
| Long-term debt of VIE, net | | |
| Long-term debt of VIE | 1,295 | 1,311 |
| Total liabilities of VIE | $1,377 | $1,393 |

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

## 9. Kingston Fossil Plant Ash Spill

### The Event

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

### Claims and Litigation

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

Financial Impact

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

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

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As work continues to progress and more information is available, TVA will review its estimates and revise them as appropriate. TVA has accrued a portion of the estimated cost in current liabilities. Amounts spent since the event through March 31, 2014, totaled $1.0 billion. The remaining estimated liability at March 31, 2014, was $118 million.

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

Insurance

TVA had property and excess liability insurance programs in place at the time of the Kingston ash spill. TVA pursued claims under both the property and excess liability programs and has settled all of its property insurance claims and some of its excess liability insurance claims. In April 2012, TVA initiated arbitration proceedings against the remaining three excess liability insurance companies in accordance with the policies' dispute resolution provisions. TVA has successfully resolved two of these proceedings and is pursuing the third, which is scheduled to begin in June 2014. TVA is seeking recovery of certain costs incurred in the cleanup project, including the costs of removing ash from property or waters owned by the State of Tennessee, and related expenses. TVA has received insurance proceeds of $253 million. The insurance proceeds are being recorded as reductions to the regulatory asset and will reduce amounts collected in future rates.

10. Other Long-Term Liabilities

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

Other Long-Term Liabilities

| | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| Interest rate swap liabilities | $1,223 | $1,199 |
| Environmental agreements liability | 153 | 190 |
| EnergyRight® purchase obligation | 149 | 149 |
| Coal contract derivative liabilities | 49 | 35 |
| Membership interests of VIE subject to mandatory redemption | 37 | 38 |
| Commodity swap derivative liabilities | 24 | 36 |
| Currency swap liabilities | 6 | 15 |
| Other | 236 | 199 |
| Total other long-term liabilities | $1,877 | $1,861 |

TVA purchases certain loans receivable from its LPCs in association with the EnergyRight® Solutions program. The loans receivable are then transferred to a third-party bank with which TVA has agreed to repay in full any loan receivable that has been in default for 180 days or more or that TVA has determined is uncollectible. Given this continuing involvement, TVA accounts for the transfer of the loans receivable as secured borrowings. The current and long-term portions of the resulting financing obligation are reported in Accounts payable and accrued liabilities and Other long-term liabilities, respectively, on TVA's Consolidated Balance Sheets. As of March 31, 2014 and September 30, 2013, the carrying amount of the financing obligation reported in Accounts payable and accrued liabilities was approximately $37 million. See Note 6 for information regarding the associated loans receivable.

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11. Asset Retirement Obligations

During the six months ended March 31, 2014, TVA's total ARO liability increased $86 million. The increase in the liability resulted from accretion. This was partially offset by ash area settlement projects that were conducted during the six months ended March 31, 2014. The nuclear and non-nuclear accretion were deferred as regulatory assets, and $20 million of the related regulatory assets was amortized into expense as this amount was collected in rates.
Reconciliation of Asset Retirement Obligation Liability

| | Nuclear | Non-Nuclear | Total |
|---|---|---|---|
| Balance at September 30, 2013 | $2,399 | $1,089 | $3,488 |
| Settlements (ash storage areas) | — | (7) | (7) |
| Accretion (recorded as regulatory asset) | 67 | 26 | 93 |
| Balance at March 31, 2014 | $2,466 | $1,108 | $3,574 (1) |

Note
(1) The current portion of ARO in the amount of $39 million is included in Accounts payable and accrued liabilities at March 31, 2014.

12. Debt and Other Obligations

Debt Outstanding

Total debt outstanding at March 31, 2014, and September 30, 2013, consisted of the following:
Debt Outstanding

| | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| Short-term debt | | |
| Short-term debt, net | $1,691 | $2,432 |
| Current maturities of long-term debt of variable interest entities | 31 | 30 |
| Current maturities of power bonds | 32 | 32 |
| Total current debt outstanding, net | 1,754 | 2,494 |
| Long-term debt | | |
| Long-term debt of variable interest entities | 1,295 | 1,311 |
| Long-term power bonds(1) | 22,096 | 22,400 |
| Unamortized discounts, premiums, and other | (82) | (85) |
| Total long-term debt, net | 23,309 | 23,626 |
| Total outstanding debt | $25,063 | $26,120 |

Note
(1) Includes net exchange losses from currency transactions of $71 million at March 31, 2014 and $43 million at September 30, 2013.

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Debt Securities Activity

The table below summarizes the long-term debt securities activity for the period from October 1, 2013, to March 31, 2014.

Debt Securities Activity

| | Date | Amount | Interest Rate | |
|---|---|---|---|---|
| Redemptions/Maturities(1) | | | | |
| electronotes® | First Quarter 2014 | $4 | 3.56 | % |
| electronotes® | Second Quarter 2014 | 326 | 4.52 | % |
| 2009 Series A | November 2013 | 2 | 2.25 | % |
| 2009 Series B | December 2013 | 1 | 3.77 | % |
| Total redemptions/maturities of power bonds | | 333 | | |
| Variable interest entities | Second Quarter 2014 | 15 | 4.30 | % |
| Total redemptions/maturities of debt | | $348 | | |

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

Credit Facility Agreements

TVA and the U.S. Treasury, pursuant to the TVA Act, have entered into a memorandum of understanding under which the U.S. Treasury provides TVA with a $150 million credit facility. This credit facility was renewed for 2014 with a maturity date of September 30, 2014. Access to this credit facility or other similar financing arrangements with the U.S. Treasury has been available to TVA since the 1960s. TVA plans to use the U.S. Treasury credit facility as a secondary source of liquidity. The interest rate on any borrowing under this facility is based on the average rate on outstanding marketable obligations of the United States with maturities from date of issue of one year or less. There were no outstanding borrowings under the facility at March 31, 2014, The availability of this credit facility may be impacted by how the U.S. government addresses the situation of approaching its debt limit.

TVA also has funding available in the form of three long-term revolving credit facilities totaling $2.5 billion. One $1.0 billion credit facility matures on June 25, 2017, another $1.0 billion credit facility matures on December 13, 2017, and the $500 million credit facility matures on April 5, 2018. The interest rate on any borrowing under these facilities varies based on market factors and the rating of TVA's senior unsecured long-term non-credit-enhanced debt. TVA is required to pay an unused facility fee on the portion of the total $2.5 billion that TVA has not borrowed or committed under letters of credit. This fee, along with letter of credit fees, may fluctuate depending on the rating of TVA's senior unsecured long-term non-credit-enhanced debt. At March 31, 2014, and September 30, 2013, there were approximately $800 million of letters of credit outstanding under the facilities, and there were no borrowings outstanding. See Note 14 — Other Derivative Instruments — Collateral.

Lease/Leaseback Obligations

Prior to 2004, TVA received approximately $945 million in proceeds by entering into lease/leaseback transactions for 24 new peaking combustion turbine units. TVA also received approximately $389 million in proceeds by entering into lease/leaseback transactions for qualified technological equipment and software in 2003. Due to TVA's continuing involvement in the operation and maintenance of the leased units and equipment and its control over the distribution of power produced by the combustion turbine facilities during the leaseback term, TVA accounted for the lease proceeds as financing obligations. At March 31, 2014, and September 30, 2013, the outstanding leaseback obligations were $712 million and $761 million, respectively.

13. Accumulated Other Comprehensive Income (Loss)

AOCI represents market valuation adjustments related to TVA's currency swaps. The currency swaps are cash flow hedges and are the only derivatives in TVA's portfolio that have been designated and qualify for hedge accounting treatment. TVA records exchange rate gains and losses on its foreign currency-denominated debt in net income and marks its currency swap assets and liabilities to market through other comprehensive income (loss) ("OCI"). TVA then reclassifies an amount out of AOCI into net income, offsetting the exchange gain/loss recorded on the debt. During the three and six months ended March 31, 2014, TVA reclassified $7 million and $29 million, respectively, of gains related to its cash flow hedges from AOCI to Interest expense. See Note 14.

TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. As such, certain items that would generally be reported in AOCI or that would impact

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the statements of operations are recorded as regulatory assets or regulatory liabilities. See Note 7, Note 14 — Overview of Accounting Treatment, Note 15 — Fair Value Measurements, and Note 17.

## 14. Risk Management Activities and Derivative Transactions

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

### Overview of Accounting Treatment

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

The following tables summarize the accounting treatment that certain of TVA's financial derivative transactions receive:

Summary of Derivative Instruments That Receive Hedge Accounting Treatment (part 1)
Amount of Mark-to-Market Gain (Loss) Recognized in OCI

| | | | Three Months Ended March 31 | | Six Months Ended March 31 | |
|---|---|---|---|---|---|---|
| Derivatives in Cash Flow Hedging Relationship | Objective of Hedge Transaction | Accounting for Derivative Hedging Instrument | 2014 | 2013 | 2014 | 2013 |
| Currency swaps | To protect against changes in cash flows caused by changes in foreign currency exchange rates (exchange rate risk) | Unrealized gains and losses are recorded in AOCI and reclassified to interest expense to the extent they are offset by gains and losses on the hedged transaction | $2 | $(49) | $22 | $(16) |

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

| | Three Months Ended March 31 | | Six Months Ended March 31 | |
|---|---|---|---|---|
| Derivatives in Cash Flow Hedging Relationship | 2014 | 2013 | 2014 | 2013 |
| Currency swaps | $7 | $(63) | $29 | $(58) |

Note
There were no ineffective portions or amounts excluded from effectiveness testing for any of the periods presented. Based on forecasted foreign currency exchange rates, TVA expects to reclassify approximately $40 million of losses from AOCI to interest expense within the next twelve months to offset amounts anticipated to be recorded in interest expense related to exchange gain on the debt.

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

| | | | Three Months Ended March 31[1] | | Six Months Ended March 31[1] | |
|---|---|---|---|---|---|---|
| Derivative Type | Objective of Derivative | Accounting for Derivative Instrument | 2014 | 2013 | 2014 | 2013 |
| Interest rate swaps | To fix short-term debt variable rate to a fixed rate (interest rate risk) | Mark-to-market gains and losses are recorded as regulatory assets or liabilities until settlement, at which time the gains/losses are recognized in gain/loss on derivative contracts. | $— | $— | $— | $— |
| Commodity contract derivatives | To protect against fluctuations in market prices of purchased coal or natural gas (price risk) | Mark-to-market gains and losses are recorded as regulatory assets or liabilities. Realized gains and losses due to contract settlements are recognized in fuel expense as incurred. | — | — | — | — |
| Commodity derivatives under financial trading program ("FTP") | To protect against fluctuations in market prices of purchased commodities (price risk) | Mark-to-market gains and losses are recorded as regulatory assets or liabilities. Realized gains and losses are recognized in fuel expense or purchased power expense when the related commodity is used in production. | (4) | (32) | (24) | (77) |

Note
(1) All of TVA's derivative instruments that do not receive hedge accounting treatment have unrealized gains (losses) that would otherwise be recognized in income
but instead are deferred as regulatory assets and liabilities. As such, there was no related gain (loss) recognized in income for these unrealized gains (losses) for the three months and six months ended March 31, 2014 and 2013.

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Mark-to-Market Values of TVA Derivatives

| | At March 31, 2014 | | At September 30, 2013 | |
|---|---|---|---|---|
| **Derivatives that Receive Hedge Accounting Treatment** | | | | |
| | Balance | Balance Sheet Presentation | Balance | Balance Sheet Presentation |
| Currency swaps | | | | |
| £200 million Sterling | $(6) | Other long-term liabilities | $(15) | Other long-term liabilities |
| £250 million Sterling | 63 | Other long-term assets | 51 | Other long-term assets |
| £150 million Sterling | 11 | Other long-term assets | 10 | Other long-term assets |
| **Derivatives that Do Not Receive Hedge Accounting Treatment** | | | | |
| | Balance | Balance Sheet Presentation | Balance | Balance Sheet Presentation |
| Interest rate swaps | | | | |
| $1.0 billion notional | (902) | Other long-term liabilities | (886) | Other long-term liabilities |
| $476 million notional | (310) | Other long-term liabilities | (300) | Other long-term liabilities |
| $42 million notional | (11) | Other long-term liabilities | (13) | Other long-term liabilities |
| Commodity contract derivatives | (134) | Other long-term assets $2; Other current assets $5; Other long-term liabilities $(49); Accounts payable and accrued liabilities $(92) | (141) | Other long-term assets $1; Other current assets $2; Other long-term liabilities $(35); Accounts payable and accrued liabilities $(109) |
| Derivatives under FTP[1] | (104) | Other current assets $(64); Other long-term liabilities $(24); Accounts payable and accrued liabilities $(16) | (166) | Other current assets $(97); Other long-term liabilities $(36); Accounts payable and accrued liabilities $(33) |

Note

(1) Fair values of certain derivatives under the FTP that were in net liability positions totaling $65 million and $100 million at March 31, 2014 and September 30, 2013, respectively, are recorded in TVA's margin cash accounts in Other current assets. These derivatives are transacted with futures commission merchants, and cash deposits have been posted to the margin cash accounts held with each futures commission merchant to offset the net liability positions in full.

