

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

BUSINESS

TXU Corp. is a holding company conducting its operations principally through its TXU Energy Holdings and TXU Electric Delivery subsidiaries. TXU Energy Holdings is engaged in electricity generation, residential and business retail electricity sales as well as wholesale energy markets activities, largely in Texas. TXU Electric Delivery is engaged in regulated electricity transmission and distribution operations in Texas.

Business Strategy

Overview

In 2004, senior management reviewed TXU Corp.'s operations and launched a three-phase restructuring program to restore financial strength, drive performance improvement with a competitive industrial company perspective and allocate capital in a disciplined and efficient manner.

- Phase one involved divesting of value-disadvantaged businesses and using the sales proceeds, operating cash flows and cash on hand to simplify the capital structure and improve financial flexibility. This phase also included changing pricing and commodity price hedging strategies to reflect rising natural gas prices, resolving significant litigation risks and lowering business process costs through a significant outsourcing arrangement. Phase one was completed in 2004. As discussed in Note 2 to Financial Statements, these restructuring actions resulted in net charges to 2004 income from continuing operations totaling \$1.2 billion (\$828 million after-tax). Also see Note 4 to Financial Statements for the effect on results from discontinued operations.
- Phase two included implementation of initiatives to achieve operational excellence across the business, targeting industry-leading performance standards for productivity, reliability and customer service and embedding a high-performance industrial culture. Phase two work has been largely completed during 2005 but will remain ongoing as a basis for continuous process improvement.
- Phase three included an in depth analysis of the growth strategy for TXU Corp. and its two business segments. This analysis was completed in November 2005, and the results are summarized immediately below. A more detailed discussion of business strategies is presented in Part I of this Form 10-K.

TXU Corp.'s goal over the next five years is to create two industry leaders: a deregulated solid fuel power generator with quality scale in several markets and a regulated wires company that will drive efficient management of required transmission and distribution network investments and help redefine customer service levels through effective deployment of new technologies.

TXU Corp. continues to evaluate a wide variety of transactions for the execution of growth strategies by TXU Energy Holdings and TXU Electric Delivery described below.

TXU Energy Holdings Strategy and Opportunities

TXU Energy Holdings' power generation operation intends to:

- further implement the TXU Operating System, a program to drive productivity improvement through deployment of an industrial skill set, targeting the achievement of top quartile cost levels within three years with ongoing production improvements to enhance an advantaged lignite/coal-fired generation operating capability;
- leverage the TXU Operating System to pursue certain attractive growth opportunities in ERCOT that will add needed capacity and enhance the market's fuel diversity; and
- seek opportunities to double the size of its lignite/coal-fired generation fleet over the next five years, building a national solid fuel generation company with quality scale in multiple markets by applying TXU Operating System capabilities on a broader set of assets through transactions with other coal-fired generation plant owners.

TXU Energy Holdings' retail sales operation intends to:

- improve profitability and operational performance in Texas through ongoing cost leadership, innovative product and service offerings and excellence in customer service to distinguish itself; and
- monitor potential opportunities to expand in other regions if and when those develop.

TXU Energy Holdings' wholesale energy markets operation intends to:

- continue to support the generation and retail sales operations, striving for market leadership and excellence in optimizing the performance of the generation assets and sourcing power for the retail business; and
- monitor and manage TXU Energy Holdings' commodity price risks; and
- engage in complementary activities such as the structuring of long-term contractual arrangements.

TXU Electric Delivery Strategy and Opportunities

TXU Electric Delivery intends to:

- utilize the TXU Operating System to achieve top decile costs, service levels and network reliability through efficient capital and technology deployment and business operations, specifically through increased investment in the transmission and distribution network and in new technologies such as automated meter reading and remote system monitoring;
- achieve top decile reliability before the end of the decade; and
- seek opportunities to scale its operating advantage and technology program regionally, pursue operating efficiencies, leverage its asset management capabilities over a larger grid and drive a coordinated technology and infrastructure investment program to improve reliability.

KEY CHALLENGES AND INITIATIVES

Following is a discussion of the key challenges facing management and the initiatives currently underway to manage such challenges:

Competitive Markets and Customer Retention

In Texas, 2005 was the fourth full year of a competitive retail market, and competitive activity has resulted in lower retail customer counts and sales volumes. The area representing TXU Corp.'s historical service territory prior to deregulation, largely in north Texas, consisted of approximately 3 million electricity consumers (measured by meter counts) as of year-end 2005. TXU Corp. currently has approximately 2.1 million retail customers in that territory and has acquired approximately 230,000 retail customers in other competitive areas in Texas. Retail sales volumes declined 17%, 12% and 12% in 2005, 2004 and 2003, respectively; including all markets in which TXU Corp. competes. Declines in both customer counts and related sales volumes reflect competitive activity in the business market and to a lesser extent in the residential market. As retail sales have declined, wholesale sales volumes have increased over this period with TXU Corp.'s shift from retail to wholesale market services. In responding to the competitive landscape, TXU Corp. is focusing on the following key initiatives:

- Customer retention strategy remains focused on delivering world-class customer service and improving the overall customer experience. In line with this strategy, TXU Corp. continues to implement initiatives to improve call center response time and effectiveness as well as online interaction with customers.
- TXU Corp. customizes its price/service product offerings to customer classes with service enhancements proven to be valued by those customers. TXU Corp. continues to develop price/service products with greater flexibility that are designed to fit varying customer need profiles.
- Initiatives in the small and medium-business segment are focused largely on targeted programs to retain the existing highest-value customers and to recapture customers who have switched. Tactical programs put into place include improved customer service, new product price/service offerings and a direct-sales force for customers with demand of 200 kilowatts and above.
- TXU Corp. remains focused on driving profitability by targeting customers with the highest economic potential and delivering with a low-cost model. Initiatives include a more disciplined contracting and pricing approach, a comprehensive hedging strategy to better protect against pricing volatility, improved economic segmentation of the large-business market to provide for more targeted sales and marketing efforts and more effective deployment of the direct-sales force.

Natural Gas Price & Market Heat-Rate Exposure

Wholesale electricity prices in the Texas market generally move with the price of natural gas because marginal demand is generally met with gas-fired generation plants. Wholesale electricity prices also move with market heat rates, which are a measure of the efficiency of the marginal supplier (generally gas plants) in generating electricity. The wholesale market price of power divided by the market price of natural gas represents the market heat rate. Market heat rates are currently near historical lows following the substantial increase in more efficient gas-fired generation capacity in Texas in the early 2000's. In contrast, natural gas prices have increased significantly in recent years, but historically the price has fluctuated due to the effects of weather, changes in industrial demand and supply availability, and other economic and market factors.

In contrast to TXU Corp.'s gas-fired generation units, changes in natural gas prices have no significant effect on the cost of generating electricity from TXU Corp.'s nuclear-powered and lignite/coal-fired plants. All other factors being equal, these baseload generation assets, which provided 56% of supply volumes in 2005, increase or decrease in value as natural gas prices rise or fall, respectively, because of the effect of natural gas prices on wholesale power prices.

With the exposure to variability of natural gas prices, sales price management and hedging activities are critical to the profitability of the business. TXU Corp. continues to have price flexibility in the large business market and in all markets outside of its historical service territory. With respect to residential and small business customers in the historical service territory, TXU Corp. must offer regulated price-to-beat rates until January 1, 2007, but has the flexibility to offer prices other than the price-to-beat rate. Price-to-beat rates can be adjusted up or down twice a year at TXU Corp.'s option, subject to approval by the Commission, based on changes in natural gas prices. The challenge in adjusting these rates is determining the appropriate timing, considering past and projected movements in natural gas prices, such that gross margin levels can be sustained while remaining competitive with other retailers who have price flexibility. In response to rising natural gas prices, TXU Corp. has increased the price-to-beat rates twice in each of the years 2005, 2004 and 2003.

TXU Corp. is both a producer and a buyer of wholesale electricity. The combined effect of the generation and retail business is considered by management to be a partial natural hedge against near-term price volatility in wholesale electricity and natural gas markets. With this natural hedge and TXU Corp.'s wholesale market positions, for 2006 TXU Corp.'s portfolio position is significantly balanced with respect to changes in natural gas prices, given TXU Corp.'s projections of baseload unit availability, customer churn and assuming no further changes in the price-to-beat rates. The primary sensitivity to natural gas prices over the near term derives from changes in the price-to-beat rates for residential and small business customers and from potential customer losses; that is, higher price-to-beat rates triggered by higher gas prices could result in increased profitability but also more customer churn, and vice versa.

TXU Corp.'s longer term approach to managing commodity price risk focuses on the following:

- improving customer service to attract and retain high-value customers;
- refining retail pricing strategy to more appropriately reflect the magnitude and costs of natural gas price risk;
- continuing reduction of fixed costs to better withstand gross margin volatility; and
- employing disciplined hedging and risk management strategies through physical and financial energy-related (power and natural gas) contracts to partially hedge gross margins.

Under a commodity price risk management program commenced in October 2005, TXU Corp. has been supplementing its hedging and risk management portfolio with natural gas-related financial instruments that are expected to reduce exposure to the effects of changes in natural gas prices over the next five years. These transactions are being accounted for as cash flow hedges; i.e., hedges of variability of future power prices as a result of movements in natural gas prices. See discussion below under "Application of Critical Accounting Policies."

TXU Corp. still retains exposure to changes in market heat rates. TXU Corp.'s market heat rate exposure derives from its generation portfolio and may increase over time with expected generation capacity increases. TXU Corp. expects that increases in market heat rates would increase the value of its generation assets because higher market heat rates generally result in higher wholesale power prices, and vice versa.

On an ongoing basis, TXU Corp. will continue monitoring its overall commodity risks and seek to balance its portfolio based on its desired level of exposure to natural gas prices and market heat rates. Portfolio balancing may include the execution of incremental transactions or the unwind of existing transactions. As a result, commodity price exposures and their effect on earnings could change from time to time.

The following scenarios are presented to quantify the potential impact of movements in natural gas prices and market heat rates. As described earlier, for 2006 TXU Corp.'s portfolio position is significantly balanced with respect to changes in natural gas prices at current forecast business performance levels and assuming no further changes in the price-to-beat rates. Illustratively, in the unlikely case that TXU Corp.'s sales prices immediately and fully adjusted to reflect changes in wholesale power prices due to changes in natural gas prices, and taking into account the hedges in place at year-end 2005 under the program described above, TXU Corp. could experience an approximate \$350 million reduction in 2006 pretax earnings for every \$1.00 per MMBtu reduction in natural gas prices (approximate 9% change in current price) sustained over the full year. In the same scenario of full and immediate pass-through of wholesale power price changes to sales prices, where natural gas prices and other nonprice conditions remained unchanged but ERCOT electricity prices declined by \$5/MWh (approximate 6% change in current price) for a full year because of declining market heat rates, TXU Corp. could experience an approximate \$310 million reduction in annual pretax earnings.

See additional discussion of risk measures under "Quantitative and Qualitative Disclosure About Market Risk."

Impact of Volatile Energy Prices

Natural gas prices rose to unprecedented levels in the latter part of 2005, reflecting a world-wide increase in energy prices compounded by hurricane-related infrastructure damage. The related rise in retail electricity prices has elevated public awareness of energy costs and could dampen customer demand going forward, particularly in peak usage periods. Sustained high energy prices and/or ongoing price volatility also creates a potential risk for regulatory and/or legislative intervention with the mechanisms that govern the competitive wholesale and retail markets in Texas. TXU Corp. continues to work closely with the relevant regulatory bodies, as evidenced by the implementation of the October 2005 retail price-to-beat rate increase, under which TXU Corp. voluntarily implemented a discount on the increase until the end of 2005. The discount resulted in a net price-to-beat increase based on natural gas prices in the week prior to Hurricane Katrina making landfall.

Cost Exposure Related to Nuclear Asset Outages

TXU Corp.'s nuclear assets are comprised of two electricity generating units at Comanche Peak, each with a capacity of 1,150 MW. The Comanche Peak plant represents approximately 13% of TXU Corp.'s total generation capacity. The nuclear generation facilities represent TXU Corp.'s lowest marginal cost source of electricity. Assuming both nuclear generating units experienced an outage, the unfavorable impact to pretax earnings is estimated to be approximately \$4 million per day before consideration of any insurance proceeds. Maintaining safe, reliable and efficient operations at the Comanche Peak plant is one of TXU Corp.'s top priorities. Also see discussion of nuclear insurance in Note 9 to Financial Statements.