Cash Flow Hedging Strategy for Currency Swaps

To protect against exchange rate risk related to three British pound sterling denominated Bond transactions, TVA entered into foreign currency hedges at the time the Bond transactions occurred. TVA had the following currency swaps outstanding as of March 31, 2014:

Currency Swaps Outstanding
At March 31, 2014

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

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

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Derivatives Not Receiving Hedge Accounting Treatment

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

For the three months ended March 31, 2014 and 2013, the changes in market value of the interest rate swaps resulted in deferred unrealized gains (losses) of $(163) million and $99 million, respectively. For the six months ended March 31, 2014 and 2013, the changes in market value of the interest rate swaps resulted in deferred unrealized gains (losses) of $(25) million and $213 million, respectively.

Commodity Derivatives. TVA enters into certain derivative contracts for coal and natural gas that require physical delivery of the contracted quantity of the commodity. TVA marks to market all such contracts and defers the market values as regulatory assets or liabilities on a gross basis. At March 31, 2014, TVA's coal and natural gas contract derivatives had terms of four years and up to one year, respectively.

Commodity Contract Derivatives

| | At March 31, 2014 | | | At September 30, 2013 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Notional Amount | Fair Value (MtM) | Number of Contracts | Notional Amount | Fair Value (MtM) |
| Coal contract derivatives | 18 | 36 million tons | $(131) | 19 | 43 million tons | $(140) |
| Natural gas contract derivatives | 21 | 52 million mmBtu | $(3) | 13 | 39 million mmBtu | $(1) |

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

At March 31, 2014 and September 30, 2013, the risks hedged under the FTP were the economic risks associated with the prices of natural gas, fuel oil, and crude oil. At March 31, 2014 and September 30, 2013, TVA had no outstanding coal contract derivatives under the FTP. There were no futures contracts or options contracts outstanding under the FTP at March 31, 2014, and swap contracts under the FTP had remaining terms of four years or less.

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Derivatives Under Financial Trading Program

| | At March 31, 2014 | | At September 30, 2013 | |
|---|---|---|---|---|
| | Notional Amount | Fair Value (MtM) (in millions) | Notional Amount | Fair Value (MtM) (in millions) |
| Natural gas (in mmBtu) | | | | |
| Futures contracts | — | $— | — | $— |
| Swap contracts | 132,482,500 | (105) | 152,922,500 | (169) |
| Option contracts | — | — | — | — |
| Natural gas financial positions | 132,482,500 | $(105) | 152,922,500 | $(169) |
| Fuel oil/crude oil (in barrels) | | | | |
| Futures contracts | — | $— | — | $— |
| Swap contracts | — | 1 | 1,205,000 | 3 |
| Option contracts | — | — | — | — |
| Fuel oil/crude oil financial positions | — | $1 | 1,205,000 | $3 |

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

TVA defers all FTP unrealized gains (losses) as regulatory liabilities (assets) and records only realized gains or losses to match the delivery period of the underlying commodity. In addition to the open commodity derivatives disclosed above, TVA had closed derivative contracts with market values of $(3) million at March 31, 2014, and $(8) million at September 30, 2013. Unrealized gains and losses related to the FTP at March 31, 2014 and September 30, 2013 were as follows:

Financial Trading Program Unrealized Gains (Losses)

| FTP unrealized gains (losses) deferred as regulatory liabilities (assets) | At March 31, 2014 | At September 30, 2013 |
|---|---|---|
| Natural gas | $(105) | $(169) |
| Fuel oil/crude oil | 1 | 3 |

Realized gains and losses related to the FTP for the three and six months ended March 31, 2014 and 2013 were as follows:

Financial Trading Program Realized Gains (Losses)

| | For the Three Months Ended March 31 | | For the Six Months Ended March 31 | |
|---|---|---|---|---|
| Decrease (increase) in fuel expense | 2014 | 2013 | 2014 | 2013 |
| Natural gas | $(3) | $(20) | $(18) | $(48) |
| Fuel oil/crude oil | — | — | 1 | 2 |
| Coal | — | — | — | (1) |

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Financial Trading Program Realized Gains (Losses)

| Decrease (increase) in purchased power expense | For the Three Months Ended March 31 | | For the Six Months Ended March 31 | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Natural gas | $(1) | $(13) | $(7) | $(32) |

Offsetting of Derivative Assets and Liabilities

The amounts of TVA's derivative instruments as reported in the Consolidated Balance Sheets as of March 31, 2014, and September 30, 2013, are shown in the table below.

| | As of March 31, 2014 | | |
|---|---|---|---|
| | Gross Amounts of Recognized Assets/Liabilities | Gross Amounts Offset in the Balance Sheet (1) | Net Amounts of Assets/Liabilities Presented in the Balance Sheet (2) |
| Assets | | | |
| Currency swaps | $74 | $(74) | $— |
| Commodity derivatives under FTP | 61 | (60) | 1 |
| Total derivatives subject to master netting or similar arrangement | 135 | (134) | 1 |
| Total derivatives not subject to master netting or similar arrangement | 7 | — | 7 |
| Total | $142 | $(134) | $8 |
| Liabilities | | | |
| Currency swaps (3) | $(6) | $— | $(6) |
| Interest rate swaps (3) | (1,223) | — | (1,223) |
| Commodity derivatives under FTP | (165) | 125 | (40) |
| Total derivatives subject to master netting or similar arrangement | (1,394) | 125 | (1,269) |
| Total derivatives not subject to master netting or similar arrangement | (141) | — | (141) |
| Total | $(1,535) | $125 | $(1,410) |

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

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

Notes
(1) Amounts primarily include counterparty netting of derivative contracts, margin account deposits for futures commission merchants transactions, and cash collateral received or paid in accordance with the accounting guidance for derivatives and hedging transactions.
(2) There are no derivative contracts subject to a master netting arrangement or similar agreement which are not offset in the balance sheets.
(3) Letters of credit of approximately $800 million were posted as collateral at both March 31, 2014 and September 30, 2013, to partially secure the liability positions of the currency swap and one of the interest rate swaps in accordance with the collateral requirements for these derivatives.

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Other Derivative Instruments

Investment Fund Derivatives. Investment funds consist primarily of funds held in the Nuclear Decommissioning Trust ("NDT"), Asset Retirement Trust ("ART"), and Supplemental Executive Retirement Plan ("SERP"). All securities in the trusts are classified as trading. See Note 15 — Investments for a discussion of the trusts' objectives and the types of investments included in the various trusts. These trusts may invest in derivative instruments which may include swaps, futures, options, forwards, and other instruments. At March 31, 2014, and September 30, 2013, the fair value of derivative instruments in these trusts was not material to TVA's consolidated financial statements.

Collateral. TVA's interest rate swaps and currency swaps contain contract provisions that require a party to post collateral (in a form such as cash or a letter of credit) when the party's liability balance under the agreement exceeds a certain threshold. At March 31, 2014, the aggregate fair value of all derivative instruments with credit-risk related contingent features that were in a liability position was $1.2 billion. TVA's collateral obligations at March 31, 2014, under these arrangements were approximately $800 million, for which TVA had posted approximately $800 million in letters of credit. These letters of credit reduce the available balance under the related credit facilities. TVA's assessment of the risk of its nonperformance includes a reduction in its exposure under the contract as a result of this posted collateral.

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

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

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

Counterparty Credit Risk

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

Credit of Customers. The majority of TVA's counterparty credit risk is associated with trade accounts receivable from delivered power sales to LPCs, all located in the Tennessee Valley region. To a lesser extent, TVA is exposed to credit risk from industries and federal agencies directly served and from exchange power arrangements with a small number of investor-owned regional utilities related to either delivered power or the replacement of open positions of longer-term purchased power or fuel agreements. TVA had concentrations of accounts receivable from three LPCs that represented 24 percent of total outstanding accounts receivable at March 31, 2014, and 26 percent of total outstanding accounts receivable at September 30, 2013.

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

Credit of Derivative Counterparties. TVA has entered into derivative contracts for hedging purposes, and TVA's NDT fund and defined benefit pension plan have entered into derivative contracts for investment purposes. If a counterparty to one of TVA's hedging transactions defaults, TVA might incur substantial costs in connection with entering into a replacement hedging transaction. If a counterparty to the derivative contracts into which the NDT fund and the pension plan have entered for investment purposes defaults, the value of the investment could decline significantly or perhaps become worthless. TVA has concentrations of credit risk from the banking and coal industries because multiple companies in these industries serve as counterparties to TVA in various derivative transactions. At March 31, 2014, all of TVA's currency swaps, interest rate swaps, and commodity derivatives under the FTP were with counterparties whose Moody's credit rating was Baa2 or higher. At March 31, 2014, all of TVA's coal contract derivatives were with counterparties whose Moody's credit rating, or TVA's internal analysis when such information was unavailable, was Caa1 or higher. See Derivatives Not Receiving Hedge Accounting Treatment.

TVA currently utilizes two active futures commission merchants ("FCMs") to clear commodity contracts, including futures, options, and similar financial derivatives. These transactions are executed under the FTP by the FCMs on exchanges on behalf of TVA. TVA maintains margin cash accounts with the FCMs. TVA makes deposits to the margin cash accounts to

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adequately cover any net liability positions on its derivatives transacted with the FCMs. See the note to the Mark-to-Market Values of TVA Derivatives table.

Credit of Suppliers. If one of TVA's fuel or purchased power suppliers fails to perform under the terms of its contract with TVA, TVA might lose the money that it paid to the supplier under the contract and have to purchase replacement fuel or power on the spot market, perhaps at a significantly higher price than TVA was entitled to pay under the contract. In addition, TVA might not be able to acquire replacement fuel or power in a timely manner and thus might be unable to satisfy its own obligations to deliver power. To help ensure a reliable supply of coal, TVA had coal contracts with multiple suppliers at March 31, 2014. The contracted supply of coal is sourced from multiple geographic regions of the United States and is to be delivered via various transportation methods (for example, barge, rail and truck). TVA purchases the majority of its natural gas requirements from a variety of suppliers under short-term contracts.

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

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

15. Fair Value Measurements

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

Valuation Techniques

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

| | | |
|---|---|---|
| Level 1 | — | Unadjusted quoted prices in active markets accessible by the reporting entity for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing. |
| Level 2 | — | Pricing inputs other than quoted market prices included in Level 1 that are based on observable market data and that are directly or indirectly observable for substantially the full term of the asset or liability. These include quoted market prices for similar assets or liabilities, quoted market prices for identical or similar assets in markets that are not active, adjusted quoted market prices, inputs from observable data such as interest rate and yield curves, volatilities and default rates observable at commonly quoted intervals, and inputs derived from observable market data by correlation or other means. |
| Level 3 | — | Pricing inputs that are unobservable, or less observable, from objective sources. Unobservable inputs are only to be used to the extent observable inputs are not available. These inputs maintain the concept of an exit price from the perspective of a market participant and should reflect assumptions of other market participants. An entity |

should consider all market participant assumptions that are available without unreasonable cost and effort. These are given the lowest priority and are generally used in internally developed methodologies to generate management's best estimate of the fair value when no observable market data is available.

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

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

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Investments

At March 31, 2014, Investment funds were composed of $1.8 billion of securities classified as trading and measured at fair value and less than $1 million of equity investments not required to be measured at fair value. Trading securities are held in the NDT, ART, and SERP. The NDT holds funds for the ultimate decommissioning of TVA's nuclear power plants. The ART holds funds primarily for the costs related to the future closure and retirement of TVA's other long-lived assets. TVA established a SERP for certain executives in critical positions to provide supplemental pension benefits tied to compensation that exceeds limits set by Internal Revenue Service rules applicable to the qualified defined benefit pension plan. The NDT and SERP are invested in a mix of investments generally designed to achieve a return in line with overall equity market performance, and the ART is invested in a mix of investments generally designed to achieve a return in line with equity and fixed-income market performance.

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

Private partnership investments may include holdings of investments in private real estate, venture capital, buyout, mezzanine or subordinated debt, restructuring or distressed debt, and special situations through funds managed by third-party investment managers. Investments in private partnerships generally involve a three-to-four-year period where the investor contributes capital. This is followed by a period of distribution, typically over several years. The investment period is generally, at a minimum, ten years or longer. The NDT had unfunded commitments related to private partnerships of $135 million at March 31, 2014. These investments have no redemption or limited redemption options and may also have imposed restrictions on the NDT’s ability to liquidate its investment. There are no readily available quoted exchange prices for these investments. The fair value of the investments is based on TVA’s ownership percentage of the fair value of the underlying investments as provided by the investment managers. These investments are typically valued on a quarterly basis. TVA’s private partnership investments are valued at net asset values ("NAV") as a practical expedient for fair value. TVA classifies its interest in these types of investments as Level 3 within the fair value hierarchy.

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

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

Unrealized Investment Gains (Losses)

| | For the Three Months Ended March 31 | | For the Six Months Ended March 31 | |
|---|---|---|---|---|
| Financial Statement Presentation | 2014 | 2013 | 2014 | 2013 |

| | | | | | |
|---|---|---|---|---|---|
| SERP | Other income (expense) | $— | $1 | $1 | $1 |
| NDT | Regulatory asset | 6 | 36 | 36 | 49 |
| ART | Regulatory asset | 2 | 14 | 18 | 17 |

Currency and Interest Rate Swaps

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

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Commodity Contract Derivatives and Commodity Derivatives Under FTP

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

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

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

Nonperformance Risk

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

Nonperformance risk for most of TVA's derivative instruments is an adjustment to the initial asset/liability fair value. TVA adjusts for nonperformance risk, both of TVA (for liabilities) and the counterparty (for assets), by applying credit valuation adjustments ("CVAs"). TVA determines an appropriate CVA for each applicable financial instrument based on the term of the instrument and TVA's or the counterparty's credit rating as obtained from Moody's. For companies that do not have an observable credit rating, TVA uses internal analysis to assign a comparable rating to the company. TVA discounts each financial instrument using the historical default rate (as reported by Moody's for CY 1983 to CY 2012) for companies with a similar credit rating over a time period consistent with the remaining term of the contract. The application of CVAs resulted in a $1 million decrease in the fair value of assets and a $1 million decrease in the fair value of liabilities at March 31, 2014.

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Fair Value Measurements

The following tables set forth by level, within the fair value hierarchy, TVA's financial assets and liabilities that were measured at fair value on a recurring basis as of March 31, 2014, and September 30, 2013. Financial assets and liabilities have been classified in their entirety based on the lowest level of input that is significant to the fair value measurement. TVA's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the determination of the fair value of the assets and liabilities and their classification in the fair value hierarchy levels.

Fair Value Measurements
At March 31, 2014

| Assets | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Netting[1] | Total |
|---|---|---|---|---|---|
| Investments | | | | | |
| Equity securities | $165 | $— | $— | $— | $165 |
| Debt securities | | | | | |
| U.S. government corporations and agencies | 69 | 61 | — | — | 130 |
| Corporate debt securities | — | 297 | — | — | 297 |
| Residential mortgage-backed securities | — | 12 | — | — | 12 |
| Commercial mortgage-backed securities | — | 6 | — | — | 6 |
| Collateralized debt obligations | — | 21 | — | — | 21 |
| Private partnerships | — | — | 180 | — | 180 |
| Commingled funds[2] | | | | | |
| Equity security commingled funds | — | 893 | — | — | 893 |
| Debt security commingled funds | — | 123 | — | — | 123 |
| Total investments | 234 | 1,413 | 180 | — | 1,827 |
| Currency swaps | — | 74 | — | (74) | — |
| Commodity contract derivatives | — | — | 7 | — | 7 |
| Commodity derivatives under FTP | | | | | |
| Swap contracts | — | 61 | — | (60) | 1 |
| Total | $234 | $1,548 | $187 | $(134) | $1,835 |

| Liabilities | Quoted Prices in Active Markets for Identical Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Netting[1] | Total |
|---|---|---|---|---|---|
| Currency swaps | $— | $6 | $— | $— | $6 |
| Interest rate swaps | — | 1,223 | — | — | 1,223 |

| | | | | | |
|---|---|---|---|---|---|
| Commodity contract derivatives | — | 3 | 138 | — | 141 |
| Commodity derivatives under FTP | | | | | |
| Swap contracts | — | 165 | — | (125 ) | 40 |
| Total | $— | $1,397 | $138 | $(125 ) | $1,410 |

Notes
(1) Due to the right of setoff and method of settlement, TVA elects to record commodity derivatives under the FTP based on its net commodity position with the counterparty or FCM. Deposits are made to TVA's margin cash accounts held with each FCM to offset any net liability positions in full for derivatives that are transacted with FCMs. TVA records currency swaps net of cash collateral received from or paid to the counterparty.
(2) Commingled funds represent investment funds comprising multiple individual financial instruments and are classified in the table based on their existing investment portfolio as of the measurement date. Commingled funds primarily composed of one class of security are classified in that category.

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Fair Value Measurements
At September 30, 2013

| Assets | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Netting(1) | Total |
|---|---|---|---|---|---|
| Investments | | | | | |
| Equity securities | $151 | $— | $— | $— | $151 |
| Debt securities | | | | | |
| U.S. government corporations and agencies | 38 | 67 | — | — | 105 |
| Corporate debt securities | — | 255 | — | — | 255 |
| Residential mortgage-backed securities | — | 25 | — | — | 25 |
| Commercial mortgage-backed securities | — | 7 | — | — | 7 |
| Collateralized debt obligations | — | 10 | — | — | 10 |
| Private partnerships | — | — | 159 | — | 159 |
| Commingled funds(2) | | | | | |
| Equity security commingled funds | — | 741 | — | — | 741 |
| Debt security commingled funds | — | 248 | — | — | 248 |
| Total investments | 189 | 1,353 | 159 | — | 1,701 |
| Currency swaps | — | 61 | — | (33) | 28 |
| Commodity contract derivatives | — | — | 3 | — | 3 |
| Commodity derivatives under FTP | | | | | |
| Swap contracts | — | 101 | — | (98) | 3 |
| Total | $189 | $1,515 | $162 | $(131) | $1,735 |

| Liabilities | Quoted Prices in Active Markets for Identical Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Netting(1) | Total |
|---|---|---|---|---|---|
| Currency swaps | $— | $15 | $— | $— | $15 |
| Interest rate swaps | — | 1,199 | — | — | 1,199 |
| Commodity contract derivatives | — | 1 | 143 | — | 144 |
| Commodity derivatives under FTP | | | | | |
| Swap contracts | — | 267 | — | (198) | 69 |
| Total | $— | $1,482 | $143 | $(198) | $1,427 |

Notes
(1) Due to the right of setoff and method of settlement, TVA elects to record commodity derivatives under the FTP based on its net commodity position with the counterparty or FCM. Deposits are made to TVA's margin cash accounts

held with each FCM to offset any net liability positions in full for derivatives that are transacted with FCMs. TVA records currency swaps net of cash collateral received from or paid to the counterparty.
(2) Commingled funds represent investment funds comprising multiple individual financial instruments and are classified in the table based on their existing investment portfolio as of the measurement date.  Commingled funds primarily composed of one class of security are classified in that category.

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

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

Fair Value Measurements Using Significant Unobservable Inputs

| | For the Three Months Ended March 31 | | For the Six Months Ended March 31 | |
|---|---|---|---|---|
| | Private Partnerships | Commodity Contract Derivatives | Private Partnerships | Commodity Contract Derivatives |
| Balance at beginning of period | $66 | $(224) | $53 | $(267) |
| Purchases | 70 | — | 83 | — |
| Issuances | — | — | — | — |
| Sales | (1) | — | (2) | — |
| Settlements | — | — | — | — |
| Net unrealized gains (losses) deferred as regulatory assets and liabilities | 2 | 76 | 3 | 119 |
| Balance at March 31, 2013 | $137 | $(148) | $137 | $(148) |
| | | | | |
| Balance at beginning of period | $169 | $(145) | $159 | $(140) |
| Purchases | 6 | — | 14 | — |
| Issuances | — | — | — | — |
| Sales | (2) | — | (5) | — |
| Settlements | — | — | — | — |
| Net unrealized gains (losses) deferred as regulatory assets and liabilities | 7 | 14 | 12 | 9 |
| Balance at March 31, 2014 | $180 | $(131) | $180 | $(131) |

There were no realized gains or losses related to the instruments measured at fair value using significant unobservable inputs that affected net income during the three and six months ended March 31, 2014. All unrealized gains and losses related to these instruments have been reflected as increases or decreases in regulatory assets and liabilities. See Note 7.

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

Quantitative Information about Level 3 Fair Value Measurements

| | Fair Value at March 31, 2014 | Valuation Technique(s) | Unobservable Inputs | Range |
|---|---|---|---|---|
| Assets | | | | |
| Commodity contract derivatives | $7 | Discounted cash flow | Credit risk | 17 %* |
| | | Pricing model | | |

| | | | | |
|---|---|---|---|---|
| | | | Coal supply and demand | 0.9 - 1.0 billion tons/year |
| | | | Long-term market prices | $12.30 - $67.66/ton |
| Liabilities | | | | |
| Commodity contract derivatives | $138 | Pricing model | Coal supply and demand | 0.9 - 1.0 billion tons/year |
| | | | Long-term market prices | $12.30 - $67.66/ton |

* Applies to only one contract.

Other Financial Instruments Not Recorded at Fair Value

TVA uses the methods and assumptions described below to estimate the fair value of each significant class of financial instrument. The fair values of the financial instruments held at March 31, 2014, and September 30, 2013, may not be representative of the actual gains or losses that will be recorded when these instruments mature or are called or presented for early redemption. The estimated values of TVA's financial instruments not recorded at fair value at March 31, 2014, and September 30, 2013, were as follows:

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Estimated Values of Financial Instruments Not Recorded at Fair Value

| | | At March 31, 2014 | | At September 30, 2013 | |
|---|---|---|---|---|---|
| | Valuation Classification | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| EnergyRight® receivables (including current portion) | Level 2 | $151 | $151 | $150 | $150 |
| Loans and other long-term receivables, net | Level 2 | $92 | $82 | $73 | $67 |
| EnergyRight® purchase obligation (including current portion) | Level 2 | $186 | $204 | $186 | $210 |
| Membership interest of variable interest entity subject to mandatory redemption (including current portion) | Level 2 | $39 | $50 | $40 | $50 |
| Long-term outstanding power bonds (including current maturities), net | Level 2 | $22,046 | $24,957 | $22,347 | $24,603 |
| Long-term debt of variable interest entities (including current maturities) | Level 2 | $1,326 | $1,420 | $1,341 | $1,386 |

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

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

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

16. Other Income (Expense), Net

Income and expenses not related to TVA’s operating activities are summarized in the following table:
Other Income (Expense), Net

| | For the Three Months Ended March 31 | | For the Six Months Ended March 31 | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| External services | $6 | $4 | $11 | $11 |
| Interest income | 6 | 6 | 12 | 11 |
| Gains (losses) on investments | 1 | 2 | 3 | 3 |
| Miscellaneous | — | (1) | 1 | 1 |
| Total other income (expense), net | $13 | $11 | $27 | $26 |

17. Benefit Plans

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

The components of net periodic benefit cost and other amounts recognized as changes in regulatory assets for the three and six months ended March 31, 2014, and 2013, were as follows:

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Components of TVA's Benefit Plans

| | For the Three Months Ended March 31 | | | | For the Six Months Ended March 31 | | | |
|---|---|---|---|---|---|---|---|---|
| | Pension Benefits | | Other Post-Retirement Benefits | | Pension Benefits | | Other Post-Retirement Benefits | |
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| Service cost | $30 | $43 | $4 | $7 | $65 | $77 | $9 | $12 |
| Interest cost | 140 | 111 | 6 | 6 | 279 | 234 | 15 | 15 |
| Expected return on plan assets | (109) | (105) | — | — | (217) | (214) | — | — |
| Amortization of prior service cost | (6) | (5) | (1) | (1) | (11) | (11) | (3) | (3) |
| Recognized net actuarial loss | 73 | 98 | 2 | 6 | 142 | 188 | 5 | 13 |
| Total net periodic benefit cost recognized | $128 | $142 | $11 | $18 | $258 | $274 | $26 | $37 |

TVA contributes to the Plan such amounts as are necessary on an actuarial basis to provide the Plan with assets sufficient to meet TVA-funded benefit obligations to be paid to members. In consideration of TVA's $1.0 billion contribution to the Plan in September 2009, the Plan's Rules and Regulations ("Plan's Rules") were amended to temporarily suspend the minimum annual contribution requirements for a four year period from FY 2010 through FY 2013. In August 2013, the TVA Board approved a $250 million contribution to the Plan for FY 2014, which exceeds the minimum required by the Plan's Rules. As of March 31, 2014, TVA had contributed $126 million and will contribute the remaining $124 million by September 30, 2014. TVA does not separately set aside assets to fund other benefit costs, but rather funds such costs on an as-paid basis. For the six months ended March 31, 2014, TVA provided approximately $24 million for other post-retirement benefit plans and approximately $6 million to the SERP. For the six months ended March 31, 2013, TVA provided approximately $26 million to other post-retirement benefit plans and approximately $6 million to the SERP.

## 18. Contingencies and Legal Proceedings

### Contingencies

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

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

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

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

Nuclear. Provision for decommissioning costs of nuclear generating units is based on options prescribed by the NRC procedures to dismantle and decontaminate the facilities to meet the NRC criteria for license termination. At March 31, 2014, the present value of the estimated future decommissioning cost of $2.5 billion was included in AROs. The actual decommissioning costs may vary from the derived estimates because of, among other things, changes in current assumptions, such as the assumed dates of decommissioning, changes in regulatory requirements, changes in technology, and changes in the cost of labor, materials, and equipment. Utilities that own and operate nuclear plants are required to use different procedures in calculating nuclear decommissioning costs under GAAP than those that are used in calculating nuclear decommissioning costs when reporting to the NRC. The two sets of procedures produce different estimates for the costs of

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decommissioning primarily because of the difference in the discount rates used to calculate the present value of decommissioning costs.

TVA maintains a NDT to provide funding for the ultimate decommissioning of its nuclear power plants. TVA monitors the value of its NDT and believes that, over the long term and before cessation of nuclear plant operations and commencement of decommissioning activities, adequate funds from investments will be available to support decommissioning. TVA's nuclear power units are currently authorized to operate until 2020-2036, depending on the unit. It may be possible to extend the operating life of some of the units with approval from the NRC. See Note 7 and Note 11.