Environmental Regulations

TXU Corp. is subject to various environmental laws and regulations related to sulfur dioxide, nitrogen oxide and mercury emissions as well as other environmental contaminants that impact air and water quality. TXU Corp. is in compliance with all current laws and regulations, but regulatory authorities continue to evaluate existing requirements and consider proposals for changes. TXU Corp. is closely monitoring any potential legislative changes pertaining to greenhouse gas emissions, proposals for which remain in the formative stages. See discussion in Part I of this Form 10-K under "Environmental Matters."

APPLICATION OF CRITICAL ACCOUNTING POLICIES

TXU Corp.'s significant accounting policies are detailed in Note 1 to Financial Statements. TXU Corp. follows accounting principles generally accepted in the US. Application of these accounting policies in the preparation of TXU Corp.'s consolidated financial statements requires management to make estimates and assumptions about future events that affect the reporting of assets and liabilities at the balance sheet dates and revenue and expense during the periods covered. The following is a summary of certain critical accounting policies of TXU Corp. that are impacted by judgments and uncertainties and under which different amounts might be reported using different assumptions or estimation methodologies.

Derivative Instruments and Mark-to-Market Accounting — TXU Corp. enters into contracts for the purchase and sale of energy, and also enters into other derivative instruments such as options, swaps, futures and forwards primarily to manage commodity price and interest rate risks. Under SFAS 133, these instruments are subject to mark-to-market accounting, and the determination of market values for these instruments is based on numerous assumptions and estimation techniques.

Mark-to-market accounting recognizes changes in the fair value of derivative instruments as market prices change. The availability of quoted market prices in energy markets is dependent on the type of commodity (e.g., natural gas, electricity, etc.), time period specified and location of delivery. In computing the mark-to-market valuations, each market segment is separated into liquid and illiquid periods. The liquid period varies by region and commodity. Generally, the liquid period is supported by broker quotes and frequent trading activity. For illiquid periods, fair value is estimated based on forward price curves developed using industry-accepted market modeling techniques that take into account available market information. TXU Corp. recognizes losses but not gains related to illiquid periods.

SFAS 133 allows for "normal" purchase or sale elections and hedge accounting designations, which generally eliminates the requirement for mark-to-market recognition in net income. (However, cash flow hedge ineffectiveness is recognized in net income.) Results of operations can be materially impacted by such elections and designations, as they reduce the volatility of net income that can result from fluctuations in fair values. Because TXU Corp.'s natural long power position (generation load) is not marked-to-market, management strives to make elections under SFAS 133 with respect to economic hedges of that position that allow accounting results to be more reflective of the economic position. Derivative contracts held for proprietary trading purposes are marked-to-market.

The effect of mark-to-market and hedge accounting on the financial statements is presented below (includes effects of commodity and debt-related transactions):

| | Year Ended December 31, | | |
|---|--------------------------------|-----------------|-----------------|
| | 2005 | 2004 | 2003(a) |
| Effect on income from continuing operations (after-tax): | | | |
| Net gains (losses) from mark-to-market accounting for commodity contracts..... | \$ 6 | \$ (59) | \$ (88) |
| Net cash flow hedge ineffectiveness gains (losses)..... | (18) | (12) | 23 |
| Net cash flow hedge losses recognized (reclassified from accumulated other comprehensive income — to offset hedged transactions)..... | (77) | (44) | (122) |
| Amount recognized as a reduction to loss on early extinguishment of debt upon redemption of related debt | — | 5 | — |
| Amortization of net gains on settled fair value hedges (b)..... | 7 | 10 | 14 |
| Total..... | <u>\$ (82)</u> | <u>\$ (100)</u> | <u>\$ (173)</u> |
| Effect on other comprehensive income from continuing operations (after-tax): | | | |
| Net losses in fair value of cash flow hedges..... | \$ (47) | \$ (75) | \$ (85) |
| Net cash flow hedge losses recognized in net income..... | 77 | 44 | 122 |
| Total..... | <u>\$ 30</u> | <u>\$ (31)</u> | <u>\$ 37</u> |

(a) Amounts exclude the cumulative effect of changes in accounting principles discussed in Note 3 to Financial Statements.

(b) See Note 7 to Financial Statements.

The effect of mark-to-market and hedge accounting on the balance sheet is as follows:

| | December 31, | |
|--|---------------------|-----------------|
| | 2005 | 2004 |
| Net derivative liability related to cash flow hedges | \$ (164) | \$ (166) |
| Net derivative liability related to interest rate fair value hedges..... | (71) | (24) |
| Other derivative assets | 9 | — |
| Total net cash flow hedge and other derivative liability..... | <u>\$ (226)</u> | <u>\$ (190)</u> |
| Net commodity contract asset (a) | <u>\$ 36</u> | <u>\$ 31</u> |
| Long-term debt fair value adjustments —increase/(decrease)..... | <u>\$ (44)</u> | <u>\$ 15</u> |
| Net accumulated other comprehensive loss included in shareholders' equity (after-tax amounts)..... | <u>\$ (142)</u> | <u>\$ (172)</u> |

- (a) Excludes amounts not arising from mark-to-market valuations such as payments and receipts of cash and other consideration associated with commodity hedging and trading activities.

Under a commodity price risk management program commenced in October 2005, TXU Corp. has been supplementing its hedging and risk management portfolio with market instruments that are expected to reduce exposure to the effects of changes in natural gas prices over the next five years. The majority of these market instruments are natural gas-related derivative instruments. As of early February 2006, TXU Corp. had effectively sold forward, over the five year period from 2006 to 2010, approximately 385 million MMBtu of natural gas using instruments that have been designated as cash flow hedges of future power sales. The values of the hedge instruments are based on natural gas prices, and power prices do not necessarily move in tandem with gas prices. Given the size of the hedge program and the cross-commodity nature of the hedges, the program may result in greater volatility of net income due to hedge ineffectiveness gains and losses, as well as greater mark-to-market gains and losses reported in other comprehensive income, than TXU Corp. has experienced in recent years. For example, a change of 0.1 (or 1%) in forward market heat rates could result in cash flow hedge ineffectiveness gains or losses of \$20 to \$35 million pretax.

Revenue Recognition — TXU Corp.'s revenue includes an estimate for unbilled revenue that is calculated at the end of the period based on estimated daily consumption after the meter read date and valued at rates in effect when the consumption is billed. Estimated daily consumption is derived using historical revenue information adjusted for weather and other measurable factors affecting consumption. Calculations of unbilled revenues during certain interim periods are generally subject to more estimation variability because of seasonal changes in demand. Accrued unbilled revenues totaled \$494 million, \$422 million and \$411 million at December 31, 2005, 2004 and 2003, respectively.

Accounting for Contingencies — The financial results of TXU Corp. may be affected by judgments and estimates related to loss contingencies. A significant contingency that TXU Corp. accounts for is the loss associated with uncollectible trade accounts receivable. The determination of such bad debt expense is based on factors such as historical write-off experience, aging of accounts receivable balances, changes in operating practices, regulatory rulings, general economic conditions and customers' behaviors. With the opening of the Texas electricity market to competition in 2002, many historical measures used to estimate bad debts were less reliable. The changing business climate, including a regulatory change in 2004 that allows a REP to disconnect nonpaying customers in its historical service territory, increased customer churn due to competitor actions and the recent significant increases in energy prices adds to the complexity of the estimation process. Historical results alone are not always indicative of future results causing management to consider potential changes in customer behavior. Bad debt expense totaled \$56 million, \$90 million and \$119 million for the years ended December 31, 2005, 2004 and 2003, respectively.

During 2004, management assessed the progress and status of matters in litigation and recorded a net \$84 million (\$55 million after-tax) charge for the anticipated settlement of litigation (estimated litigation liability of \$150 million less \$66 million in pledged reimbursements from insurance carriers). In January 2005, TXU Corp. reached a comprehensive settlement of the consolidated amended securities class action lawsuit initially filed in October 2002. The agreement included a one-time payment to the class members of \$150 million, of which \$101 million was received in reimbursement from insurance carriers. As a result, a credit to earnings of \$35 million (\$23 million after-tax) was recorded in 2005 to reduce the previously recorded amounts.

See Note 16 to Financial Statements under “Retail Clawback Credit” for a discussion of the effects on earnings of this regulatory-related contingency.

Accounting for Income Taxes — TXU Corp.’s income tax expense and related balance sheet amounts involve significant management estimates and judgments. Amounts of deferred income tax assets and liabilities, as well as current and noncurrent accruals, involve judgments and estimates of the timing and probability of recognition of income and deductions by taxing authorities. In assessing the likelihood of realization of deferred tax assets, management considers estimates of the amount and character of future taxable income. Actual income taxes could vary from estimated amounts due to the future impacts of various items, including changes in income tax laws, TXU Corp.’s financial condition and results of operations in future periods, as well as final review of filed tax returns by taxing authorities. TXU Corp.’s income tax returns are regularly subject to examination by applicable tax authorities. In management’s opinion, an adequate reserve has been made for any future taxes that may be owed as a result of any examination. See Notes 9 and 11 to Financial Statements for discussion of income tax matters.

Impairment of Long-Lived Assets — TXU Corp. evaluates long-lived assets for impairment whenever indications of impairment exist, in accordance with the requirement of SFAS 144. One of those indications is a current expectation that “more likely than not” a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. In this circumstance, impairment may be evaluated based on the current market price of the asset. For TXU Corp.’s baseload generation assets, another possible indication would be an expected long-term decline in natural gas prices. In this circumstance, the impairment test would be based on future undiscounted cash flows associated with the asset, in accordance with SFAS 144. The determination of the existence of these and other indications of impairment involves judgments that are subjective in nature and may require the use of estimates in forecasting future results and cash flows related to an asset or group of assets. Further, the unique nature of TXU Corp.’s property, plant and equipment, which includes a fleet of generation assets with a diverse fuel mix and individual plants that have varying production or output rates, requires the use of significant judgments in determining the existence of impairment indications and the grouping of assets for impairment testing.

TXU Corp.’s most significant long-lived asset in terms of carrying value is its Comanche Peak nuclear generation facility. The net book value of the facility was \$7.3 billion at December 31, 2005. TXU Corp. believes that the net book value of the facility significantly exceeds the estimated current market value. However, TXU Corp. estimates that future undiscounted cash flows from the facility significantly exceed net book value. Significant assumptions used in this analysis are forward price curves for natural gas and power, market heat rates and production estimates. TXU Corp. has conservatively estimated that a sustained structural decline in natural gas prices of at least 60% from current levels would need to occur before any risk of impairment would arise, assuming market heat rates remain unchanged.

Depreciation — The depreciable lives of property, plant and equipment are based on management’s estimates/determinations of the assets’ economical useful lives. To the extent that the actual lives differ from these estimates there would be an impact on the amount of depreciation charged to earnings. Consolidated depreciation expense as a percent of average depreciable property approximated 2.3% for 2005 and 2004 and 2.5% for 2003. The declines in these percentages were due primarily to increases in the estimated depreciable lives of lignite/coal-fired generation facilities.

The Comanche Peak nuclear-powered generation units were originally estimated to have a useful life of 40 years, based on the life of the operating licenses granted by the NRC. Over the last several years, the NRC has granted 20-year extensions to the initial 40-year terms for several commercial power reactors. Based on these extensions and current expectations of industry practice, the useful life of the Comanche Peak nuclear-powered generation units was extended to 60 years effective April 2003. TXU Energy Holdings expects to file a license extension request in accordance with timing and other provisions established by the NRC.

Regulatory Assets — The financial statements at December 31, 2005 and 2004, reflect total regulatory assets of \$1.9 billion and \$2.0 billion, respectively. These amounts consisted primarily of generation-related regulatory assets recoverable by transition (securitization) bonds as discussed immediately below. Rate regulation is premised on the full recovery of prudently incurred costs and a reasonable rate of return on invested capital. The assumptions and judgments used by regulatory authorities continue to have an impact on the recovery of costs, the rate earned on invested capital and the timing and amount of assets to be recovered by rates. (See disclosures in Note 19 to Financial Statements under “Regulatory Assets and Liabilities.”)