Non-Nuclear Decommissioning. The present value of the estimated future non-nuclear decommissioning ARO was $1.1 billion at March 31, 2014. This decommissioning cost estimate involves estimating the amount and timing of future expenditures and making judgments concerning whether or not such costs are considered a legal obligation. Estimating the amount and timing of future expenditures includes, among other things, making projections of the timing and duration of the asset retirement process and how costs will escalate with inflation. The actual decommissioning costs may vary from the derived estimates because of changes in current assumptions, such as the assumed dates of decommissioning, changes in regulatory requirements, changes in technology, and changes in the cost of labor, materials, and equipment.

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

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

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

TVA estimates that compliance with future Clean Air Act ("CAA") requirements (excluding greenhouse gas ("GHG") requirements) could lead to additional costs of $1.2 billion from 2014 to 2022. There could be additional material costs if reductions of GHGs, including carbon dioxide, are mandated under the CAA or by legislation or regulation, or if future legislative, regulatory, or judicial actions lead to more stringent emission reduction requirements for conventional pollutants. These costs cannot reasonably be predicted at this time because of the uncertainty of such potential actions.

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

TVA operations at some TVA facilities have resulted in oil spills and other contamination that TVA is addressing. At March 31, 2014, TVA’s estimated liability for cleanup and similar environmental work for those sites for which sufficient information is available to develop a cost estimate (primarily the TVA sites) was approximately $16 million on a non-discounted basis and was included in Accounts payable and accrued liabilities and Other long-term liabilities on the Consolidated Balance Sheet.

Legal Proceedings

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

General. At March 31, 2014, TVA had accrued approximately $272 million of probable losses with respect to Legal Proceedings and estimated the range of these losses to be from $272 million to $284 million. Of the accrued amount, $153 million is included in Other long-term liabilities, $91 million is included in Accounts payable and accrued liabilities, and $28 million is included in Regulatory assets. TVA is currently unable to estimate any amount or any range of amounts of reasonably possible losses, and no assurance can be given that TVA will not be subject to significant additional claims and liabilities. If actual liabilities significantly exceed the estimates made, TVA's results of operations, liquidity, and financial condition could be materially adversely affected.

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

The liabilities related to the Environmental Agreements are included in Accounts payable and accrued liabilities and Other long-term liabilities on the March 31, 2014 Consolidated Balance Sheet. In conjunction with the approval of the Environmental Agreements, the TVA Board determined that it was appropriate to record TVA's liabilities under the Environmental Agreements as regulatory assets, and they are included as such on the March 31, 2014 Consolidated Balance Sheet and will be recovered in rates in future periods.

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

Legal Proceedings Related to the Kingston Ash Spill. Seventy-eight lawsuits based on the Kingston ash spill have been filed in the United States District Court for the Eastern District of Tennessee. Fifteen of these lawsuits have been dismissed, and 63 lawsuits are active and in various stages of litigation. Plaintiffs are residents, businesses, and property owners in the Kingston area and allege tort claims for damage to property (for example, nuisance, strict liability, trespass, and negligence), with some plaintiffs also alleging claims for personal injury, business loss, and inverse condemnation. Plaintiffs seek unspecified compensatory and punitive damages, court orders to clean up properties, and other relief. TVA is the only active defendant in these actions.

A bench trial on the issue of dike failure causation in the seven earliest cases was held in September and October 2011 ("Phase I trial"). Plaintiffs in the 56 remaining cases have agreed to be bound by the Phase I trial record and decision. In August 2012, the court issued its Phase I decision, finding that certain actions by TVA contributed to the ash spill. On November 20, 2012, the court ordered the parties to participate in mediation within 120 days of the issuance of the order. The court has extended the mediation period four times, and the mediation period is now scheduled to end on June 16, 2014. If the case is not resolved through mediation, the case will proceed to the damages phase ("Phase II") trial, during which the individual plaintiffs must prove both that they incurred damages and that the ash spill was the cause of the damages. The date for the Phase II trial has not yet been set.

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

Civil Penalty and Natural Resource Damages for the Kingston Ash Spill. In June 2010, TDEC issued a civil penalty order of approximately $12 million to TVA for the Kingston ash spill, citing violations of the Tennessee Solid Waste

Disposal Act and the Tennessee Water Quality Control Act. Of the $12 million, TVA has paid $10 million, and TDEC has approved environmental projects valued at $2 million as a credit against the remaining penalty amount. TVA has completed projects or committed funds that total nearly $2 million. As part of a memorandum of agreement for the natural resource damage assessment process, TVA agreed to pay $250 thousand each year for three years as a down payment on the amount of natural resource damages ultimately established, and to reimburse TDEC and the U.S. Fish and Wildlife Service for their costs.

Case Involving Tennessee Valley Authority Retirement System. In March 2010, eight current and former participants in and beneficiaries of Tennessee Valley Authority Retirement System ("TVARS") filed suit in the United States District Court for the Middle District of Tennessee against the six then-current members of the TVARS Board. The lawsuit challenged the TVARS Board's decision to suspend the TVA contribution requirements for 2010 through 2013, and to amend the TVARS Rules and Regulations to (1) reduce the calculation for COLA benefits for CY 2010 through CY 2013, (2) reduce the interest crediting rate for the fixed fund accounts, and (3) increase the eligibility age to receive COLAs from age 55 to 60. The plaintiffs allege that these actions violated the TVARS Board members' fiduciary duties to the plaintiffs (and the purported class) and the plaintiffs' contractual rights, among other claims. The plaintiffs sought, among other things, unspecified damages, an order directing the TVARS Board to rescind the amendments, and the appointment of a seventh TVARS Board member. Five of the six individual defendants filed motions to dismiss the lawsuit, while the remaining defendant filed an answer to the complaint. In July 2010, TVA moved to intervene in the suit in the event it was not dismissed. In September 2010, the district court dismissed the breach of fiduciary duty claim against the directors without prejudice, allowing the plaintiffs to file an amended complaint within 14 days against TVARS and TVA but not the individual directors. The plaintiffs previously had voluntarily withdrawn their constitutional claims, so the court also dismissed those claims without prejudice. The court dismissed with prejudice the plaintiffs' claims for breach of contract, violation of the Internal Revenue Code, and appointment of a seventh TVARS Board member.

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

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

In June 2012, multiple intervenor groups submitted a petition to the NRC to (1) hold in abeyance all pending reactor licensing decisions that would depend upon the WCD and (2) establish a process for ensuring that the remanded proceeding complies with the public participation requirements of Section 189a of the Atomic Energy Act. In August 2012, the NRC issued an order (the "August 2012 NRC Order") preventing the issuance of a final licensing decision in all proceedings affected by the petition, including Watts Bar Unit 2 and Bellefonte Units 3 and 4. While resolution of unrelated contentions can proceed, the NRC stated that it will not issue final licensing decisions until it has “appropriately addressed” the D.C. Circuit decision, and all pending contentions concerning the WCD are being held in abeyance pending the NRC's completion of an environmental review and generic rulemaking addressing the shortcomings identified by the D.C. Circuit. A draft rule and Environmental Impact Statement addressing the D.C. Circuit decision were issued by the NRC staff for public comment in September 2013. The NRC is currently scheduled to address this issue by early October 2014.

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

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

In July 2012, BREDL petitioned for the admission of another new, late-filed contention stemming from the D.C. Circuit's order vacating the WCD. This contention is being held in abeyance pursuant to the August 2012 NRC Order.

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

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

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

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

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

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

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

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

Gallatin Fossil Plant NPDES Permit Administrative Appeal. SACE, TCWN, and the Sierra Club filed a challenge to the NPDES permit for the Gallatin Fossil Plant in June 2012. TDEC is the defendant in the challenge. TVA's motion to intervene was granted in September 2012. Administrative discovery is underway. The matter has been set for a hearing before the TN Board in September 2014.

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

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

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

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- Twelve separate petitions on various issues

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

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

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

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in millions except where noted)

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") explains the results of operations and general financial condition of the Tennessee Valley Authority ("TVA"). The MD&A should be read in conjunction with the accompanying unaudited consolidated financial statements and TVA's Annual Report on Form 10-K for the fiscal year ended September 30, 2013 (the "Annual Report").

Executive Overview

Sales were relatively flat for the three-month period ended March 31, 2014, and two percent lower for the six-month period ended March 31, 2014, as compared to the same periods of 2013. Sales to local power company customers of TVA ("LPCs") increased during the three-month and six-month periods ended March 31, 2014, as compared to the same periods of 2013, due to colder-than-normal weather. However, these increases were offset by a reduction in sales to industrial customers primarily driven by United States Enrichment Corporation ("USEC"), a subsidiary of the parent company, USEC, Inc., and historically TVA's largest directly served customer, as USEC began ceasing operations in May 2013.

TVA had net income for the three-month and six-month periods ended March 31, 2014, of $295 million and $228 million, respectively, as compared with net income of $54 million and a net loss of $191 million for the same periods of 2013.

Revenue from the sales of electricity increased seven percent for the three months ended March 31, 2014, compared with the same period of the prior year. This was primarily due to a $158 million increase in base revenues resulting from colder-than-normal weather and to a lesser degree changes in TVA's wholesale base rate approved by the TVA Board in August 2013. This increase was partially offset by a decrease in revenue from USEC. Revenue from the sales of electricity was flat for the six months ended March 31, 2014, compared with the same period of the prior year.

Operating and maintenance expenses decreased $83 million and $195 million, respectively, for the three-month and six-month periods ended March 31, 2014, as compared with the same periods of 2013, primarily due to the timing of refueling outages and other projects as well as cost savings initiatives undertaken by management. TVA continues to make operational changes to its generating fleet and to pursue cost reduction initiatives across all business units with a goal of keeping its rates competitive.

During the six months ended March 31, 2014, TVA made the strategic decision to use cash and cash equivalents of $1.1 billion to reduce long-term and short-term debt.

Recent inspections by the Nuclear Regulatory Commission ("NRC") determined that TVA has met all requirements in connection with the red finding for Browns Ferry Nuclear Plant ("Browns Ferry"), and the NRC has closed this finding. Additionally, the NRC has closed the hydrology issues at Sequoyah Nuclear Plant ("Sequoyah") and Watts Bar Nuclear Plant ("Watts Bar"), and these plants have returned to routine and baseline NRC inspection schedules. All six TVA nuclear reactors generated electricity at or near full power during the severe cold in January 2014, supporting the response from all segments of TVA's generation and transmission system to provide electricity for heating homes and keeping essential services open across the Tennessee Valley.

During the second quarter of 2014, TVA completed a significant milestone in its cleanup of the ash spill at the Kingston Fossil Plant ("Kingston") with the completion of a seismically designed, underground retaining wall around the containment cell. In addition, TVA plans to finish the cap and cover of the containment cell by the end of 2014.

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Results of Operations

Sales of Electricity

The following table compares TVA's energy sales for the three and six months ended March 31, 2014, and 2013:
Sales of Electricity
(millions of kWh)

| | Three Months Ended March 31 | | | | Six Months Ended March 31 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | 2013 | Change | Percent Change | 2014 | 2013 | Change | Percent Change |
| Local power companies | 36,862 | 34,025 | 2,837 | 8.3 % | 69,543 | 64,687 | 4,856 | 7.5 % |
| Industries directly served | 4,309 | 7,447 | (3,138) | (42.1)% | 8,576 | 15,002 | (6,426) | (42.8)% |
| Federal agencies and other | 750 | 826 | (76) | (9.2)% | 1,580 | 1,722 | (142) | (8.2)% |
| Total sales of electricity | 41,921 | 42,298 | (377) | (0.9)% | 79,699 | 81,411 | (1,712) | (2.1)% |

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

| | 2014 Actual | Normal[(1)] | Percent Variation | 2013 Actual | Normal[(1)] | Percent Variation | 2014 Actual | 2013 Actual | Percent Change |
|---|---|---|---|---|---|---|---|---|---|
| Heating Degree Days | | | | | | | | | |
| Three Months Ended March 31 | 2,144 | 1,812 | 18.3 % | 1,856 | 1,812 | 2.4 % | 2,144 | 1,856 | 15.5 % |
| Six Months Ended March 31 | 3,498 | 3,115 | 12.3 % | 3,071 | 3,115 | (1.4)% | 3,498 | 3,071 | 13.9 % |
| Cooling Degree Days | | | | | | | | | |
| Three Months Ended March 31 | 1 | 12 | (91.7)% | 6 | 12 | (50.0)% | 1 | 6 | (83.3)% |
| Six Months Ended March 31 | 92 | 79 | 16.5 % | 38 | 79 | (51.9)% | 92 | 38 | 142.1 % |

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

Sales of electricity decreased 377 million kilowatt hours ("kWh") for the three months ended March 31, 2014, compared to the three months ended March 31, 2013, primarily due to a decrease in demand from industries directly served. The reduced demand was largely the result of a decrease in demand by USEC, which began ceasing operations during the third quarter of 2013. Partially offsetting this decrease in sales to industries directly served was an increase in sales to LPCs due primarily to 16 percent more heating degree days than the same period in the prior year.