Approximately \$1.8 billion in regulatory asset stranded costs arising prior to the 1999 Restructuring Legislation became subject to recovery through issuance of transition (securitization) bonds by TXU Electric Delivery in accordance with the Settlement Plan with the Commission as described in Note 16 to Financial Statements. As a result of the final approval of the Settlement Plan in January 2003, an extraordinary loss of \$134 million (net of income tax benefit of \$72 million) was recorded in the fourth quarter of 2002 principally to writedown this regulatory asset. The carrying value of the regulatory asset after the writedown represented the projected future cash flows to be recovered from REPs through revenues as a transition charge to service the principal and estimated interest on the bonds. An extraordinary gain of \$16 million (net of tax of \$9 million) was recorded in 2004, representing an increase in the carrying value of the regulatory asset subject to securitization, due to the issuance of the second and final tranche of the securitization bonds in June 2004. The increase in the related regulatory asset was due to the effect of higher than estimated interest rates on the bonds and therefore increased amounts to be recovered from REPs through revenues as a transition charge to service the bonds. At December 31, 2005, this regulatory asset totaled \$1.5 billion.

Other regulatory assets that TXU Corp. believes are probable of recovery, but are subject to review and possible writedown in any future regulatory rate case, totaled \$382 million at December 31, 2005. These amounts consist primarily of securities reacquisition costs, storm-related costs, recoverable deferred income taxes and employee retirement costs.

Defined Benefit Pension Plans and Other Postretirement Benefit Plans — TXU Corp. offers pension benefits through either a defined benefit pension plan or a cash balance plan and also offers certain health care and life insurance benefits to eligible employees and their eligible dependents upon the retirement of such employees from TXU Corp. Reported costs of providing noncontributory defined pension benefits and other postretirement benefits are dependent upon numerous factors, assumptions and estimates.

Benefit costs are impacted by actual employee demographics (including but not limited to age, compensation levels and years of accredited service), the level of contributions made to retiree plans and earnings on plan assets. TXU Corp.’s retiree plan assets are primarily made up of equity and fixed income investments. Changes made to the provisions of the plans may also impact current and future benefit costs. Fluctuations in actual equity market returns as well as changes in general interest rates may result in increased or decreased benefit costs in future periods. Benefit costs may also be significantly affected by changes in key actuarial assumptions, including anticipated rates of return on plan assets and the discount rates used in determining the projected benefit obligation.

In accordance with accounting rules, changes in benefit obligations associated with these factors may not be immediately recognized as costs on the income statement, but are recognized in future years over the remaining average service period of plan participants. As such, significant portions of benefit costs recorded in any period may not reflect the actual level of cash benefits provided to plan participants. TXU Corp. recorded pension costs and other postretirement benefit costs as summarized in the following table:

| | <u>Year Ended December 31,</u> | | |
|---|--------------------------------|---------------|---------------|
| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| Pension costs under SFAS 87 | \$ 46 | \$ 58 | \$ 45 |
| Other postretirement benefit costs under SFAS 106 | 71 | 80 | 100 |
| Total (a) | <u>\$ 117</u> | <u>\$ 138</u> | <u>\$ 145</u> |

(a) Includes amounts deferred as regulatory assets and amounts capitalized as part of construction projects, which totaled approximately \$58 million, \$27 million and \$26 million for 2005, 2004 and 2003, respectively.

Detailed information regarding TXU Corp.'s pension and postretirement benefits is provided in Note 12 to Financial Statements. Additional analysis regarding pension and other postretirement benefit plans:

- Pension and other postretirement benefit costs decreased \$21 million to \$117 million in 2005 due primarily to fewer active employees following the 2004 Capgemini outsourcing and TXU Gas disposition transactions and other 2004 restructuring actions. (See Note 2 to Financial Statements.)
- The decline in other postretirement benefit costs in 2004 of \$20 million from \$100 million in 2003 was due primarily to the effect of the Medicare Prescription Drug Improvement and Modernization Act of 2003 enacted in December 2003.
- A total curtailment charge of \$5 million is included in pension and other postretirement benefit costs in 2004 due to the effects of the Capgemini outsourcing and TXU Gas disposition transactions.

In 2005, the assumed pension and other postretirement benefit costs discount rate was 6.00%. The expected rate of return on assets was 8.75% for pension costs and 8.67% for other postretirement costs.

Sensitivity of these costs to changes in key assumptions is as follows:

| <u>Assumption</u> | <u>Increase/(decrease) in 2005 Costs</u> |
|---|--|
| Discount rate – 1% increase | \$(24) |
| Discount rate – 1% decrease | \$ 36 |
| Expected return on assets – 1% increase | \$(19) |
| Expected return on assets – 1% decrease | \$ 19 |

Regulatory Recovery of Pension and Other Postretirement Benefit Costs — In June 2005, an amendment to PURA relating to pension and other postretirement benefits was enacted by the Legislature of the State of Texas. This amendment provides for the recovery by TXU Electric Delivery of pension and other postretirement benefit costs for all applicable former employees of the regulated predecessor integrated electric utility (i.e., certain TXU Energy Holdings' active and retired employees). The amendment additionally authorizes TXU Electric Delivery to establish a regulatory asset or liability for the difference between the amounts of pension and other postretirement benefits approved in current billing rates and the actual amounts that would otherwise have been recorded as charges or credits to earnings. Accordingly, in the second quarter of 2005 TXU Electric Delivery began deferring (principally as a regulatory asset or property) additional pension and postretirement benefit costs for the effect of the amendment, which was retroactively effective January 1, 2005. Amounts deferred are ultimately subject to regulatory approval.

Stock-based Compensation – TXU Corp. grants awards of restricted stock and performance units distributed in stock. For grants in 2004 and 2003, the number of awards ultimately distributed will be based on the performance of TXU Corp. stock versus stock price performance of a peer group of companies (Index Method) over a future period (generally three years). For grants in 2005, the number of awards to be ultimately distributed was based 50% on the Index Method and 50% on the aggregate three-year total shareholder return of TXU Corp. stock. For a small number of employees under employment agreements, the number of shares is based on the Index Method. Stock-based compensation expense, which is reported in SG&A expenses, totaled \$32 million, \$56 million and \$25 million, in 2005, 2004 and 2003, respectively. See Note 10 to Financial Statements for additional information.

The determination of fair value of stock-based compensation awards at grant date is based on valuation techniques involving a number of assumptions. The more significant assumptions are as follows:

- Expected number of shares distributable per award – the determination of the probability-weighted number of shares expected to be issued is based on expected volatility of TXU Corp.’s stock. In addition, for awards or award components that are determined based on TXU Corp. stock price versus a peer group, determination of the probability-weighted distribution also includes volatility of the peer group (index). Expected volatility is determined based on historical and implied volatilities of TXU Corp. and the mean and median of the index with reference to historical volatilities for one, two and three years and implied volatilities for 0.25, 0.5, 0.75, 1 and 1.5 years.
- Discount for risk during the vesting period – this factor reflects a discount to compensate for the risk of uncertainty during the required holding period and is based on an equity rate of return.
- Discount for liquidation restrictions – this factor estimates the discount for lack of marketability of vested awards due to the anticipated time for the approval and issuance of the awards, the black-out period immediately after the grant and additional holding requirements imposed on senior executives. This discount is determined based on an estimation of the cost of a protective put at the award date and is calculated using the Black-Scholes option pricing model using expected volatility assumptions based on historical and implied volatility as discussed above and a risk-free rate of return over the option period.

Sensitivities to these key assumptions on the \$24 million fair value of the 2005 awards are as follows:

| <u>Assumption</u> | <u>Range</u> | | | <u>Increase/(decrease) in award fair value</u> | |
|--|--------------|-------------|-------------|--|-------------|
| | <u>Low</u> | <u>Base</u> | <u>High</u> | <u>Low</u> | <u>High</u> |
| Expected number of shares distributable per award – peer performance | 0.7 shares | 0.9 shares | 1.0 shares | \$3 | \$(3) |
| Expected number of shares distributable per award – shareholder return | 0.6 shares | 0.7 shares | 0.8 shares | \$1 | \$(1) |
| Discount for risk during vesting period | 10% | 12% | 14% | \$2 | \$(1) |
| Discount for liquidation restrictions | 25% | 27.5% | 30% | \$1 | — |

RESULTS OF OPERATIONS

The results of operations and the related management's discussion of those results for all periods presented reflect the discontinuance of certain operations (see Note 4 to Financial Statements regarding discontinued operations).

Accounting Changes — See Note 3 to Financial Statements for a discussion of the effects of accounting rule changes.

Extraordinary Items — See Note 5 to Financial Statements for a discussion of an extraordinary charge recorded in 2005 and an extraordinary credit recorded in 2004.

TXU Corp. Consolidated

2005 compared to 2004

Reference is made to comparisons of results by business segment following the discussion of consolidated results. The business segment comparisons provide additional detail and quantification of items affecting financial results.

TXU Corp.'s operating revenues increased \$1.1 billion, or 12%, to \$10.4 billion in 2005.

- Operating revenues in the TXU Energy Holdings segment increased \$832 million, or 10%, to \$9.3 billion driven by higher retail and wholesale pricing, which is primarily the result of higher natural gas prices. The effect of higher pricing was partially offset by the effect of lower retail sales volumes. Retail sales volumes declined 17% primarily reflecting a net loss of customers to competitive activity, particularly in the large business market, partially offset by the effect of warmer weather.
- Operating revenues in the TXU Electric Delivery segment increased \$168 million, or 8%, to \$2.4 billion in 2005. The revenue increase was driven by a 5% increase in delivered volumes, due largely to warmer weather and an increase in delivery points. The balance of the growth reflected \$46 million in higher transition charges associated with securitization bonds issued in 2004 (offset in total by higher amortization of the related regulatory asset as discussed below). Additionally, higher transmission and distribution tariffs driven by TXU Electric Delivery's ongoing transmission investment program and market growth contributed to increased revenues.
- Consolidated revenue growth reflected a \$130 million reduction in the intercompany sales elimination, primarily reflecting lower sales by TXU Electric Delivery to TXU Energy Holdings, while its sales to nonaffiliated REPs increased.

Gross Margin

| | Year Ended December 31, | | | |
|---|-------------------------|--------------|-----------------|--------------|
| | 2005 | % of Revenue | 2004 | % of Revenue |
| Operating revenues | \$ 10,437 | 100% | \$ 9,308 | 100% |
| Costs and expenses: | | | | |
| Fuel, purchased power costs and delivery fees ... | 4,036 | 39% | 3,847 | 41% |
| Operating costs | 1,425 | 14% | 1,429 | 15% |
| Depreciation and amortization | 764 | 7% | 709 | 8% |
| Gross margin | <u>\$ 4,212</u> | <u>40%</u> | <u>\$ 3,323</u> | <u>36%</u> |

Gross margin is considered a key operating metric as it measures the effect of changes in sales volumes and pricing versus the variable and fixed costs of energy sold, whether generated or purchased, as well as the variable and fixed costs to deliver energy.

Gross margin increased \$889 million, or 27%, to \$4.2 billion in 2005.

- The TXU Energy Holdings segment's gross margin increased \$832 million, or 38%, to \$3.0 billion, driven by higher pricing partially offset by higher per MWh cost of purchased power and gas/oil-fired generation as well as the effect of lower sales volumes.
- The TXU Electric Delivery segment's gross margin increased \$80 million, or 7%, to \$1.2 billion in 2005, driven by higher operating revenues.

Operating costs were \$1.4 billion in both 2005 and 2004.

- TXU Energy Holdings' operating costs declined \$37 million, or 5%. As discussed below in the business segment analysis, this decline was due to a number of factors, including the absence of \$43 million of costs related to activities no longer performed.
- TXU Electric Delivery's operating costs rose \$28 million, or 4%, driven by increased spending for reliability initiatives and higher property taxes due to increased investments in property.

Depreciation and amortization (consisting almost entirely of amounts related to generation plants and the delivery system shown in the gross margin table above) increased \$16 million, or 2%, to \$776 million in 2005. The increase included higher amortization of the transition bond regulatory asset and higher depreciation due to normal additions of property, largely offset by a change in the carrying value of software assets in connection with the Capgemini outsourcing transaction and the effect of reduced 2005 depreciation rates for lignite/coal-fired plants due to extending the estimated useful lives.

SG&A expense decreased \$310 million, or 28%, to \$781 million in 2005. The decline reflected:

- \$93 million resulting from cost reduction initiatives including the Capgemini outsourcing agreement;
- \$52 million in nonrecurring executive compensation costs in 2004;
- \$50 million in reduced incentive compensation expense including \$15 million due to a one-time incentive compensation program in wholesale operations in 2004;
- \$42 million in consulting and professional fees in 2004 related to the formulation and execution of strategic initiatives;
- \$35 million in lower bad debt expense as a result of stricter disconnect policies and more focused collection activities; and
- \$15 million in reduced pension and other postretirement benefits primarily due to the effect of Texas legislation enacted in the second quarter of 2005. (See Note 12 to Financial Statements.)

Other income totaled \$151 million in 2005 and \$148 million in 2004. Other deductions totaled \$45 million in 2005 and \$1.2 billion in 2004. The other deductions in 2004 primarily represented charges related to the restructuring actions discussed in Note 2 to Financial Statements. Also see Note 18 to Financial Statements for detail of other income and deductions.

Interest income increased \$20 million to \$48 million in 2005 primarily reflecting losses on interest rate swaps in 2004 (related to a note receivable) and higher interest earned on short-term investments in 2005.

Interest expense and related charges increased \$107 million, or 15%, to \$802 million in 2005 reflecting \$66 million due to higher average borrowings and \$41 million due to higher average interest rates.

Income tax expense on income from continuing operations before extraordinary gain (loss) and cumulative effect of changes in accounting principles included:

- \$138 million in additional tax benefit recorded in the first quarter of 2005 related to the TXU Europe write-off. This benefit reflects identification of tax planning strategies TXU Corp. would implement to ensure utilization of capital losses associated with the write-off of the investment in TXU Europe; and
- \$75 million tax benefit recorded in the second quarter of 2004 arising from the sale of TXU Fuel.

The effective income tax rate excluding the effect of these benefits was 32.0% in 2005 and 95.1% in 2004. The 2005 effective income tax rate reflects a \$29 million benefit for the reversal of previously established tax reserves due to current period events. The 2004 effective rate reflected the limited deductibility of expenses recorded in connection with the repurchase of convertible and equity-linked debt securities on a small income base.

Income from continuing operations before extraordinary items and the cumulative effect of changes in accounting principle (an after-tax measure) increased to \$1.8 billion in 2005 from \$81 million in 2004.

- Earnings in the TXU Energy Holdings segment increased \$1.0 billion to \$1.4 billion driven by improved gross margin, the effect of restructuring-related charges in 2004 and lower SG&A expenses.
- Earnings in the TXU Electric Delivery segment increased \$96 million, or 38%, to \$351 million driven by higher operating revenues and the impact of unusual charges in 2004 reported in other deductions (restructuring-related charges and a rate case settlement charge – see Note 2 to Financial Statements).
- Corporate and other activities resulted in net expenses of \$6 million in 2005 compared to \$582 million in 2004. The improvement of \$576 million reflected (all amounts after-tax):
 - \$382 million of debt extinguishment losses due primarily to restructuring-related actions in 2004;
 - \$138 million income tax benefit recorded in 2005 related to TXU Europe;
 - \$56 million for a litigation accrual in 2004;
 - \$52 million pre and after-tax in nonrecurring executive compensation in 2004;
 - \$27 million in restructuring-related consulting and professional fees in 2004;
 - \$23 million in additional insurance recovery in 2005 related to the securities litigation settlement,

partially offset by the recognition in 2004 of a \$75 million income tax benefit arising from the sale of TXU Fuel.

Net pension and postretirement benefit costs reduced income from continuing operations by \$38 million in 2005 and \$64 million in 2004.

Income from discontinued operations (an after-tax measure) totaled \$5 million in 2005 and \$378 million in 2004. See Note 4 to Financial Statements for details.

Diluted results per share of common stock were net income of \$2.50 in 2005 compared to a net loss of \$0.64 in 2004.

- The 2005 diluted per share results reflect a \$1.02 per share unfavorable impact associated with the November 2004 accelerated share repurchase program, which was settled in May 2005 for \$523 million in cash. This settlement amount includes the difference between the initial price of the shares and the actual costs of the shares purchased by the counterparty under the program as well as related fees and expenses. Because of TXU Corp.'s stated intention to settle the program in cash rather than shares, accounting rules require that earnings used in the diluted earnings per share calculation be reduced by the change in fair value of the settlement, which was \$498 million (without tax benefit) in the period. Also see Note 8 to Financial Statements.
- Per share results in 2004 were unfavorably impacted by a \$1.41 per share effect from TXU Corp.'s repurchase of TXU Energy Holdings' exchangeable preferred membership interests in April 2004 (see Note 8 to Financial Statements). For 2004, results per diluted share of common stock equaled results per basic share because of antidilution accounting rules.
- The comparison of diluted net income per share benefited from a \$0.48 per share impact of 114 million fewer average shares outstanding in 2005. Basic average common shares outstanding decreased 21% to 476 million shares reflecting the repurchase of 105 million shares in November 2004 under the accelerated share repurchase program and the repurchase of 12 million shares in 2005. (See Note 8 to Financial Statements.) Diluted average common shares decreased 19% to 486 million shares.

TXU Corp. Consolidated

2004 compared to 2003

TXU Corp.'s operating revenues increased \$708 million, or 8%, to \$9.3 billion in 2004.

- Operating revenues in the TXU Energy Holdings segment rose \$509 million, or 6%, to \$8.5 billion reflecting higher retail and wholesale pricing, partially offset by the effect of a mix shift to lower-price wholesale sales. Retail volumes declined 12% due to competitive activity and milder weather primarily in the summer.
- Operating revenues in the TXU Electric Delivery segment increased \$139 million, or 7%, to \$2.2 billion reflecting \$87 million in transition charges associated with securitization bonds issued in August 2003 and June 2004 (offset in total by higher amortization of the related regulatory asset as discussed below) as well as higher transmission and distribution fees (tariffs).
- Consolidated revenue growth also reflected a \$60 million reduction in the intercompany sales elimination, primarily reflecting lower sales by TXU Electric Delivery to TXU Energy Holdings as sales to nonaffiliated REPs increased.

Gross Margin

| | Year Ended December 31, | | | |
|---|-------------------------|--------------|-----------------|--------------|
| | 2004 | % of Revenue | 2003 | % of Revenue |
| Operating revenues | \$ 9,308 | 100% | \$ 8,600 | 100% |
| Costs and expenses: | | | | |
| Fuel, purchased power and delivery fees | 3,847 | 41% | 3,640 | 42% |
| Operating costs..... | 1,429 | 15% | 1,389 | 16% |
| Depreciation and amortization..... | 709 | 8% | 654 | 8% |
| Gross margin..... | <u>\$ 3,323</u> | <u>36%</u> | <u>\$ 2,917</u> | <u>34%</u> |

Gross margin increased \$406 million, or 14%, to \$3.3 billion in 2004.

- The TXU Energy Holdings segment's gross margin increased \$383 million, or 21%, to \$2.2 billion. Higher gross margin reflected initiatives taken to respond to higher natural gas prices, including retail pricing actions and more cost effective sourcing of power. The gross margin increase reflected higher retail and wholesale prices partially offset by the effect of lower retail volumes and lower results from hedging and risk management activities. The average cost per MWh of power produced and purchased was about even with 2003 as higher purchased power costs due to rising natural gas prices were largely offset by lower cost of power produced due to reduced utilization of high heat rate gas-fired generation and higher lignite and nuclear facility output.
- The TXU Electric Delivery segment's gross margin increased \$17 million, or 2%, to \$1.1 billion driven by higher operating revenues.

Operating costs increased \$40 million, or 3%, to \$1.4 billion in 2004, driven by \$25 million in incremental costs primarily associated with a planned outage for refueling at the nuclear generation facility and a \$12 million increase in third-party transmission costs.

Depreciation and amortization (including amounts shown in the gross margin table above) rose \$36 million, or 5%, to \$760 million in 2004. This increase reflected \$87 million in higher regulatory asset amortization arising from issuances of TXU Electric Delivery securitization bonds in August 2003 and June 2004 (offsetting the same amount of revenue increase), normal additions and replacements of equipment and the effect of higher asset retirement obligations due to new mining activity. These increases were partially offset by a \$56 million impact of lower depreciation related to TXU Energy Holdings' generation fleet, due primarily to extensions of estimated depreciable lives to better reflect useful lives (see Note 1 to Financial Statements) and a decrease in amortization due to a reduction in the carrying values of software assets in connection with the Capgemini outsourcing transaction.

SG&A expense increased \$184 million, or 20%, to \$1.1 billion in 2004. The increase reflected:

- \$112 million in higher incentive compensation expense due to the improved performance of the business and achievement of certain targets related to trading activities;
- \$54 million in consulting and professional fees incurred in the formulation and execution of strategic initiatives and \$52 million in compensation expense under Mr. Wilder's employment agreement, due largely to the increase in TXU Corp.'s stock price,

partially offset by \$29 million in lower bad debt expense and \$4 million in reduced marketing expenses.

Other income totaled \$148 million in 2004 and \$58 million in 2003. Other deductions totaled \$1.2 billion in 2004 and \$42 million in 2003. See Note 18 to Financial Statements for additional detail.

Interest expense and related charges decreased \$89 million, or 11%, to \$695 million in 2004, primarily reflecting an \$82 million decrease due to lower average interest rates and a \$7 million decrease due to lower average borrowings.

The effective income tax rate on income from continuing operations before extraordinary gain and cumulative effect of changes in accounting principles was 34.1% in 2004 and 30.8% in 2003. The increase was driven by several factors, including the nondeductibility of certain executive compensation and the limited deductibility of expenses recorded in connection with the repurchase of convertible and equity-linked debt securities, partially offset by the \$75 million tax benefit arising from the recognition of tax benefits related to the 2002 write-off of the investment in TXU Europe and the ongoing benefits of lignite depletion and investment tax credit amortization on a lower income base.

Income from continuing operations before extraordinary gain and cumulative effect of changes in accounting principles (an after-tax measure) decreased \$485 million to \$81 million in 2004. This performance reflected a decrease of \$89 million in the TXU Energy Holdings segment. Results in the TXU Energy Holdings segment reflected several unusual charges reported in other deductions and discussed in Note 2 to Financial Statements, partially offset by higher gross margin. Earnings in the TXU Electric Delivery segment declined \$3 million reflecting \$13 million after-tax of severance costs and \$14 million after-tax for a rate case settlement, partially offset by higher transmission-related revenues. Corporate and other expenses increased \$393 million, primarily reflecting (all amounts after-tax):

- debt extinguishment losses of \$382 million;
- litigation accrual of \$56 million;
- nonrecurring executive compensation expenses of \$52 million;
- consulting fees of \$35 million;
- other items totaling \$25 million (primarily stock-based compensation and severance costs),

partially offset by:

- recognition of a \$75 million tax benefit associated with TXU Europe as a result of a capital gain generated by the sale of TXU Fuel;
- the effect of \$11 million in equity losses in 2003 related to the telecommunications business, then a joint venture; and
- lower net external and affiliate interest expense (net of interest income) of \$64 million due to financing-related activity, including interest income of \$29 million on TXU Energy Holdings' exchangeable preferred membership interests acquired by TXU Corp.

Net pension and postretirement benefit costs reduced income from continuing operations by \$64 million after-tax in 2004 and \$69 million after-tax in 2003.

Income from discontinued operations (an after-tax measure) totaled \$378 million in 2004 and \$74 million in 2003. See Note 4 to Financial Statements for details.

Diluted results per share of common stock were a net loss of \$0.64 in 2004 compared to net income of \$0.81 in 2003. Basic average common shares outstanding decreased by 7% to 600 million shares reflecting the repurchase of 40 million shares in an accelerated repurchase plan in June 2004 and the repurchase of 105 million shares in an accelerated repurchase plan in November 2004. Diluted average common shares decreased by 21% to 600 million shares reflecting the accelerated repurchase plan transactions and the exclusion of the dilutive impacts of 114 million shares issuable under the exchangeable preferred membership interests. For 2004, results per diluted share of common stock equaled results per basic share because of antidilution accounting rules. Results in 2004 were unfavorably impacted by a \$1.41 per share effect from TXU Corp.'s repurchase of TXU Energy Holdings' exchangeable preferred membership interests in April 2004. The amounts paid in excess of the carrying value of these instruments, net of an associated income tax benefit, totaled \$849 million. This premium was charged to additional paid-in capital and treated in a manner similar to preference share dividends in computing earnings per share.