Sales of electricity decreased 1.7 billion kWh for the six months ended March 31, 2014, compared to the six months ended March 31, 2013, primarily due to a decrease in demand from industries directly served. The reduced demand was largely the result of a decrease in demand by USEC, which began ceasing operations during the third quarter of 2013. Partially offsetting this decrease in sales to industries directly served was an increase in sales to LPCs due primarily to greater than normal heating degree days as a result of a colder winter during the six months ended March 31, 2014, as compared to fewer than normal heating degree days for the six months ended March 31, 2013.

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Financial Results

The following table compares operating results for the three and six months ended March 31, 2014, and 2013:
Summary Consolidated Statements of Operations

| | Three Months Ended March 31 | | | Six Months Ended March 31 | | |
|---|---|---|---|---|---|---|
| | 2014 | 2013 | Percent Change | 2014 | 2013 | Percent Change |
| Operating revenues | $2,938 | $2,741 | 7.2 % | $5,320 | $5,320 | — % |
| Operating expenses | 2,362 | 2,380 | (0.8 )% | 4,526 | 4,903 | (7.7 )% |
| Operating income | 576 | 361 | 59.6 % | 794 | 417 | 90.4 % |
| Other income, net | 13 | 11 | 18.2 % | 27 | 26 | 3.8 % |
| Interest expense, net | 294 | 318 | (7.5 )% | 593 | 634 | (6.5 )% |
| Net income (loss) | $295 | $54 | 446.3 % | $228 | $(191 ) | 219.4 % |

Operating Revenues. Operating revenues for the three and six months ended March 31, 2014, and 2013, consisted of the following:
Operating Revenues

| | Three Months Ended March 31 | | | Six Months Ended March 31 | | |
|---|---|---|---|---|---|---|
| | 2014 | 2013 | Percent Change | 2014 | 2013 | Percent Change |
| Electricity sales | | | | | | |
| Local power companies | $2,668 | $2,350 | 13.5 % | $4,834 | $4,539 | 6.5 % |
| Industries directly served | 193 | 323 | (40.2 )% | 342 | 645 | (47.0 )% |
| Federal agencies and other | 40 | 36 | 11.1 % | 75 | 74 | 1.4 % |
| Electricity sales | 2,901 | 2,709 | 7.1 % | 5,251 | 5,258 | (0.1 )% |
| Other revenue | 37 | 32 | 15.6 % | 69 | 62 | 11.3 % |
| Total operating revenues | $2,938 | $2,741 | 7.2 % | $5,320 | $5,320 | — % |

Operating revenues increased $197 million and remained flat in the three and six months ended March 31, 2014, respectively, compared to the three and six months ended March 31, 2013, due to the following:

| | Three Month Change | Six Month Change |
|---|---|---|
| Fuel cost recovery | $34 | $(221 ) |
| Base revenue | 158 | 219 |
| Other | 5 | 2 |
| Total | $197 | $— |

Operating revenues increased $197 million for the three months ended March 31, 2014, compared to the three months ended March 31, 2013, primarily due to a $158 million increase in base revenue and a $34 million increase in fuel cost recovery. The $158 million increase in base revenue was primarily the result of higher sales volume to LPCs and the non-fuel base rate increase that became effective October 1, 2013. These items were partially offset by lower sales volume to industries directly served, which largely resulted from a decrease in demand by USEC. The $34 million increase in fuel cost recovery was largely attributable to higher fuel rates, which resulted from the use of more expensive generation resources.

Operating revenues were flat for the six months ended March 31, 2014, compared to the six months ended March 31, 2013, as a $221 million decrease in fuel cost recovery was almost entirely offset by a $219 million increase in base revenue. The $221 million decrease in fuel cost recovery was attributable to lower fuel rates, which resulted from the use of less expensive generation resources. The $219 million increase in base revenue was primarily the result of higher sales volume to LPCs and the non-fuel base rate increase that became effective October 1, 2013. These items were partially offset by a decrease in sales volume to industries directly served, which largely resulted from a decrease in demand by USEC.

TVA's wholesale rate structure provides price signals intended to encourage LPCs and end-use customers to shift energy usage from high-cost generation periods to less expensive generation periods. Under the revised wholesale structure, weather can positively or negatively impact both volume and effective rates, while only volume was impacted under the former

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wholesale structure. This is because the wholesale structure includes two components: a demand charge and an energy charge. The demand charge is based on the customer's peak monthly usage and increases as the peak increases. The energy charge is based on the kWhs used by the customer. The rate structure also establishes a separate fuel rate that includes the costs of natural gas, fuel oil, purchased power, coal, emission allowances, nuclear fuel, and other fuel-related commodities; realized gains and losses on derivatives purchased to hedge the costs of such commodities; and tax equivalents associated with the fuel cost adjustments.

Operating Expenses. Operating expenses for the three and six months ended March 31, 2014, and 2013, consisted of the following:

Operating Expenses

| | Three Months Ended March 31 | | | Six Months Ended March 31 | | |
|---|---|---|---|---|---|---|
| | 2014 | 2013 | Percent Change | 2014 | 2013 | Percent Change |
| Fuel | $663 | $672 | (1.3)% | $1,206 | $1,466 | (17.7)% |
| Purchased power | 313 | 288 | 8.7% | 564 | 533 | 5.8% |
| Operating and maintenance | 793 | 876 | (9.5)% | 1,600 | 1,795 | (10.9)% |
| Depreciation and amortization | 453 | 408 | 11.0% | 894 | 836 | 6.9% |
| Tax equivalents | 140 | 136 | 2.9% | 262 | 273 | (4.0)% |
| Total operating expenses | $2,362 | $2,380 | (0.8)% | $4,526 | $4,903 | (7.7)% |

The following table summarizes TVA's net generation and purchased power in millions of kWh by generating source and the percentage of all electric power generated and purchased for the periods indicated:

Power Supply from TVA-Operated Generation Facilities and Purchased Power

| | Three Months Ended March 31 | | | | Six Months Ended March 31 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| | kWh (in millions) | Percent of Total Power Supply | kWh (in millions) | Percent of Total Power Supply | kWh (in millions) | Percent of Total Power Supply | kWh (in millions) | Percent of Total Power Supply |
| Coal-fired | 16,936 | 40% | 14,648 | 34% | 29,292 | 36% | 32,299 | 39% |
| Nuclear | 13,576 | 32% | 13,151 | 31% | 27,217 | 33% | 23,740 | 29% |
| Hydroelectric | 4,304 | 10% | 5,606 | 13% | 8,741 | 11% | 9,019 | 11% |
| Natural gas and/or oil-fired | 2,765 | 6% | 3,873 | 9% | 5,763 | 7% | 7,683 | 9% |
| Renewable resources (non-hydro) | — | —% | 1 | —% | 2 | —% | 5 | —% |
| Total TVA-operated generation facilities | 37,581 | 88% | 37,279 | 87% | 71,015 | 87% | 72,746 | 88% |
| Purchased power | 5,144 | 12% | 5,707 | 13% | 10,190 | 13% | 10,070 | 12% |
| Total power supply | 42,725 | 100% | 42,986 | 100% | 81,205 | 100% | 82,816 | 100% |

Fuel expense decreased $9 million for the three months ended March 31, 2014, as compared to the same period of the prior year, primarily due to the timing of the fuel cost recovery mechanism. The fuel cost recovery mechanism provides a means to regularly adjust rates in order to reflect changing fuel and purchased power costs, including realized gains and losses relating to fuel commodity hedging transactions under TVA’s financial trading program ("FTP"). See Note 14 — Derivatives Not Receiving Hedge Accounting Treatment — Derivatives Under FTP. There is typically a lag between the occurrence of a change in fuel and purchased power costs and the reflection of the change in rates due to the operation of the fuel cost recovery mechanism. This difference is recorded as a regulatory asset or liability and represents over-collected revenues (regulatory liabilities) or under-collected revenues (regulatory assets).

As a result of this treatment, eligible fuel expenses are correctly matched to the related revenue on the statements of operations. For the three months ended March 31, 2014, the fuel cost recovery mechanism decreased fuel expense by $74 million, as compared to the same period of the prior year. In addition, the regulatory asset balance for the fuel cost adjustment receivable was $133 million at March 31, 2014, compared to $13 million at March 31, 2013. Balances in the fuel cost receivable regulatory asset account represent under-collected revenues that will offset fuel and purchased power costs as the costs are recovered in fuel rates in a future period. Partially offsetting the decrease in fuel expense resulting from the timing of the fuel cost recovery mechanism was an increase in fuel expense of $34 million due to increased volume of fuel consumed, primarily due to a 16 percent increase in coal-fired generation, compared to the same period of the prior year. Additionally, higher fuel prices contributed to an increase in fuel expense of $31 million, largely due to higher prices for natural gas, as compared to the same period of the prior year.

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Purchased power expense increased $25 million for the three months ended March 31, 2014, as compared to the same period of the prior year, primarily due to higher market prices for natural gas, as TVA's primary source of purchased power is natural gas-fired generation. The average Henry Hub natural gas spot price for the three months ended March 31, 2014, was $5.05 per mmBtu, which was 45 percent higher than the average price for the same period of the prior year. Partially offsetting the increase in the price of purchased power was a 10 percent decrease in the volume of power purchased.

Operating and maintenance expense decreased $83 million for the three months ended March 31, 2014, compared with the same period of the prior year. This decrease was primarily attributable to cost savings initiatives undertaken by management including a $33 million decrease in contract labor and $24 million decrease in materials and supplies. See Key Initiatives and Challenges — Cost Reduction Initiatives. In addition, pension and post-retirement financing and service cost decreased $17 million due to an increase in the discount rate.

Depreciation and amortization expense increased $45 million for the three months ended March 31, 2014, compared with the same period of the prior year, primarily due to an increase in the amount of accelerated depreciation recognized for certain coal-fired units to be idled.

Tax equivalents expense increased $4 million during the three months ended March 31, 2014, compared to the same period of the prior year. This increase primarily reflects an increase in the accrued tax equivalent expense related to the FCA. The accrued tax equivalent expense is equal to five percent of the FCA revenues and increased for the three months ended March 31, 2014, as compared to the same period of the prior year.

Fuel expense decreased $260 million for the six months ended March 31, 2014, as compared to the same period of the prior year, primarily due to the timing of the fuel cost recovery mechanism and the utilization of less expensive generation resources. For the six months ended March 31, 2014, the fuel cost recovery mechanism decreased fuel expense by $152 million as compared to the same period of the prior year. As a result of fewer nuclear outages during the six months ended March 31, 2014, compared to the same period of the prior year, nuclear generation increased by 15 percent. Due to the utilization of less expensive nuclear generation, TVA reduced generation of its more expensive coal-fired and gas-fired generation resources, resulting in a decrease of fuel expense of $75 million for the six months ended March 31, 2014, as compared to the same period of the prior year. Additionally, a reduction in sales volume of two percent caused a decrease in fuel expense of $33 million.

Purchased power expense increased $31 million for the six months ended March 31, 2014, as compared to the same period of the prior year, primarily due to higher market prices for natural gas, as TVA's primary source of purchased power is natural gas-fired generation. The average Henry Hub natural gas spot price for the six months ended March 31, 2014, was $4.44 per mmBtu, which was 29 percent higher than the average price for the same period of the prior year. Partially offsetting the increase in the price of purchased power expense was a decrease in expense related to the fuel cost recovery mechanism.

Operating and maintenance expense decreased $195 million for the six months ended March 31, 2014, compared with the same period of the prior year. This decrease was primarily attributable to a $100 million decrease in expenses related to planned nuclear refueling outages as well as a decrease in outage projects and scheduled maintenance during the six months ended March 31, 2014, as compared with the same period of the prior year. In addition, pension and post-retirement financing and service cost decreased $25 million due to an increase in the discount rate. The remaining $70 million decrease is primarily a result of cost savings initiatives undertaken by management. See Key Initiatives and Challenges — Cost Reduction Initiatives.

Depreciation and amortization expense increased $58 million for the six months ended March 31, 2014, compared with the same period of the prior year, primarily due to an increase in the amount of accelerated depreciation recognized for certain coal-fired units to be idled.

Tax equivalents expense decreased $11 million in the six months ended March 31, 2014, compared to the same period of the prior year. This change primarily reflects a decrease in gross revenues from the sale of power (excluding sales or deliveries to other federal agencies and off-system sales with other utilities) during 2013 compared to 2012.

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Interest Expense. Interest expense and interest rates for the three and six months ended March 31, 2014, and 2013, were as follows:

Interest Expense

| | Three Months Ended March 31 | | | Six Months Ended March 31 | | |
|---|---|---|---|---|---|---|
| | 2014 | 2013 | Percent Change | 2014 | 2013 | Percent Change |
| Interest Expense[1] | | | | | | |
| Interest expense | $336 | $359 | (6.4)% | $675 | $714 | (5.5)% |
| Allowance for funds used during construction and nuclear fuel expenditures | (42) | (41) | 2.4% | (82) | (80) | 2.5% |
| Net interest expense | $294 | $318 | (7.5)% | $593 | $634 | (6.5)% |

| | 2014 | 2013 | Percent Change | 2014 | 2013 | Percent Change |
|---|---|---|---|---|---|---|
| Interest Rates (average) | | | | | | |
| Long-term outstanding power bonds[2] | 5.603% | 5.777% | (3.0)% | 5.590% | 5.767% | (3.1)% |
| Long-term debt of variable interest entities | 4.604% | 4.875% | (5.6)% | 4.601% | 4.875% | (5.6)% |
| Membership interests subject to mandatory redemption | 7.180% | — | 100.0% | 7.033% | — | 100.0% |
| Discount notes | 0.036% | 0.085% | (57.6)% | 0.050% | 0.104% | (51.9)% |
| Blended | 5.166% | 5.498% | (6.0)% | 5.121% | 5.455% | (6.1)% |

Notes

(1) Interest expense includes interest on long-term debt obligations, including amortization of debt discounts, issuance, and reacquisition costs, net.