Energy-Related Commodity Contracts and Mark-to-Market Activities

The table below summarizes the changes in commodity contract assets and liabilities for the years ended December 31, 2005, 2004 and 2003. The net changes in these assets and liabilities, excluding “cumulative effect of change in accounting principle” and “other activity” as described below, represent the net effect of mark-to-market accounting for positions in the commodity contract portfolio, which excludes positions that are subject to hedge accounting. For the 2005 period, this effect totaled \$9 million in unrealized net gains (\$32 million in net gains on open positions less \$23 million in reversals of net gains recognized in prior periods.) These positions consist largely of economic hedge transactions, but also include some proprietary trading.

| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|--|----------------|--------------|---------------|
| Net commodity contract asset at beginning of period..... | \$ 23 | \$ 108 | \$ 316 |
| Cumulative effect of change in accounting principle (1)..... | — | — | (75) |
| Settlements of positions included in the opening balance (2)..... | (23) | (61) | (145) |
| Unrealized mark-to-market valuations of positions held at end of period (3)..... | 32 | (29) | 9 |
| Other activity (4)..... | <u>(88)</u> | <u>5</u> | <u>3</u> |
| Net commodity contract asset (liability) at end of period | <u>\$ (56)</u> | <u>\$ 23</u> | <u>\$ 108</u> |

- (1) Represents a portion of the pretax cumulative effect of the rescission of EITF 98-10. See Note 3 to Financial Statements.
(2) Represents reversals of unrealized mark-to-market valuations of these positions recognized in earnings prior to the beginning of the period, to offset realized gains and losses upon settlement.
(3) Includes \$15 million in gains recorded in 2005 at the inception of a contract.
(4) These amounts do not arise from mark-to-market valuations. Includes initial values of positions involving the receipt or payment of cash or other consideration such as option premiums paid and received and related amortization. Also includes \$75 million of natural gas received in 2005 related to physical swap transactions and a \$12 million charge related to nonperformance by a coal contract counterparty.

The decline in net commodity contract positions since 2003 reflects an accounting rule change issued in 2003 that limited mark-to-market accounting to contracts that met the definition of a derivative. Certain energy contracts previously marked-to-market were not derivatives (see Note 3 to Financial Statements). The decline also reflected reduced trading activities following the sale of retail gas operations outside of Texas in 2003 and the use of normal and cash flow hedge designations in the remaining contract portfolio.

In addition to the net effect of recording unrealized mark-to-market gains and losses that are reflected in changes in commodity contract assets and liabilities, similar effects arise in the recording of unrealized ineffectiveness gains and losses associated with commodity-related cash flow hedges. These effects, which include reversals of previously recorded unrealized ineffectiveness gains and losses to offset realized gains and losses upon settlement, are reflected in the balance sheet as changes in cash flow hedge and other derivative assets and liabilities. The total net effect of recording unrealized gains and losses under mark-to-market accounting is summarized as follows:

| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|--|----------------|-----------------|-----------------|
| Unrealized gains/(losses) related to commodity contract positions..... | \$ 9 | \$ (90) | \$ (136) |
| Ineffectiveness gains/(losses) related to cash flow hedges (a)..... | <u>(27)</u> | <u>(19)</u> | <u>36</u> |
| Total unrealized losses related to commodity contracts..... | <u>\$ (18)</u> | <u>\$ (109)</u> | <u>\$ (100)</u> |

(a) See Note 15 to Financial Statements.

These amounts are included in the “hedging and risk management activities” component of revenues.

Maturity Table — Included in the net commodity contract liability above at December 31, 2005 is a net asset of \$36 million representing cumulative unrealized mark-to-market net gains that have been recognized in current and prior years' earnings. More than offsetting this net asset is a net liability of \$92 million included in the December 31, 2005 balance sheet that is comprised principally of amounts representing current and prior years' net receipts of cash or other consideration, including amounts related to natural gas physical swap transactions, as well as option premiums net of amortization. The following table presents the unrealized net commodity contract asset arising from mark-to-market accounting as of December 31, 2005, scheduled by contractual settlement dates of the underlying positions.

| <u>Source of fair value</u> | Maturity dates of unrealized net commodity contract assets at December 31, 2005 | | | | |
|--|--|------------------|------------------|------------------------------|--------------|
| | Less than 1 year | 1-3 years | 4-5 years | Excess of 5 years | Total |
| Prices actively quoted..... | \$ 40 | \$100 | \$17 | \$ — | \$ 157 |
| Prices provided by other external sources | (87) | (46) | (25) | — | (158) |
| Prices based on models..... | <u>36</u> | <u>1</u> | <u>—</u> | <u>—</u> | <u>37</u> |
| Total | <u>\$ (11)</u> | <u>\$ 55</u> | <u>\$ (8)</u> | <u>\$ —</u> | <u>\$ 36</u> |
| Percentage of total fair value..... | (31)% | 153% | (22)% | —% | 100% |

As the above table indicates, 122% of the net unrealized mark-to-market valuation gains at December 31, 2005 mature within three years. This is reflective of the terms of the positions and the methodologies employed in valuing positions for periods where there is less market liquidity and visibility. The “prices actively quoted” category reflects only exchange traded contracts with active quotes available. The “prices provided by other external sources” category represents forward commodity positions at locations for which over-the-counter broker quotes are available. Over-the-counter quotes for power in ERCOT extend through 2006 and 2010, depending upon delivery point, and for natural gas generally extend through 2010. The “prices based on models” category contains the value of all nonexchange traded options, valued using industry accepted option pricing models. In addition, this category contains other contractual arrangements which may have both forward and option components. In many instances, these contracts can be broken down into their component parts and modeled as simple forwards and options based on prices actively quoted. As the modeled value is ultimately the result of a combination of prices from two or more different instruments, it has been included in this category.

TXU Energy Holdings**Financial Results**

| | Year Ended December 31, | | |
|---|-------------------------|-----------------|-----------------|
| | 2005 | 2004 | 2003 |
| Operating revenues | <u>\$ 9,327</u> | <u>\$ 8,495</u> | <u>\$ 7,986</u> |
| Costs and expenses: | | | |
| Fuel, purchased power costs and delivery fees | 5,320 | 5,265 | 5,117 |
| Operating costs..... | 667 | 704 | 685 |
| Depreciation and amortization..... | 313 | 350 | 407 |
| Selling, general and administrative expenses..... | 522 | 667 | 636 |
| Franchise and revenue-based taxes | 114 | 117 | 124 |
| Other income | (64) | (110) | (48) |
| Other deductions..... | 15 | 610 | 22 |
| Interest income..... | (70) | (31) | (8) |
| Interest expense and related charges | <u>393</u> | <u>353</u> | <u>323</u> |
| Total costs and expenses..... | <u>7,210</u> | <u>7,925</u> | <u>7,258</u> |
| Income from continuing operations before income taxes and cumulative effect of changes in accounting principles | 2,117 | 570 | 728 |
| Income tax expense..... | <u>687</u> | <u>162</u> | <u>231</u> |
| Income from continuing operations before cumulative effect of changes in accounting principles..... | <u>\$ 1,430</u> | <u>\$ 408</u> | <u>\$ 497</u> |

TXU Energy Holdings

Sales Volume Data

| | <u>Year Ended December 31,</u> | | | <u>Change %</u> | <u>Change %</u> |
|---|--------------------------------|----------------|----------------|------------------|------------------|
| | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2005/2004</u> | <u>2004/2003</u> |
| Sales volumes: | | | | | |
| Retail electricity sales volumes (GWh): | | | | | |
| Historical service territory (a): | | | | | |
| Residential | 29,239 | 30,897 | 34,082 | (5.4) | (9.3) |
| Small business (b) | <u>9,004</u> | <u>10,476</u> | <u>12,673</u> | <u>(14.1)</u> | <u>(17.3)</u> |
| Total historical service territory..... | 38,243 | 41,373 | 46,755 | (7.6) | (11.5) |
| Other territories (a): | | | | | |
| Residential | 3,416 | 3,089 | 1,899 | 10.6 | 62.7 |
| Small business (b) | <u>674</u> | <u>363</u> | <u>313</u> | <u>85.7</u> | <u>16.0</u> |
| Total other territories | 4,090 | 3,452 | 2,212 | 18.5 | 56.1 |
| Large business and other customers..... | <u>15,843</u> | <u>25,466</u> | <u>30,955</u> | <u>(37.8)</u> | <u>(17.7)</u> |
| Total retail electricity..... | 58,176 | 70,291 | 79,922 | (17.2) | (12.1) |
| Wholesale electricity sales volumes | <u>52,001</u> | <u>48,309</u> | <u>36,809</u> | <u>7.6</u> | <u>31.2</u> |
| Total sales volumes..... | <u>110,177</u> | <u>118,600</u> | <u>116,731</u> | <u>(7.1)</u> | <u>1.6</u> |
| Retail volumes (GWh) – weather adjusted (c): | | | | | |
| Residential | 31,612 | 33,987 | | (7.0) | |
| Small business | 9,533 | 10,839 | | (12.0) | |
| Large business and other customers..... | 15,828 | 25,466 | | (37.8) | |
| Average volume (kWh) per retail customer (d): | | | | | |
| Residential | 15,825 | 15,619 | 15,959 | 1.3 | (2.1) |
| Small business | 32,078 | 34,095 | 39,728 | (5.9) | (14.2) |
| Large business and other customers..... | 243,538 | 351,542 | 421,203 | (30.7) | (16.5) |
| Average volume (kWh) per retail customer – weather adjusted (c): | | | | | |
| Residential | 15,319 | 15,619 | | (1.9) | |
| Small business | 31,598 | 34,095 | | (7.3) | |
| Large business and other customers..... | 243,304 | 351,542 | | (30.8) | |
| Weather (service territory average) – percent of normal (e): | | | | | |
| Percent of normal: | | | | | |
| Cooling degree days..... | 107.0% | 90.0% | 95.7% | | |
| Heating degree days..... | 90.0% | 90.1% | 98.1% | | |

- (a) Historical service and other territory data for 2003 is best estimate.
- (b) Customers with demand of less than 1 MW annually.
- (c) 2005 amounts adjusted for estimated weather effect as compared to 2004.
- (d) Calculated using average number of customers for period.
- (e) Weather data is obtained from Weatherbank, Inc., an independent company that collects and archives weather data from reporting stations of the National Oceanic and Atmospheric Administration (a federal agency under the US Department of Commerce).

TXU Energy Holdings

Customer Count Data

| | <u>Year Ended December 31,</u> | | | <u>Change %</u> | <u>Change %</u> |
|--|--------------------------------|--------------|--------------|------------------|------------------|
| | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2005/2004</u> | <u>2004/2003</u> |
| Customer counts: | | | | | |
| Retail electricity customers (end of period and in thousands) (a): | | | | | |
| Historical service territory (b): | | | | | |
| Residential..... | 1,769 | 1,951 | 2,059 | (9.3) | (5.2) |
| Small business (c) | <u>281</u> | <u>309</u> | <u>316</u> | <u>(9.1)</u> | <u>(2.2)</u> |
| Total historical service territory..... | 2,050 | 2,260 | 2,375 | (9.3) | (4.8) |
| Other territories (b): | | | | | |
| Residential..... | 213 | 194 | 148 | 9.8 | 31.1 |
| Small business (c) | <u>7</u> | <u>6</u> | <u>5</u> | <u>16.7</u> | <u>20.0</u> |
| Total other territories | 220 | 200 | 153 | 10.0 | 30.7 |
| Large business and other customers | <u>55</u> | <u>76</u> | <u>69</u> | <u>(27.6)</u> | <u>10.1</u> |
| Total retail electricity customers..... | <u>2,325</u> | <u>2,536</u> | <u>2,597</u> | <u>(8.3)</u> | <u>(2.3)</u> |

- (a) Based on number of meters.
(b) Historical service and other territory data for 2003 is best estimate.
(c) Customers with demand of less than 1 MW annually.