(2) The average interest rates on long-term debt obligations reflected in the table above are calculated using an average of long-term debt balances at the end of each month in the periods above and interest expense for those periods.

Net interest expense decreased $24 million for the three months ended March 31, 2014, as compared to the same period of the prior year. This decrease was attributable to a decrease in both the average balance and average interest rate of TVA’s outstanding debt.

Net interest expense decreased $41 million for the six months ended March 31, 2014, as compared to the same period of the prior year. This decrease was attributable to a decrease in both the average balance and average interest rate of TVA’s outstanding debt.

Liquidity and Capital Resources

Sources of Liquidity

To meet cash needs and contingencies, TVA depends on various sources of liquidity. TVA’s primary sources of liquidity are cash from operations and proceeds from the issuance of short-term and long-term debt. Current liabilities may exceed current assets from time to time in part because TVA uses short-term debt to fund short-term cash needs, as well as to pay scheduled maturities and other redemptions of long-term debt. The daily balance of cash and cash equivalents maintained is based on near-term expectations for cash expenditures and funding needs.

In addition to cash from operations and proceeds from the issuance of short-term and long-term debt, TVA's sources of liquidity also include a $150 million credit facility with the United States ("U.S.") Treasury, three long-term revolving credit facilities totaling $2.5 billion, and proceeds from any other financing arrangements such as lease financings, call monetization transactions, sales of assets, and sales of receivables and loans. Management expects these sources, certain of which are described below, to provide adequate liquidity to TVA for the foreseeable future.

The TVA Act authorizes TVA to issue Bonds in an amount not to exceed $30.0 billion outstanding at any time. At March 31, 2014, TVA had $23.7 billion of Bonds outstanding (not including noncash items of foreign currency exchange loss of $71 million and net discount on sale of the amount of outstanding Bonds of $82 million). Due to this limit on Bonds, TVA may not be able to use Bonds to finance all of the capital investments planned over the next decade. However, TVA believes that other forms of financing not subject to the limitation, including lease financings, could provide supplementary funding if needed. See Lease Financings below and Note 8. Also, the impact of energy efficiency and demand response initiatives may reduce generation requirements and thereby reduce capital needs. TVA anticipates that capital spending needs can be met with a combination of Bonds, lease arrangements, energy prepayments, additional power revenues through rate increases, cost reductions, or other ways.

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Debt Securities. TVA’s Bonds are not obligations of the United States, and the United States does not guarantee the payments of principal or interest on Bonds. TVA’s Bonds consist of power bonds and discount notes. Power bonds have maturities of between one and 50 years. Discount notes have maturities of less than one year. Power bonds and discount notes have a first priority and equal claim of payment out of net power proceeds. Net power proceeds are defined as the remainder of TVA's gross power revenues after deducting the costs of operating, maintaining, and administering its power properties 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 from the sale or other disposition of any power facility or interest therein. In addition to power bonds and discount notes, TVA had outstanding at March 31, 2014, the long-term debt of two variable interest entities. See Lease Financings below and Note 12 — Debt Securities Activity for additional information.

The following table provides additional information regarding TVA's short-term borrowings.

Short-Term Borrowing Table

| | At March 31 2014 | Three Months Ended March 31 2014 | Six Months Ended March 31 2014 | At March 31 2013 | Three Months Ended March 31 2013 | Six Months Ended March 31 2013 |
|---|---|---|---|---|---|---|
| Amount Outstanding (at End of Period) or Average Amount Outstanding (During Period) | | | | | | |
| Discount Notes | $1,691 | $1,718 | $1,924 | $2,045 | $1,098 | $1,239 |
| Weighted Average Interest Rate | | | | | | |
| Discount Notes | 0.054 % | 0.036 % | 0.050 % | 0.090 % | 0.085 % | 0.104 % |
| Maximum Month-End Amount Outstanding (During Period) | | | | | | |
| Discount Notes | N/A | $1,950 | $2,442 | N/A | $2,045 | $2,045 |

In October 2013, one credit rating agency placed the ratings on the United States sovereign debt on rating watch negative, and subsequently placed TVA's rating on rating watch negative. Rating watch is typically event driven, while the negative status indicates a heightened probability of a downgrade. In March 2014, the agency removed the rating watch negative on the ratings on United States sovereign debt and changed the outlook to stable, and subsequently removed the rating watch negative on TVA’s rating and changed the outlook to stable.

Credit Facility Agreements. TVA and the U.S. Treasury, pursuant to the TVA Act, have entered into a memorandum of understanding under which the U.S. Treasury provides TVA with a $150 million credit facility. This credit facility was renewed for 2014 and has a maturity date of September 30, 2014. Access to this credit facility or other similar financing arrangements with the U.S. Treasury has been available to TVA since the 1960s. TVA plans to use the U.S. Treasury credit facility as a secondary source of liquidity. The interest rate on any borrowing under this facility is based on the average rate on outstanding marketable obligations of the United States with maturities from date of issue of one year or less. There were no outstanding borrowings under the facility at March 31, 2014. The availability of this credit facility may be impacted by how the U.S. government addresses the situation of approaching its debt limit.

The following table provides additional information regarding TVA's funding available in the form of three long-term revolving credit facilities. The credit facilities accommodate the issuance of letters of credit. The interest rate on any borrowing under these facilities varies based on market factors and the rating of TVA's senior unsecured long-term non-credit enhanced debt. See Note 12 — Credit Facility Agreements and Note 14 — Other Derivative Instruments — Collateral.

Summary of Long-Term Credit Facilities
At March 31, 2014
(in billions)

| Maturity Date | Facility Limit | Letters of Credit Outstanding | Cash Borrowings | Availability |
|---|---|---|---|---|
| June 2017 | $1.0 | $0.2 | $— | $0.8 |
| December 2017 | 1.0 | 0.1 | — | 0.9 |
| April 2018 | 0.5 | 0.5 | — | — |
| Total | $2.5 | $0.8 | $— | $1.7 |

In April 2014, UBS AG, Stamford Branch, assigned all of its rights and obligations under the $1.0 billion credit facility that matures in December 2017 to Sumitomo Mitsui Banking Corporation.

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Lease Financings. TVA has entered into certain leasing transactions with special purpose entities to obtain third-party financing for its facilities. These special purpose entities are sometimes identified as variable interest entities ("VIEs") of which TVA is determined to be the primary beneficiary. TVA is required to account for these VIEs on a consolidated basis. See Note 8. TVA may seek to enter into similar arrangements in the future, but has no immediate plans to do so.

Summary Cash Flows

A major source of TVA's liquidity is operating cash flows resulting from the generation and sales of electricity. A summary of cash flow components for the six months ended March 31, 2014, and 2013, follows:

Summary Cash Flows

| | Six Months Ended March 31 | |
|---|---|---|
| | 2014 | 2013 |
| Cash provided by (used in): | | |
| Operating activities | $1,426 | $1,148 |
| Investing activities | (1,374) | (1,204) |
| Financing activities | (1,148) | 107 |
| Net (decrease) increase in cash and cash equivalents | $(1,096) | $51 |

Operating

Net cash flow provided by operating activities increased by $278 million for the six months ended March 31, 2014, compared to the same period in the prior year, due primarily to the increase in net income from operations as a result of TVA’s continued efforts to improve cost management, working capital, and operational performance in addition to the recovery of $161 million in insurance proceeds related to the Kingston ash spill. These increases in cash flow provided by operating activities were partially offset by an increase of $126 million in pension contributions.

Investing

The majority of TVA’s investing cash flows are due to investments in property, plant, and equipment for new generating assets and existing facilities, environmental projects, and transmission upgrades necessary to maintain reliability. Net cash flows used in investing activities increased $170 million in the six months ended March 31, 2014, compared to the same period in the prior year. The increase was primarily related to the ongoing work on Watts Bar Unit 2 and transmission and clean air projects for the six months ended March 31, 2014.

Financing

Net cash flows used in financing was over $1.1 billion for the six months ended March 31, 2014, compared to $107 million net cash flows provided by financing for the six months ended March 31, 2013. The increase in cash flows used in financing was due primarily to net redemptions of debt of $1.1 billion during the six months ended March 31, 2014, as compared to net issuances of debt of $211 million during the six months ended March 31, 2013. This $1.3 billion change in net issuance and redemptions of debt was primarily due to TVA’s strategic decision to use cash on hand to reduce debt and meet funding needs in the six months ended March 31, 2014.

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Cash Requirements and Contractual Obligations

TVA has certain obligations and commitments to make future payments under contracts. The following table sets forth TVA's estimates of future payments at March 31, 2014.

Commitments and Contingencies
Payments due in the year ending September 30

| | 2014(1) | 2015 | 2016 | 2017 | 2018 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Debt(2) | $1,719 | $1,032 | $32 | $1,555 | $1,682 | $17,728 | $23,748 |
| Interest payments relating to debt | 615 | 1,192 | 1,147 | 1,133 | 1,044 | 17,957 | 23,088 |
| Debt of VIEs | 15 | 32 | 33 | 35 | 36 | 1,175 | 1,326 |
| Interest payments relating to debt of VIEs | 31 | 60 | 58 | 58 | 56 | 747 | 1,010 |
| Lease obligations | | | | | | | |
| Capital | 3 | 6 | 6 | 6 | 6 | 60 | 87 |
| Non-cancelable operating | 20 | 35 | 33 | 32 | 27 | 88 | 235 |
| Purchase obligations | | | | | | | |
| Power | 113 | 206 | 222 | 231 | 233 | 3,734 | 4,739 |
| Fuel | 751 | 1,231 | 788 | 451 | 517 | 1,919 | 5,657 |
| Other | 230 | 205 | 185 | 188 | 189 | 1,616 | 2,613 |
| Environmental Agreements | 61 | 62 | 65 | 44 | 4 | — | 236 |
| Membership interest of VIE subject to mandatory redemption | 1 | 2 | 2 | 2 | 2 | 30 | 39 |
| Interest payments related to membership interests of VIE subject to mandatory redemption | 2 | 3 | 3 | 2 | 2 | 16 | 28 |
| Flood response commitment to NRC | 11 | 36 | 1 | — | — | — | 48 |
| Litigation settlements | 6 | 2 | — | — | — | — | 8 |
| Environmental cleanup costs-Kingston ash spill | 50 | 68 | — | — | — | — | 118 |
| Payments on other financings | 34 | 104 | 104 | 104 | 104 | 401 | 851 |
| Payments to U.S. Treasury | | | | | | | |
| Return of Power Program Appropriation Investment | 10 | — | — | — | — | — | 10 |
| Return on Power Program Appropriation Investment | 5 | 8 | 8 | 8 | 8 | 93 | 130 |
| Retirement Plan(3) | 124 | 215 | — | — | — | — | 339 |
| Total | $3,801 | $4,499 | $2,687 | $3,849 | $3,910 | $45,564 | $64,310 |

Notes

(1) Period April 1 – September 30, 2014

(2) Does not include noncash items of foreign currency exchange loss of $71 million and net discount on sale of Bonds of $82 million.

(3) Tennessee Valley Authority Retirement System calculates TVA's minimum required annual contribution to the pension plan prior to the beginning of each fiscal year based on pension plan rules. The amount listed for 2015 is the minimum required contribution, and the calculation has not yet been completed for any years beyond 2015. See Note 17.

In addition to the obligations above, TVA has energy prepayment obligations in the form of revenue discounts.

Energy Prepayment Obligations

Payments due in the year ending September 30

| | 2014[1] | 2015 | 2016 | 2017 | 2018 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Energy Prepayment Obligations | $50 | $100 | $100 | $100 | $100 | $10 | $460 |

Note

(1) Period April 1 – September 30, 2014

EnergyRight® Solutions Program. TVA purchases certain loans receivable from its LPCs in association with the EnergyRight® Solutions program. The loans receivable are then transferred to a third-party bank with which TVA has agreed to repay in full any loan receivable that has been in default for 180 days or more or that TVA has determined is uncollectible. As of March 31, 2014, the total carrying amount of the loans receivable, net of discount, was approximately $151 million. Such

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amounts are not reflected in the Commitments and Contingencies table above. The total carrying amount of the financing obligation was approximately $186 million. See Note 6 and Note 10 for additional information.

Liquidity Challenges Related to Generation Resources

Nuclear Response Capability. Since the events that occurred in 2011 at the Fukushima Daiichi Nuclear Power Plant, the NRC has issued and adopted additional detailed guidance on the expected response capability to be developed by each nuclear plant site. TVA submitted integrated strategies to the NRC on February 28, 2013. TVA has developed plans and schedules for the development and implementation of strategies and physical plant modifications to address the actions outlined in this guidance for all of its plants, including Watts Bar Unit 2. The initial studies, including the required plant walkdowns, have been completed. Flooding and seismic re-evaluations to determine any further plant modifications are scheduled for completion in mid-2015.