TXU Energy Holdings

Revenue and Market Share Data

| | Year Ended December 31, | | | Change % 2005/2004 | Change % 2004/2003 |
|--|-------------------------|-----------------|-----------------|-----------------------|-----------------------|
| | 2005 | 2004 | 2003 (a) | | |
| Operating revenues (millions of dollars): | | | | | |
| Retail electricity revenues: | | | | | |
| Historical service territory: | | | | | |
| Residential | \$ 3,444 | \$ 3,164 | \$ 3,152 | 8.8 | 0.4 |
| Small business (b) | <u>1,086</u> | <u>1,103</u> | <u>1,213</u> | <u>(1.5)</u> | <u>(9.1)</u> |
| Total historical service territory..... | 4,530 | 4,267 | 4,365 | 6.2 | (2.2) |
| Other territories: | | | | | |
| Residential | 405 | 298 | 159 | 35.9 | 87.4 |
| Small business (b) | <u>65</u> | <u>34</u> | <u>25</u> | <u>91.2</u> | <u>36.0</u> |
| Total other territories | 470 | 332 | 184 | 41.6 | 80.4 |
| Large business and other customers..... | <u>1,330</u> | <u>1,771</u> | <u>1,935</u> | <u>(24.9)</u> | <u>(8.5)</u> |
| Total retail electricity revenues..... | 6,330 | 6,370 | 6,484 | (0.6) | (1.8) |
| Wholesale electricity revenues | 2,807 | 1,886 | 1,258 | 48.8 | 49.9 |
| Hedging and risk management activities..... | (164) | (103) | 30 | 59.2 | — |
| Other revenues | <u>354</u> | <u>342</u> | <u>214</u> | <u>3.5</u> | <u>59.8</u> |
| Total operating revenues..... | <u>\$ 9,327</u> | <u>\$ 8,495</u> | <u>\$ 7,986</u> | <u>9.8</u> | <u>6.4</u> |

Hedging and risk management activities (c):

| | | | | | |
|--|-----------------|-----------------|--------------|--|--|
| Net realized gains (losses) on settled positions..... | \$ (40) | \$ 6 | \$ 130 | | |
| Reversal of prior years' net unrealized gains on positions settled in current period..... | (23) | (61) | (145) | | |
| Other net unrealized losses, including ineffectiveness..... | <u>(101)</u> | <u>(48)</u> | <u>45</u> | | |
| Total net gains (losses) | <u>\$ (164)</u> | <u>\$ (103)</u> | <u>\$ 30</u> | | |

Average revenues per MWh:

| | | | | | |
|---|-----------|-----------|----------|------|------|
| Residential | \$ 117.86 | \$ 101.88 | \$ 92.02 | 15.7 | 10.7 |
| Small business | \$ 118.90 | \$ 104.87 | \$ 95.38 | 13.4 | 9.9 |
| Large business and other customers..... | \$ 83.96 | \$ 69.54 | \$ 62.51 | 20.7 | 11.2 |

Estimated share of ERCOT retail markets (d):

| | | | |
|--|-----|-----|-----|
| Historical service territory: | | | |
| Residential (e) | 72% | 81% | 86% |
| Small business (e) | 71% | 78% | 82% |
| Total ERCOT: | | | |
| Residential..... | 39% | 44% | 46% |
| Small business..... | 29% | 31% | 32% |
| Large business and other customers | 17% | 33% | 37% |

(a) Historical service and other territory data for 2003 is best estimate.

(b) Customers with demand of less than 1 MW annually.

(c) Includes amounts that offset the effects of settled physical energy contracts that are reported in revenues and fuel and purchased power costs.

(d) Based on number of meters, except large business which is based upon annualized consumption.

(e) Estimated market share is based on the number of customers that have choice.

TXU Energy Holdings

Production, Purchased Power and Delivery Cost Data

| | Year Ended December 31, | | | Change % 2005/2004 | Change % 2004/2003 |
|---|-------------------------|----------------|----------------|-----------------------|-----------------------|
| | 2005 | 2004 | 2003 | | |
| Fuel, purchased power costs and delivery fees | | | | | |
| (\$ millions): | | | | | |
| Nuclear fuel | \$ 78 | \$ 82 | \$ 80 | (4.9) | 2.5 |
| Lignite/coal | <u>475</u> | <u>506</u> | <u>491</u> | <u>(6.1)</u> | <u>3.1</u> |
| Total baseload fuel | 553 | 588 | 571 | (6.0) | 3.0 |
| Gas/oil fuel and purchased power | 3,060 | 2,912 | 2,913 | 5.1 | — |
| Other costs | <u>281</u> | <u>221</u> | <u>81</u> | <u>27.1</u> | <u>—</u> |
| Fuel and purchased power costs | 3,894 | 3,721 | 3,565 | 4.6 | 4.4 |
| Delivery fees (a) | <u>1,426</u> | <u>1,544</u> | <u>1,552</u> | <u>(7.6)</u> | <u>(0.5)</u> |
| Total | <u>\$5,320</u> | <u>\$5,265</u> | <u>\$5,117</u> | <u>1.0</u> | <u>2.9</u> |
| Fuel and purchased power costs (which | | | | | |
| excludes generation plant operating costs) per | | | | | |
| MWh: | | | | | |
| Nuclear generation | \$ 4.23 | \$ 4.31 | \$ 4.49 | (1.9) | (4.0) |
| Lignite/coal generation (b) | \$ 11.68 | \$ 12.96 | \$ 12.53 | (9.9) | 3.4 |
| Gas/oil generation and purchased power | \$ 61.66 | \$ 47.95 | \$ 46.12 | 28.6 | 4.0 |
| Delivery fees per MWh | \$ 24.20 | \$ 21.75 | \$ 18.93 | 11.3 | 14.9 |
| Production and purchased power volumes | | | | | |
| (GWh): | | | | | |
| Nuclear | 18,371 | 18,979 | 17,717 | (3.2) | 7.1 |
| Lignite/coal | <u>44,005</u> | <u>42,339</u> | <u>41,311</u> | <u>3.9</u> | <u>2.5</u> |
| Total baseload generation | 62,376 | 61,318 | 59,028 | 1.7 | 3.9 |
| Gas/oil generation | 3,504 | 4,726 | 13,250 | (25.9) | (64.3) |
| Purchased power | <u>46,133</u> | <u>56,007</u> | <u>49,915</u> | <u>(17.6)</u> | <u>12.2</u> |
| Total energy supply | 112,013 | 122,051 | 122,193 | (8.2) | (0.1) |
| Less line loss and power imbalances | <u>1,836</u> | <u>3,451</u> | <u>5,462</u> | <u>(46.8)</u> | <u>(36.8)</u> |
| Net energy supply volumes | <u>110,177</u> | <u>118,600</u> | <u>116,731</u> | <u>(7.1)</u> | <u>1.6</u> |
| Baseload capacity factors (%): | | | | | |
| Nuclear | 91.5% | 94.3% | 88.1% | (3.0) | 7.0 |
| Lignite/coal | 89.8% | 86.0% | 84.6% | 4.4 | 1.7 |
| Total baseload | 90.3% | 88.4% | 85.6% | 2.1 | 3.3 |

(a) Includes delivery fee charges from TXU Electric Delivery that are eliminated in consolidation (\$1.284 billion in 2005, \$1.418 billion in 2004 and \$1.477 billion in 2003).

(b) Includes depreciation and amortization of lignite mining assets, which is reported in the depreciation and amortization expense line item, but is part of overall fuel costs.

TXU Energy Holdings

2005 Compared to 2004

Operating revenues increased \$832 million, or 10%, to \$9.3 billion in 2005. Retail electricity revenues decreased \$40 million, or 1%, to \$6.3 billion.

- The retail revenue decline reflected a \$1.1 billion decrease attributable to a 17% drop in sales volumes, primarily reflecting a net loss of customers due to competitive activity, particularly in the large business market, partially offset by the effect of warmer weather. A total volume decline of 38% in the large business market also reflected a strategy to target higher margin customers in that market. Total residential and small business volumes fell 6%, driven by competitive activity and stricter disconnect policies and more focused collection activities, partially offset by the effect of increased consumption by residential customers due to warmer weather.
- The effect of lower retail volumes was partially offset by \$886 million in higher pricing due to increased price-to-beat rates, reflecting regulatory-approved fuel factor increases in 2005, and higher pricing in the competitive business market, both resulting from the effects of higher natural gas prices. A favorable \$171 million mix shift in the composition of retail sales from large business to residential and small business also offset the effect of lower volumes.
- Retail electricity customer counts at December 31, 2005 declined 8% from December 31, 2004. Total residential and small business customer counts in the historical service territory declined 9% and in all combined territories declined 8%.

Wholesale electricity revenues grew \$921 million, or 49%, to \$2.8 billion reflecting \$777 million in higher prices due to the effect of increased natural gas prices on wholesale electricity prices and \$144 million due to an 8% increase in sales volumes. The wholesale sales volume increase was driven by a shift in the composition of the customer base from retail to wholesale and weather-related increases in wholesale demand.

The increase in other revenues of \$12 million primarily reflected higher retail (business customers) gas revenues due to increased natural gas prices, partially offset by the effect of no longer providing customer care support to TXU Gas after the first half of 2004 and the sale of TXU Fuel in June 2004.

Net losses from hedging and risk management activities, which are reported in revenues and include both realized and unrealized (mark-to-market) gains and losses, totaled \$164 million in 2005 and \$103 million in 2004. Because most of the hedging and risk management activities are intended to mitigate the risk of commodity price movements on revenues and fuel and purchased power costs, the changes in such results should not be viewed in isolation, but rather taken together with the effects of pricing and cost changes on gross margin. Results in 2005 included:

- \$133 million in net realized losses associated with hedges entered into in prior years (largely 2003), the offsetting effects of which are reported in revenues and fuel and purchased power costs. This amount includes \$88 million in losses related to cash flow hedges, which had been recognized in other comprehensive income;
- \$84 million reversal of net unrealized gains previously recognized on power positions settled in the current period, the offsetting effects of which are reported in revenues and fuel and purchased power costs;
- \$79 million in net realized gains on settlement of commodity trading positions, including some proprietary trading activity, largely entered into in 2005 and relating primarily to natural gas; and
- \$31 million of unrealized ineffectiveness losses relating to cash flow hedges.

Gross Margin

| | Year Ended December 31, | | | |
|---|-------------------------|--------------|-----------------|--------------|
| | 2005 | % of Revenue | 2004 | % of Revenue |
| Operating revenues | \$ 9,327 | 100% | \$ 8,495 | 100% |
| Costs and expenses: | | | | |
| Fuel, purchased power costs and delivery fees | 5,320 | 57% | 5,265 | 62% |
| Generation plant operating costs | 667 | 7% | 704 | 8% |
| Depreciation and amortization | <u>309</u> | <u>3%</u> | <u>327</u> | <u>4%</u> |
| Gross margin | <u>\$ 3,031</u> | <u>33%</u> | <u>\$ 2,199</u> | <u>26%</u> |

Gross margin increased \$832 million, or 38%, to \$3.0 billion in 2005. This growth primarily reflected the relatively low fuel costs of TXU Energy Holdings' nuclear and lignite/coal-fired baseload plants, as well as the continued improved productivity of the baseload plants, in an environment of increasing wholesale power prices. The increased wholesale power prices were driven by rising natural gas prices. Retail prices, including price-to-beat rates, were increased in response to higher wholesale prices. The gross margin performance was mitigated by the effect of lower retail sales volumes.

Gross margin as a percent of revenues increased 7 percentage points to 33%. The improvement reflected:

- higher pricing, as the average retail sales price per MWh rose 20%, and the average wholesale sales price per MWh rose 38%;
- improved production efficiency in lignite/coal-fired generation operations and lower cost per ton of purchased coal resulting in a 8% decline in baseload fuel costs per MWh;
- a 19% decrease in planned and unplanned lignite/coal-fired plant outage days;
- a favorable mix shift in the composition of supply from purchased power to baseload generation; and
- a favorable mix shift in the composition of retail sales from large business to residential,

partially offset by:

- a 29% increase in combined per MWh purchased power costs and fuel costs in gas/oil-fired generation, due to rising natural gas prices;
- an 11% increase in delivery fees per MWh;
- decreased nuclear generation plant output due to two planned refueling outages in 2005 compared to one in 2004; and
- an unfavorable mix shift in the composition of total sales from retail to wholesale.

Operating costs decreased \$37 million, or 5%, to \$667 million in 2005. The decline reflected:

- \$30 million in lower benefits expense including \$13 million in lower pension and other postretirement benefit costs (see discussion in SG&A expenses below regarding these costs);
- the absence of \$18 million of costs associated with 9 combustion turbine units no longer operated for TXU Energy Holdings' benefit;
- a \$17 million effect of no longer providing customer care support to TXU Gas (largely offset by lower related revenues), the operations of which were sold in October 2004; and
- the absence of \$8 million of costs associated with the TXU Fuel business sold in June 2004,

partially offset by:

- \$25 million in higher maintenance costs associated with planned nuclear unit outages in 2005, reflecting two outages in 2005 and one outage in 2004; and
- \$15 million in supplier credits recorded in 2004.

Depreciation and amortization (consisting almost entirely of amounts related to generation plants shown in the gross margin table above) decreased \$37 million, or 11%, to \$313 million. The decline included \$19 million due to the effect of the transfer of information technology assets, principally capitalized software, to a TXU Corp. affiliate in connection with the Capgemini outsourcing transaction. The decrease also reflected a \$13 million effect of reduced 2005 depreciation rates for lignite/coal-fired plants due to extending the estimated useful lives.