Extreme Flooding Preparedness. Updates to the TVA analytical hydrology model have indicated that under "probable maximum flood" conditions, some of TVA's dams would not be high enough to contain the flood waters. A "probable maximum flood” is an extremely unlikely event, and TVA is taking actions with the aim of ensuring that in the case of such an event, flood waters would pass safely and would not cause failure of these dams. TVA implemented interim dam modifications in 2010 and plans to replace these interim modifications with permanent structures. Construction is scheduled to begin in the spring of 2014, and TVA has made a commitment to the NRC to complete construction by October 2015.

In March 2013, the NRC advised TVA of multiple apparent violations associated with TVA’s management of several aspects of certain hydrology issues associated with Watts Bar and Sequoyah (in addition to the flooding concerns related to TVA's dams described above). The NRC inspected TVA's corrective actions associated with the violations related to hydrology and flooding in December 2013. The NRC inspection did not identify any significant concerns. The NRC closed its inquiry into these violations in the second quarter of 2014.

Watts Bar Unit 2. Construction of Watts Bar Unit 2 is continuing in accordance with the schedule and budget expectations approved by the TVA Board in April 2012. The total estimated cost of completion is in the range of $4.0 billion to $4.5 billion. The project team has shifted its focus from large-scale construction to completion and testing of individual plant systems. TVA plans to bring Watts Bar Unit 2 into commercial operation by December 2015.

The regulatory reviews associated with the issuance of an NRC operating license are continuing. The NRC issued an extension to the Watts Bar Unit 2 construction permit on November 21, 2013. The revised permit expires on September 30, 2016. The NRC is continuing with its effort to resolve the waste confidence issue, both generally and with respect to Watts Bar Unit 2, and has indicated that it will not issue final licenses until it completes its reassessment of the environmental impacts of the storage of nuclear waste. The NRC reviews of TVA’s actions associated with post-Fukushima requirements are underway and are not currently anticipated to result in any concerns that would affect the timely issuance of an operating license.

Challenges to the project include completing complex work and required documentation; reverification of previously completed systems; completion of open vessel testing; addressing emergent work identified during testing, as well as emergent licensing issues; and successfully transitioning the site into dual-unit operation.

See Note 18 — Legal Proceedings — Administrative Proceedings Regarding Watts Bar Unit 2 for additional information.

Bellefonte Unit 1. The incorporation of Watts Bar Unit 2 lessons learned into the Bellefonte Nuclear Plant ("Bellefonte") Unit 1 completion estimate has revealed some similar problems and inaccuracies. TVA finalized a new estimate to complete Bellefonte Unit 1 during the first quarter of 2014 putting the total estimated cost of completion in the range of $7.5 billion to $8.7 billion. Work at the site has been slowed to better allocate resources on nearer-term priorities as both budget and staffing levels have been reduced in the 2014 budget. TVA believes that the resulting budgeting and staffing levels should be sufficient to preserve Bellefonte for potential future development. TVA plans to utilize its integrated resource planning process to help determine how Bellefonte best supports TVA's overall efforts to continue to meet customer demand with low-cost, reliable power.

Key Initiatives and Challenges

Generation Resources

Nuclear Generation. In October 2010, while Browns Ferry Unit 1 was shut down for a scheduled refueling outage, TVA discovered a low pressure coolant injection valve had experienced an unanticipated failure. The NRC concluded that the valve failure, and TVA's inability to identify the failure, was an issue of “high safety significance” (which is termed a “red” finding under the NRC's Reactor Oversight Process) and designated Browns Ferry in the “multiple/repetitive degraded cornerstone” category in its performance assessment process. As a result of this designation, Browns Ferry is subject to substantially higher NRC oversight. A series of intensive inspections and assessments began in the fall of 2011. In June 2012, TVA presented its plans to improve Browns Ferry's overall performance and reduce plant risk at a public meeting with the NRC and in February 2013, TVA

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notified the NRC that Browns Ferry was ready for the NRC to conduct the significant inspection associated with the red finding (referred to as a 95003 inspection). The NRC completed this inspection and specified 10 actions that needed to be completed by November 2013 as well as additional longer-term actions that must be completed between May and December of 2014. The 10 actions due by November 2013 were completed as scheduled. The NRC conducted additional inspections in December 2013 to review TVA's completion of the November 2013 actions and on January 30, 2014, the NRC announced the results of its inspections. The NRC concluded that the requirements for closure of all 10 Tier 1 commitments had been met, and the NRC closed the red finding. Browns Ferry Unit 1 will continue to have escalated oversight until two performance indicators on safety systems return to the normal band.

Coal-Fired Units. The decision to idle or retire coal-fired units from TVA's generation fleet is being influenced in part by the two environmental agreements reached in April 2011 (the "Environmental Agreements") and by the cost of adding emission control equipment to existing units. See Note 18 — Legal Proceedings — Environmental Agreements. Under the Environmental Agreements, TVA committed, among other things, to retire, on a phased schedule, 18 coal-fired units. As of March 31, 2014, TVA had retired four coal-fired units with a summer net capability of 574 megawatts ("MW"). Additionally, TVA had idled 14 coal-fired units with a summer net capability of 2,170 MW as of March 31, 2014.

At its November 14, 2013 meeting, the TVA Board approved the completion of a natural gas-fired facility at the Paradise Fossil Plant ("Paradise") site and subsequent retirement of Paradise coal-fired Units 1 and 2. Paradise Unit 3, a coal-fired unit, would continue to be operated. Additionally, the TVA Board approved the retirement of Colbert Units 1-5 no later than June 30, 2016, as well as the retirement of Widows Creek Unit 8 in the future. TVA is currently evaluating options for idling, controlling, or replacing its Allen Fossil Plant ("Allen") and anticipates completing its evaluation in 2014.

Status of Other Generation Units. Units 1-4 at Raccoon Mountain Pumped-Storage Plant ("Raccoon Mountain"), with a total net summer capability of 1,616 MW, were taken out of service for maintenance activities in 2012 after an inspection of the turbines in each unit identified cracking in the rotor poles and the rotor rims. All four units have subsequently completed maintenance overhauls to correct these cracking problems. However, an unrelated issue was identified in certain oil-filled power cables which convey power out of the facility, resulting in TVA limiting service to three units until resolved. As of March 31, 2014, three of the four Raccoon Mountain units were in service. A return to service date for the fourth unit has not been established.

Cost Reduction Initiatives

TVA is undertaking cost reduction initiatives with the goal of keeping rates low, keeping reliability high, and continuing to fulfill its broader mission of environmental stewardship and economic development. To position itself to achieve this goal, TVA, in conjunction with other actions, completed a high-level realignment of its strategic business units during 2013.

TVA’s current focus is on reducing operating and maintenance costs through further efficiency gains and streamlining the organization. TVA’s goal is to reduce operating and maintenance costs by $500 million by 2015 as compared to its 2013 budget. Business unit leaders will work to identify ways to further streamline their organizations to achieve 2015 operating and maintenance cost reduction targets by eliminating unnecessary work; increasing productivity; minimizing overlaps, redundancies, and handoffs; and ensuring that accountability for compliance rests with its line organizations. Given that approximately 80 percent of TVA's operating and maintenance costs are related to labor, staffing level reductions will necessarily result from this process. The evaluation of staffing levels will take into account attrition, elimination of open positions, and retirements in order to minimize the impact on current personnel. Certain employees will be eligible for severance payments as a result of these cost reduction initiatives. As of March 31, 2014, TVA had accrued $25 million related to estimated future severance payments. See Note 3.

Regulatory Compliance

Coal Combustion Residual Facilities. As a result of the December 2008 ash spill at Kingston, TVA retained an independent third-party engineering firm to perform a multi-phased evaluation of the overall stability and safety of all existing embankments associated with TVA’s wet coal combustion residual ("CCR") facilities. The study showed that none of TVA’s other coal-fired plants presented risks similar to the conditions that existed at Kingston at the time of the ash spill, and that the ongoing remediation work being done at the plants should bring all of them within industry standards in terms of stability upon completion. Implementation of recommended actions is ongoing, including risk mitigation steps such as performance monitoring, designing and completing repairs, developing planning documents, obtaining permits, and generally implementing the lessons learned from the Kingston ash spill at TVA’s other CCR facilities.

TVA is planning to convert its wet ash and gypsum facilities to dry storage collection facilities. The expected cost of the CCR work is between $1.5 billion and $2.0 billion, and the work is expected to be completed by December 2022. As of March 31, 2014, $546 million of costs had been incurred since the start of the work.

TVA is studying the adequacy of CCR storage capacity at its coal-fired plants that currently have dry storage collection facilities. If it is determined that the remaining capacity is not adequate, additional storage facilities will need to be permitted and built, or off-site disposal will need to be arranged.

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Transmission Issues. TVA anticipates expenditures to increase as a result of both new and evolving compliance regulations. On October 17, 2013, the North American Electric Reliability Corporation ("NERC") approved revisions to the Transmission Planning Reliability Standards. TVA began preliminary work in 2006, and is now evaluating the final version of these standards. Costs to comply with these standards are expected to be significant.

On November 21, 2013, Federal Energy Regulatory Commission ("FERC") approved NERC Critical Infrastructure Protection ("CIP") Version 5 Reliability Standards ("Version 5"). Version 5 does not add or remove any substantial requirements; however, it does significantly increase the number of sites within the scope of these standards. The effective compliance date is April 2016. Costs for compliance with these standards cannot be estimated at this time.

On March 7, 2014, FERC issued an order for the development of new physical security standards that will mandate the identification and protection of transmission substations and their associated primary control centers. This new standard, NERC CIP-014-1— Physical Security, is currently being drafted and is expected to be filed with applicable regulatory authorities no later than June 5, 2014. Costs for compliance with this standard cannot be estimated at this time.

In addition, FERC recently issued orders for the development of new geomagnetic disturbance standards. The effects of another high impact, low frequency event, — the widespread electromagnetic pulse resulting from a high altitude initiation of a nuclear device — are also receiving increased attention and may also be the subject of future regulation.

Dam Safety Assurance Initiatives

TVA has an established dam safety program, which includes procedures based on the Federal Guidelines for Dam Safety. One aspect of the guidelines is that dam structures will be periodically reassessed to assure that TVA's dams meet current design criteria. TVA is currently performing reassessments of its assets. These assessments include material sampling of the dam and foundational structures and detailed engineering analysis. As of March 31, 2014, TVA had completed 19 assessments. Assessments on the remaining 30 dam projects are scheduled to be completed by the fourth quarter of 2017. Nine of the remaining 30 dam assessments are scheduled to be completed in 2014. To date TVA has spent $32 million, and TVA expects to spend an additional $70 million on these assessments.

It is expected that projects will be identified during these assessments, and the work will be appropriately prioritized and completed within TVA’s capital improvement process. Projects are already underway on embankments at Cherokee, Watts Bar, Tellico, and Fort Loudoun Dams to provide additional dam protection at predicted probable maximum flood conditions. Projects are also started at Cherokee and Douglas Dams to improve concrete dam stability.

Environmental Matters

TVA's activities, particularly its power generation activities, are subject to comprehensive regulation under environmental laws and regulations relating to air pollution, water pollution, and management and disposal of solid and hazardous wastes, among other issues. Emissions from all TVA-owned and operated units (including small combustion turbine units of less than 25 MW whose emissions are not required to be reported to the Environmental Protection Agency ("EPA")) have been reduced from historically high peaks. Emissions of nitrogen oxide ("$NO_x$") have been reduced by 91 percent below peak 1995 levels and emissions of sulfur dioxide ("$SO_2$") have been reduced by 95 percent below 1977 levels through CY 2013. For CY 2013, TVA’s emission of carbon dioxide ("$CO_2$") from its sources was 72 million tons, a 32 percent reduction from 2005 levels. This includes 279 tons from units rated at less than 25 MWs whose emissions are not required to be reported to the EPA. To remain consistent and provide clear information and to align with the EPA’s reporting requirements, TVA intends to continue to report $CO_2$ emissions on a CY basis.

Mercury and Air Toxic Standards for Electric Utility Units

Effective April 16, 2012, the EPA promulgated a final rule establishing standards for hazardous air pollutants emitted from steam electric utilities. The rule requires additional controls for hazardous air pollutants, including mercury, non-mercury metals, and acid gases, for some of TVA's coal-fired units by 2015-2016. TVA may choose to idle or retire some units in lieu of investing in additional controls and may in some cases construct replacement generation. The rule is expected to be the primary driver of additional emission controls for TVA's coal-fired plants over the next few years. The rule has been challenged in court, and was upheld by the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit").

Cross State Air Pollution Rule.

In July 2011, the EPA announced the final Cross State Air Pollution Rule ("CSAPR"). This rule was to replace the existing Clean Air Interstate Rule ("CAIR"), effective January 1, 2012. CSAPR was to regulate $SO_2$ and $NO_x$ emissions from upwind states that are negatively impacting ozone and fine particulate air quality in downwind states. The rule would have required greater $SO_2$ and $NO_x$ reductions than those achieved under CAIR.  CSAPR was vacated by the D.C. Circuit on August 21, 2012. However, on April 29, 2014, the U.S. Supreme Court issued an opinion reversing the D.C. Circuit, remanding the rule back to the lower court for further proceedings consistent with the Supreme Court's opinion.  Upon completion of the remand proceedings, CSAPR may get reinstated in its original form or a revised form.  Alternatively, the EPA may embark on the

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development of a new transport rule to address attainment of the 8-hour ozone standard. Any such revised or new CSAPR rule should not have a significant impact on TVA because of the changes that TVA has made to its generation mix and the controls that TVA is installing on coal-fired units to comply with the new Mercury and Air Toxic Standards. CAIR is expected to remain in place in the interim, pending the completion of the remand proceedings.

Climate Action Plan

To strengthen the Administration's efforts to increase government-wide energy efficiency and sustainability and implement goals in the President’s June 2013 Climate Action Plan, a Presidential Memorandum was issued on December 5, 2013 directing the federal government to consume 20 percent of electricity from renewable sources by 2020, to the extent economically feasible and technically practicable. The new renewable energy consumption goals are 10 percent by 2015, 15 percent by 2016, 17.5 percent by 2018, and 20 percent by 2020. To date, TVA has achieved an agency renewable energy use rate of 9.4 percent, which exceeds the Energy Policy Act goal of 7.5 percent by 2013. TVA uses renewable energy from improvements to hydroelectric facilities and other sources as low-cost ways to meet these renewable energy requirements. TVA is on track to achieve the 2020 goal of 20 percent renewable energy use.

Petition to Expand the Ozone Transport Region

On December 9, 2013, eight of the twelve states that make up the Ozone Transport Region ("OTR") submitted a petition to the EPA requesting that nine states, including Kentucky and Tennessee, be added to the OTR. TVA is unable to predict the outcome of the petition at this time. Should the petition be granted, additional controls may be required on existing electric generating units and other sources in the additional states. New and modified sources would have to install state of the art controls and meet other requirements as well.

Estimated Required Environmental Expenditures

The following table contains information about TVA's current estimates on potential projects related to environmental laws and regulations:
Air, Water, and Waste Quality Estimated Potential Environmental Expenditures[(1)]
At March 31, 2014
(in millions)

| | Estimated Timetable | Total Estimated Expenditures |
|---|---|---|
| Site environmental remediation costs[(2)] | 2014+ | $16 |
| Coal combustion residual conversion and remediation[(3)] | 2014-2023 | $1,400 |
| Proposed clean air projects[(4)] | 2014-2022 | $1,200 |
| Clean Water Act requirements[(5)] | 2014-2022 | $400 |

Notes
(1) These estimates are subject to change as additional information becomes available and as regulations change.
(2) Estimated liability for cleanup and similar environmental work for those sites for which sufficient information is available to develop a cost estimate.
(3) Includes closure of impoundments, construction of lined landfills, and construction of dewatering systems.
(4) Includes air quality projects that TVA is currently planning to undertake to comply with existing and proposed air quality regulations, but does not include any
projects that may be required to comply with potential greenhouse gas regulations or transmission upgrades.

(5) Includes projects that TVA is currently planning to comply with revised rules under the Clean Water Act (i.e. Section 316(b) and effluent limitation guidelines for steam electric power plants).

Legal Proceedings

From time to time, TVA is party to or otherwise involved in lawsuits, claims, proceedings, investigations, and other legal matters ("Legal Proceedings") that have arisen in the ordinary course of conducting its activities, as a result of catastrophic events or otherwise. TVA had accrued approximately $272 million with respect to Legal Proceedings as of March 31, 2014. No assurance can be given that TVA will not be subject to significant additional claims and liabilities. If actual liabilities significantly exceed the estimates made, TVA's results of operations, liquidity, and financial condition could be materially adversely affected.

For a discussion of certain current material Legal Proceedings, see Note 18 — Legal Proceedings, which discussion is incorporated into this Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Legislative and Regulatory Matters

In December 2010, Congress passed the Continuing Appropriations and Surface Transportation Extensions Act, 2011, which included a two-year freeze on statutory pay adjustments for all executive branch pay schedules and a two-year freeze by executive agencies on base salary increases to all senior executives. On March 26, 2013, legislation that extended the federal

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pay freeze through December 31, 2013 became law. TVA officers were subject to this freeze, and TVA continued compliance with the freeze for managers, specialists, and non-represented employees until it expired on December 31, 2013. The federal salary freeze did not apply to TVA's represented employees, whose salary increases are governed by the terms of collective bargaining agreements; certain promotions and changes in positions; and other forms of non-salary compensation such as lump-sum and incentive-based awards.

Compensation Matters

On February 28, 2014, the President and Chief Executive Officer ("CEO") approved the TVA Long-Term Retention Incentive Plan ("LTRIP"). LTRIP is designed to (1) provide retention-based long-term incentives to TVA officers and key managers who have the ability to directly impact TVA's long-term strategic objectives and (2) provide a competitive level of total compensation. Awards granted under the LTRIP are at the discretion of the Board or the CEO and are based, in part, on personal performance evaluation, talent assessment, retention risk, and other business considerations. Each award represents the right of a participant to receive a lump sum cash payment, subject to vesting, in the amount determined by the Board or the CEO. At this time, no employees have been selected to participate in the LTRIP, and no awards have been granted under the LTRIP.

Off-Balance Sheet Arrangements

At March 31, 2014, TVA had no off-balance sheet arrangements.

Critical Accounting Policies and Estimates

The preparation of financial statements requires TVA to estimate the effects of various matters that are inherently uncertain as of the date of the financial statements. Although the financial statements are prepared in conformity with accounting principles generally accepted in the U.S., TVA is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the amounts of revenues and expenses reported during the reporting period. Each of these estimates varies in regard to the level of judgment involved and its potential impact on TVA's financial results. Estimates are deemed critical either when a different estimate could have reasonably been used, or where changes in the estimate are reasonably likely to occur from period to period, and such use or change would materially impact TVA's financial condition, results of operations, or cash flows. TVA's critical accounting policies are discussed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates and Note 1 of the Notes to Consolidated Financial Statements in the Annual Report.

New Accounting Standards and Interpretations

For a discussion of TVA’s new accounting standards and interpretations, see Note 2, which discussion is incorporated into this Part I, Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Corporate Governance

At its February 13, 2014, Board meeting, members of the TVA Board of Directors selected Joe H. Ritch as chairman-elect to succeed William B. Sansom when Mr. Sansom’s term ends on May 18, 2014.

Other Matters

On March 4, 2014, President Obama submitted the Fiscal Year 2015 Budget of the U.S. Government (the “Budget”) to Congress. The Budget contains the following language regarding TVA:

Reforming TVA. Since its creation in the 1930s during the Great Depression, the federally owned and operated TVA has been producing electricity and managing natural resources for a large portion of the Southeastern United States. TVA's power service territory includes most of Tennessee and parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina, and Virginia, covering 80,000 square miles and serving more than nine million people. TVA is a self-financing Government corporation, funding operations through electricity sales and bond financing. The 2014 President's Budget announced the Administration's intentions to undertake a strategic review of options for addressing TVA's financial situation, including the possible divestiture of TVA. Since then, TVA has undergone a major internal review and taken significant steps to improve its future operating and financial performance. In addition, TVA has committed to resolve its capital financing constraints. The Administration supports TVA's ongoing operating and financial initiatives and intends to closely monitor TVA's performance. The Administration continues to believe that reducing or eliminating the Federal Government's role in programs such as TVA, which have achieved their original objectives, can help mitigate risk to taxpayers. The Administration recognizes the important role TVA serves in the Tennessee Valley and stands ready to work with the Congress and TVA's stakeholders to explore options to end Federal ties to TVA, including alternatives such as a transfer of ownership to State or local stakeholders.

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Under the Nuclear Waste Policy Act of 1982, generators of nuclear energy are required to pay a fee of one-tenth of a cent per kilowatt-hour into the Department of Energy ("DOE") nuclear waste fund. TVA's annual payment into this fund have ranged from $50 million to $55 million in recent years. In November 2013, the D.C. Circuit ordered the DOE to stop collecting nuclear waste fees until either (1) DOE complies with the Nuclear Waste Policy Act of 1982 or (2) the U.S. Congress enacts an alternative waste management plan. In accordance with the court's order, DOE has submitted a proposal to the U.S. Congress to change the fee to zero. The proposal is pending before the U.S. Congress and will become effective after 90 days of legislative session from the time of submittal unless the U.S. Congress enacts legislation that impacts the proposed fee change. In January 2014, DOE filed a petition seeking rehearing en banc of the D.C. Circuit's November 2013 decision, and in March 2014, the D.C. Circuit rejected DOE's petition. The ultimate outcome of this matter cannot be determined at this time, and TVA is continuing to make the required payments to DOE's nuclear waste fund.

TVA does not engage, and does not control any entity that is engaged, in any activity listed under Section 13(r) of the Exchange Act, which requires certain issuers to disclose certain activities relating to Iran involving the issuer and its affiliates. Based on information supplied by each such person, none of TVA's directors and executive officers are involved in any such activities. While TVA is an agency and instrumentality of the United States of America, TVA does not believe its disclosure obligations, if any, under Section 13(r), extend to the activities of any other departments, divisions or agencies of the United States.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There are no material changes related to market risks disclosed under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — Risk Management Activities in the Annual Report. See Note 14 for additional information regarding TVA's derivative transactions and risk management activities.

## ITEM 4. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

TVA's management, including the President and Chief Executive Officer, the Executive Vice President and Chief Financial Officer, and members of the Disclosure Control Committee, including the Vice President and Controller (Principal Accounting Officer), evaluated the effectiveness of TVA's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) as of March 31, 2014. Based on this evaluation, TVA's management, including the President and Chief Executive Officer, the Executive Vice President and Chief Financial Officer and members of the Disclosure Control Committee, including the Vice President and Controller (Principal Accounting Officer), concluded that TVA's disclosure controls and procedures were effective as of March 31, 2014, to ensure that information required to be disclosed by TVA in reports that it files or submits under the Exchange Act, is recorded, processed, summarized, and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by TVA in such reports is accumulated and communicated to TVA's management, including the President and Chief Executive Officer, the Executive Vice President and Chief Financial Officer and members of the Disclosure Control Committee, including the Vice President and Controller (Principal Accounting Officer), as appropriate, to allow timely decisions regarding required disclosure.

### Changes in Internal Control over Financial Reporting

During the three months ended March 31, 2014, there were no changes in TVA's internal control over financial reporting that materially affected, or are reasonably likely to materially affect, TVA's internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, TVA is party to or otherwise involved in lawsuits, claims, proceedings, investigations, and other legal matters ("Legal Proceedings") that have arisen in the ordinary course of conducting its activities, as a result of catastrophic events or otherwise. While the outcome of the Legal Proceedings to which TVA is a party cannot be predicted with certainty, any adverse outcome to a Legal Proceeding involving TVA may have a material adverse effect on TVA's financial condition, results of operations, and cash flows.

For a discussion of certain current material Legal Proceedings, see Note 18 — Legal Proceedings, which discussion is incorporated by reference into this Part II Item 1, Legal Proceedings.

ITEM 1A. RISK FACTORS

There are no material changes related to risk factors from the risk factors disclosed in Item 1A, Risk Factors in the Annual Report.

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ITEM 6. EXHIBITS

| Exhibit No. | Description |
|---|---|
| 3.1 | TVA's Bylaws adopted by the TVA Board on May 18, 2006, as amended on April 3, 2008, May 19, 2008, June 10, 2010, and February 13, 2014 |
| 10.1 | Long-Term Retention Incentive Plan |
| 10.2 | Assignment and Assumption Agreement Dated as of April 30, 2014, Between UBS AG, Stamford Branch, and Sumitomo Mitsui Banking Corporation Relating to $1,000,000,000 Winter Maturity Credit Agreement Dated as of December 13, 2012 |
| 10.3 | Amendment Dated as of December 4, 2013, to Electronotes® Selling Agent Agreement Dated as of June 1, 2006, Among TVA, LaSalle Financial Services, Inc., A.G. Edwards & Sons, Inc., Citigroup Global Markets Inc., Edward D. Jones & Co., L.P., First Tennessee Bank National Association, J.J.B. Hilliard, W.L. Lyons, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated, and Wachovia Securities, LLC |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification Executed by the Chief Executive Officer |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification Executed by the Chief Financial Officer |
| 32.1 | Section 1350 Certification Executed by the Chief Executive Officer |
| 32.2 | Section 1350 Certification Executed by the Chief Financial Officer |
| 101.INS * | TVA XBRL Instance Document |
| 101.SCH * | TVA XBRL Taxonomy Extension Schema |
| 101.CAL * | TVA XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF * | TVA XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB * | TVA XBRL Taxonomy Extension Label Linkbase |
| 101.PRE * | TVA XBRL Taxonomy Extension Presentation Linkbase |

* In accordance with Rule 406T of Regulation S-T, these XBRL (eXtensible Business Reporting Language) documents are furnished and not filed for purposes of Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under this section.

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SIGNATURES

Pursuant to the requirements of Section 13, 15(d), or 37 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 5, 2014

TENNESSEE VALLEY AUTHORITY
(Registrant)

By: /s/ William D. Johnson_______________
William D. Johnson
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ John M. Thomas, III ______________
John M. Thomas, III
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

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