SG&A expenses decreased by \$145 million, or 22%, to \$522 million in 2005. The decline reflected:

- a net \$64 million decline due to cost reduction initiatives, including the effect of the Capgemini outsourcing agreement;
- \$41 million in reduced incentive compensation expense including a \$15 million one-time incentive compensation program in wholesale operations in 2004;
- \$38 million in lower bad debt expense as a result of refining and consistently applying credit and collection policies; and
- an \$11 million net decrease in employee retirement-related expenses primarily due to the assumption by TXU Electric Delivery of pension and other postretirement benefit costs related to service of TXU Energy Holdings' employees prior to the unbundling of TXU Corp.'s electric utility business and the deregulation of the Texas electricity industry effective January 1, 2002 as discussed above (Also see Note 12 to Financial Statements),

partially offset by \$14 million in higher consulting expense primarily related to development and implementation of the TXU Operating System to improve efficiency of generation plant and mining operations.

Other income totaled \$64 million in 2005 and \$110 million in 2004. Other income in 2005 included:

- \$33 million in gains on the sale of undeveloped land and mining land;
- an \$8 million insurance reimbursement related to a generation plant fire in 2002;
- a \$7 million gain on the sale of an investment in an out-of-state power transmission project;
- \$4 million in connection with the termination of a power services contract; and
- \$2 million gain on the sale of surplus equipment.

Other income in 2004 included:

- \$88 million in amortization of the gain on the 2002 sale of two generation plants including \$58 million of the remaining unamortized gain recognized as a result of the termination of a related power purchase and tolling agreement; and
- a \$19 million gain on sale of undeveloped land.

Other deductions totaled \$15 million in 2005 and \$610 million in 2004. The 2005 amount includes:

- a \$12 million charge related to nonperformance of a counterparty in connection with a trading coal contract;
- \$12 million in transition costs associated with the Capgemini outsourcing agreement;
- \$7 million in equity losses (representing depreciation expense) in the TXU Corp. entity holding the capitalized software licensed to Capgemini;
- \$6 million in accretion expense related to the 2004 impairment of a lease for gas-fired combustion turbines no longer operated for TXU Energy Holdings' benefit;
- a \$16 million net credit adjusting the impairment loss on the leased gas-fired combustion turbines to reflect actual sub-lease proceeds under the terms of a third-party contract entered into in 2005; and
- the release of a previously recorded \$6 million reserve for restoration of property that is now expected to be used in generation plant development.

The 2004 amount includes:

- \$180 million in lease-related charges primarily related to generation and mining assets taken out of service;
- \$107 million in software write-offs;
- \$107 million for employee severance;
- \$101 million in termination costs for an existing power purchase and tolling agreement; and
- \$79 million for spare parts inventory writedowns.

Interest income increased by \$39 million to \$70 million in 2005 reflecting higher interest on short-term investments and higher average advances to affiliates.

Interest expense and related charges increased by \$40 million, or 11%, to \$393 million in 2005. The increase reflected \$26 million due to higher average interest rates and \$14 million due to higher average debt levels.

The effective income tax rate was 32.5% in 2005 and 28.4% in 2004. The increase reflects the effect of ongoing relatively fixed tax benefits of lignite depletion allowances and amortization of investment tax credits on a significantly higher 2005 income base. The 2005 effective income tax rate also reflects a \$29 million credit for the reversal of previously established tax reserves due to current period events, partially offset by \$10 million in additional tax expense related to settlement of the IRS audit for the 1994 to 1996 tax years.

Income from continuing operations increased \$1.0 billion to \$1.4 billion in 2005 driven by improved gross margin, the effect of restructuring-related charges in 2004 and lower SG&A expenses.

TXU Energy Holdings

2004 compared to 2003

Operating revenues increased \$509 million, or 6%, to \$8.5 billion in 2004. Retail electricity revenues decreased \$114 million, or 2%, to \$6.4 billion.

- The retail revenue decline reflected a \$781 million decrease attributable to a 12% drop in sales volumes, driven by the effect of competitive activity and milder weather primarily in the summer, partially offset by a \$667 million increase due to higher average pricing. Lower business market volumes also reflected a strategy to target higher margin customer segments. Higher pricing reflected increased price-to-beat rates, reflecting regulatory-approved fuel factor increases and higher pricing in the competitive business market, both resulting from higher natural gas prices.
- Retail electricity customer counts at December 31, 2004 declined 2.3% from December 31, 2003.

Wholesale electricity revenues grew \$628 million, or 50%, to \$1.9 billion reflecting a \$393 million increase attributable to a 31% rise in sales volumes and a \$235 million increase due to the effect of increased natural gas prices on wholesale prices.

Higher wholesale electricity sales volumes reflected, principally during the first half of the year, the establishment of the new northeast zone in ERCOT. Because TXU Energy Holdings has a generation plant and a relatively small retail customer base in the new zone, wholesale sales volumes increased, and wholesale power purchases also increased to meet retail sales demand in other zones and minimize congestion costs. Completion of transmission projects later in the year reduced congestion costs, resulting in normalized sales and purchase volumes. The increase in wholesale sales volumes also reflected a partial shift in TXU Energy Holdings' customer base from retail to wholesale services, particularly in the business market.

The majority of TXU Energy Holdings' natural gas physical sales and purchases are in the wholesale markets and essentially represent hedging activities. These activities are accounted for on a net basis with the exception of gas purchases for generation and retail gas sales to business customers. Effective October 1, 2003, these sales are reported gross in accordance with an accounting rule change and totaled \$126 million in revenues for the first nine months of 2004. The increase in other revenues of \$128 million to \$342 million in 2004 was primarily driven by this change.

Net results from hedging and risk management activities, which are reported in revenues and include both realized and unrealized gains and losses, declined \$133 million from a net gain of \$30 million in 2003 to a net loss of \$103 million in 2004. Results from these activities included the net effect of recording unrealized gains and losses under mark-to-market accounting, versus settlement accounting, of \$109 million in net losses in 2004 and \$100 million in net losses in 2003. Because the hedging activities are intended to mitigate the risk of commodity price movements on revenues and fuel and purchased power costs, the changes in such results should not be viewed in isolation, but rather taken together with the effects of pricing and cost changes on gross margin. The decline included:

- \$22 million in mark-to-market losses associated with required 2004 capacity auctions;
- \$19 million in increased reserves, primarily reflecting the release in 2003 of liquidity reserves related to retail contracts settled;
- \$26 million of increased cash flow hedge ineffectiveness losses;
- \$34 million of gas storage and retail gas business margin in 2003, primarily related to businesses sold in late 2003; and
- \$18 million due to a favorable settlement with a counterparty in 2003.

Gross Margin

| | Year Ended December 31, | | | |
|---|-------------------------|--------------|-----------------|--------------|
| | 2004 | % of Revenue | 2003 | % of Revenue |
| Operating revenues | \$ 8,495 | 100% | \$ 7,986 | 100% |
| Costs and expenses: | | | | |
| Fuel, purchased power costs and delivery fees | 5,265 | 62% | 5,117 | 64% |
| Operating costs | 704 | 8% | 685 | 8% |
| Depreciation and amortization | <u>327</u> | <u>4%</u> | <u>368</u> | <u>5%</u> |
| Gross margin | <u>\$ 2,199</u> | <u>26%</u> | <u>\$ 1,816</u> | <u>23%</u> |

Gross margin increased \$383 million, or 21%, to \$2.2 billion in 2004. Higher gross margin reflected initiatives taken to respond to higher natural gas prices, including retail pricing actions and more cost effective sourcing of power. The gross margin increase reflected higher retail and wholesale prices partially offset by the effect of lower retail volumes, lower results from hedging and risk management activities and increased delivery fees. The average cost per MWh of power produced and purchased was about even with 2003, as higher purchased power costs due to rising natural gas prices were largely offset by lower cost of power produced due to reduced utilization of high heat rate gas-fired generation and higher lignite and nuclear facility output. Delivery fees increased on a per MWh basis due to a lower retail clawback credit applied to delivery fees in 2004 compared to the excess mitigation credit applied in 2003, as well as increased transition charges related to the issuance of regulatory asset securitization bonds by TXU Electric Delivery.

Operating costs increased \$19 million, or 3%, to \$704 million in 2004. The increase reflected:

- \$30 million in incremental testing, inspection and component repair costs associated with the planned outage for refueling at the nuclear facility and planned lignite/coal plant outages;
- \$11 million in higher incentive compensation expense;
- an increase of \$4 million in ad valorem taxes due to higher gas prices; and
- a \$4 million increase in property insurance premiums,

partially offset by:

- a decline of \$16 million related to customer care support services previously provided to TXU Gas (largely offset by lower related revenues); and
- \$14 million due to the absence of the gas transportation subsidiary sold in June 2004 (largely offset by higher costs of energy sold related to gas-fired production).

Depreciation and amortization (including amounts shown in the gross margin table above) decreased \$57 million, or 14%, to \$350 million. The decrease was driven by extensions of estimated average depreciable lives of lignite and nuclear generation facilities' assets to better reflect their useful lives, partially offset by the effect of mining activity and the related asset retirement obligation and the effect of the transfer of information technology assets, principally capitalized software, to a TXU Corp. affiliate in connection with the Capgemini transaction. Depreciation and amortization included in gross margin represents depreciation of assets directly used in the generation of electricity.

SG&A expenses increased by \$31 million, or 5%, to \$667 million. The increase reflected:

- \$72 million in higher incentive compensation expense due to improved performance of the business and achievement of certain targets related to trading activities,

partially offset by:

- \$24 million in lower bad debt expense reflecting stricter disconnect policies, more focused collection activities, targeted customer marketing and lower accounts receivable balances;
- \$8 million from various cost reduction initiatives; and
- \$4 million in reduced marketing costs outside the historical service territory.

Other income increased by \$62 million to \$110 million in 2004. Other income in 2004 included:

- \$58 million of the remaining unamortized gain on the 2002 sale of two generation plants recognized as a result of the termination of an existing power purchase and tolling agreement;
- \$30 million in amortization of the gain on the 2002 sale of two generation plants; and
- \$19 million gain on the sale of undeveloped land.

The 2003 period also included:

- \$30 million in amortization of the gain on the 2002 sale of two generation plants; and
- a \$9 million gain on the sale of contracts related to retail gas activities outside of Texas.

Other deductions increased \$588 million to \$610 million in 2004. Other deductions in 2004 consist largely of:

- \$180 million in lease-related charges primarily related to generation and mining assets taken, or to be taken, out of service;
- \$107 million in software write-offs;
- \$107 million for employee severance;
- \$101 million in termination costs for an existing power purchase and tolling agreement; and
- \$79 million for spare parts inventory writedowns.

Interest income increased by \$23 million to \$31 million in 2004 primarily due to higher average advances to affiliates.

Interest expense and related charges increased by \$30 million, or 9%, to \$353 million in 2004. The increase reflected \$40 million due to higher average debt levels and \$12 million representing higher interest reimbursement to TXU Electric Delivery for carrying costs related to securitized regulatory assets, partially offset by \$21 million due to lower average interest rates.

The effective income tax rate decreased to 28.4% in 2004 from 31.7% in 2003 driven by the effects of ongoing tax benefits of depletion allowances and amortization of investment tax credits on a lower income base in 2004.

Income from continuing operations before cumulative effect of changes in accounting principles decreased \$89 million to \$408 million in 2004, reflecting the net restructuring related charges reported in other deductions and other income and higher SG&A expenses, partially offset by the higher gross margin. Net pension and postretirement benefit costs reduced net income by \$36 million in both 2004 and 2003.

TXU Electric Delivery**Financial Results**

| | Year Ended December 31, | | |
|---|-------------------------|---------------|---------------|
| | 2005 | 2004 | 2003 |
| Operating revenues | \$ 2,394 | \$ 2,226 | \$ 2,087 |
| Costs and expenses: | | | |
| Operating costs..... | 758 | 730 | 709 |
| Depreciation and amortization..... | 446 | 389 | 297 |
| Selling, general and administrative expenses | 201 | 219 | 207 |
| Franchise and revenue-based taxes | 247 | 248 | 250 |
| Other income | (4) | (7) | (8) |
| Other deductions | 11 | 52 | — |
| Interest income..... | (59) | (56) | (52) |
| Interest expense and related charges | <u>269</u> | <u>280</u> | <u>300</u> |
| Total costs and expenses..... | <u>1,869</u> | <u>1,855</u> | <u>1,703</u> |
| Income before income taxes, extraordinary gain and cumulative effect of change in accounting principle | 525 | 371 | 384 |
| Income tax expense | <u>174</u> | <u>116</u> | <u>126</u> |
| Income before extraordinary gain and cumulative effect of change in accounting principle | <u>\$ 351</u> | <u>\$ 255</u> | <u>\$ 258</u> |

Operating Data

| | Year Ended December 31, | | | % Change 2005/2004 | % Change 2004/2003 |
|--|-------------------------|-----------------|-----------------|-----------------------|-----------------------|
| | 2005 | 2004 | 2003 | | |
| Operating statistics – volumes: | | | | | |
| Electric energy delivered (GWh)..... | 106,780 | 101,928 | 101,810 | 4.8 | 0.1 |
| Reliability statistics (a): | | | | | |
| System Average Interruption Duration Index (SAIDI) (nonstorm)..... | 76.79 | 75.51 | 74.15 | 1.7 | 1.8 |
| System Average Interruption Frequency Index (SAIFI) (nonstorm)..... | 1.17 | 1.10 | 1.17 | 6.4 | (6.0) |
| Customer Average Interruption Duration Index (CAIDI) (nonstorm)..... | 65.60 | 68.75 | 63.30 | (4.6) | 8.6 |
| Electricity points of delivery (end of period and in thousands): | | | | | |
| Electricity distribution points of delivery (based on number of meters) (b) | 3,013 | 2,971 | 2,932 | 1.4 | 1.3 |
| Operating revenues: | | | | | |
| Electricity distribution revenues (c): | | | | | |
| Affiliated (TXU Energy Holdings) | \$ 1,276 | \$ 1,418 | \$ 1,485 | (10.0) | (4.5) |
| Nonaffiliated..... | <u>879</u> | <u>590</u> | <u>410</u> | <u>49.0</u> | <u>43.9</u> |
| Total distribution revenues | 2,155 | 2,008 | 1,895 | 7.3 | 6.0 |
| Third-party transmission revenues | 213 | 192 | 167 | 10.9 | 15.0 |
| Other miscellaneous revenues | <u>26</u> | <u>26</u> | <u>25</u> | <u>—</u> | <u>4.0</u> |
| Total operating revenues..... | <u>\$ 2,394</u> | <u>\$ 2,226</u> | <u>\$ 2,087</u> | <u>7.5</u> | <u>6.7</u> |

(a) SAIDI is the number of minutes the average customer is out of electric service in a year. SAIFI is the number of times a year that the average customer experiences an interruption to electric service. CAIDI is the duration in minutes of the average interruption to electric service.

(b) Includes lighting sites, primarily guard lights, for which TXU Energy Holdings is the REP but are not included in TXU Energy Holdings' customer count. Such sites totaled 86,495, 95,252 and 100,901 at December 31, 2005, 2004 and 2003, respectively.

(c) Includes \$152 million, \$106 million and \$19 million for the years ended December 31, 2005, 2004 and 2003, respectively, of transition charges associated with the issuance of securitization bonds. Also includes disconnect/reconnect fees and other discretionary revenues for services requested by REPs.

TXU Electric Delivery

TXU Electric Delivery’s future results are expected to be impacted by the effects of the cities rate settlement. The cities rate settlement described below under “Regulation and Rates” is expected to result in incremental expenses of approximately \$80 million, recognized almost entirely over the period from July 2006 through June 2008.

2005 compared to 2004

Operating revenues increased \$168 million, or 8%, to \$2.4 billion in 2005. This change reflected:

- \$46 million in higher transition charges associated with the issuance of securitization bonds in June 2004 (offset in total by higher amortization of the related regulatory asset as discussed below);
- approximately \$30 million related to warmer summer weather;
- \$22 million from continued implementation of power factor billing (power factor billing is a tariff adjustment applied to nonresidential end-use consumers that utilize inefficient equipment);
- \$21 million in base growth reflecting an increase in points of delivery;
- \$21 million from increased distribution tariffs to recover higher transmission costs; and
- \$21 million in increased transmission revenues due to rate increases approved in 2005 and 2004 and higher volumes.

Gross Margin

| | <u>2005</u> | <u>% of Revenue</u> | <u>2004</u> | <u>% of Revenue</u> |
|---|-----------------|---------------------|-----------------|---------------------|
| Operating revenues | \$ 2,394 | 100% | \$ 2,226 | 100% |
| Costs and expenses: | | | | |
| Transmission and distribution system operating costs..... | 758 | 32% | 730 | 33% |
| Depreciation and amortization | <u>446</u> | <u>18%</u> | <u>386</u> | <u>17%</u> |
| Gross margin | <u>\$ 1,190</u> | <u>50%</u> | <u>\$ 1,110</u> | <u>50%</u> |

Gross margin increased \$80 million, or 7%, to \$1.2 billion in 2005. The increase was driven by higher operating revenues.

Operating costs rose \$28 million, or 4%, to \$758 million. This increase reflected \$13 million in increased spending for system reliability initiatives, \$7 million in higher property taxes primarily due to increased investments in property, \$4 million in increased metering expenses due to increased labor costs to accommodate increased consumer requested activities, \$3 million in increased third-party transmission costs due to increased rates and \$3 million in higher transportation expense due to an increase in fuel and lease costs, partially offset by a \$4 million decrease in employee benefits costs, reflecting lower health care costs due to plan changes and a \$4 million reduction in pension and other postretirement benefits costs. The pension and other postretirement benefits reduction reflects an amendment to the Public Utility Regulatory Act (PURA) as discussed in Note 12 to Financial Statements.

Depreciation and amortization (consisting almost entirely of amounts shown in the gross margin table above) increased \$57 million, or 15%, to \$446 million in 2005. The increase reflected \$46 million in higher amortization of regulatory assets associated with the issuance of securitization bonds (offsetting the same amount of revenue increase) and \$14 million in higher depreciation due to normal additions and replacements of property, plant, and equipment, partially offset by a \$3 million decline reflecting the July 2004 transfer of information technology assets, principally capitalized software, to a TXU Corp. affiliate in connection with the Capgemini outsourcing transaction.

SG&A expense decreased \$18 million, or 8%, to \$201 million in 2005. The decline included \$16 million from cost reduction initiatives including the effects of the Capgemini agreement, a \$5 million decrease in employee benefits, reflecting lower health care costs due to plan changes and \$2 million reduction in pension and other postretirement benefits costs, as a result of the amendment to PURA, partially offset by \$3 million higher bad debt expense largely resulting from the establishment of an allowance for uncollectible accounts based on a credit-scoring methodology applied to outstanding REP accounts receivable.

Other deductions totaled \$11 million in 2005 and \$52 million in 2004. The 2005 amount included:

- \$3 million in costs associated with transitioning the outsourced activities to Capgemini;
- \$3 million related to TXU Electric Delivery's portion of the equity losses (representing amortization expense) of the TXU Corp. entity holding the capitalized software licensed to Capgemini; and
- \$2 million of severance-related charges stemming from the 2004 restructuring actions.

The 2004 amount included:

- a \$21 million charge for estimated settlement payments arising from the resolution of a distribution rate inquiry initiated by a number of Texas cities;
- \$20 million of severance-related charges in connection with the Capgemini outsourcing transaction and other TXU Corp. restructuring actions; and
- \$8 million related to transitioning the outsourced activities to Capgemini, including asset write-downs and other unusual charges.

Interest expense decreased \$11 million, or 4%, to \$269 million in 2005. The decrease includes \$9 million from the impact of lower average interest rates and \$2 million due to increased allowance for funds used during construction on higher construction expenditures.

The effective income tax rate increased to 33.1% in 2005 from 31.3% in 2004. The increase is due primarily to the effect of ongoing relatively fixed amortization of tax benefits (statutory tax rate changes and investment tax credits) on a higher 2005 income base, partially offset by \$4 million credit in 2005 arising from the settlement of the IRS audit for the 1994 through 1996 tax years.

Income before extraordinary gain and cumulative effect of a change in accounting principle (an after-tax measure) increased \$96 million, or 38%, to \$351 million. This increase was driven by higher operating revenues and the impact of unusual charges in 2004 reported in other deductions. Higher operating costs were partially offset by lower SG&A expenses.

TXU Electric Delivery

2004 compared to 2003

Operating revenues increased \$139 million, or 7%, to \$2.2 billion in 2004. This change reflected:

- \$87 million in higher transition charges associated with the issuance of securitization bonds in June 2004 and August 2003 (offset in total by higher amortization of the related regulatory asset as discussed below);
- \$26 million from increased distribution tariffs to recover higher transmission costs;
- \$23 million in transmission revenues from rate increases approved in 2004 and 2003;
- \$9 million from the implementation of power factor billing; and
- \$7 million in increased disconnect/reconnect fees, reflecting activities initiated by REPs; partially offset by:
- a net \$16 million in decreased revenues due to milder weather, primarily in the summer, and consumer usage efficiencies, partially offset by growth in points of delivery.

Gross Margin

| | <u>2004</u> | <u>% of Revenue</u> | <u>2003</u> | <u>% of Revenue</u> |
|---|-----------------|---------------------|-----------------|---------------------|
| Operating revenues | \$ 2,226 | 100% | \$ 2,087 | 100% |
| Costs and expenses: | | | | |
| Transmission and distribution system operating costs..... | 730 | 33% | 709 | 34% |
| Depreciation and amortization | <u>386</u> | <u>17%</u> | <u>285</u> | <u>14%</u> |
| Gross margin..... | <u>\$ 1,110</u> | <u>50%</u> | <u>\$ 1,093</u> | <u>52%</u> |

Gross margin increased \$17 million, or 2%, to \$1.1 billion in 2004. This increase was driven by higher operating revenues.

Operating costs increased \$21 million, or 3%, to \$730 million in 2004. This increase reflected \$12 million in higher third-party transmission costs, an \$8 million increase in property taxes due to property additions and increased value, a \$6 million increase in metering-related costs associated with the increased disconnect/reconnect activity, and a \$5 million increase in vegetation management to improve system reliability, partially offset by a \$4 million decrease in benefits and labor as a result of 2004 storm activity (recorded to a regulatory asset or billed to companies affected by the hurricane season) and \$6 million of various other costs that were individually insignificant.

Depreciation and amortization (consisting almost entirely of amounts shown in the gross margin table above) increased \$92 million, or 31%, to \$389 million in 2004. The increase reflected \$87 million in higher amortization of regulatory assets associated with the issuance of securitization bonds (offsetting the same amount of revenue increase) and \$13 million in higher depreciation due to normal additions and replacements of property, plant, and equipment, partially offset by a \$9 million decline reflecting the July 2004 transfer of information technology assets, principally capitalized software, to a TXU Corp. affiliate in connection with the Capgemini outsourcing transaction.

SG&A expense increased \$12 million, or 6%, to \$219 million in 2004. The increase primarily reflected an \$8 million increase in incentive compensation expense due to improved performance of the business. Increases in various costs that were individually insignificant were largely offset by lower bad debt expense reflecting a \$4 million write-off in 2003.

Other deductions totaled \$52 million in 2004 and included:

- a \$21 million charge for estimated settlement payments arising from the resolution of a distribution rate inquiry initiated by a number of Texas cities;
- \$20 million of severance-related charges in connection with the Capgemini outsourcing transaction and other cost reduction initiatives;
- \$4 million for costs associated with transitioning the outsourced activities to Capgemini;
- \$4 million in asset write-downs and other unusual charges; and
- \$2 million related to TXU Electric Delivery's portion of the equity losses (representing amortization expense) of the TXU Corp. entity holding the capitalized software licensed to Capgemini.

Interest income increased \$4 million, or 8%, to \$56 million in 2004 driven by an \$11 million increase in interest income from TXU Energy Holdings related to securitized regulatory assets, partially offset by a \$6 million decrease in interest income from TXU Energy Holdings related to the excess mitigation credit that ceased in December of 2003.

Interest expense and related charges decreased \$20 million, or 7%, to \$280 million in 2004. The decrease includes \$23 million from the impact of lower average interest rates and \$6 million in interest paid to REPs in 2003 related to the excess mitigation credit that ceased at the end of 2003, partially offset by a \$9 million impact of higher average borrowings.

The effective income tax rate decreased to 31.3% in 2004 from 32.8% in 2003. The decrease was due primarily to the favorable effects of the Medicare Act of 2003, the nontaxable prescription drug subsidy.

Income before extraordinary gain and cumulative effect of change in accounting principle (an after-tax measure) decreased \$3 million, or 1%, to \$255 million in 2004, as unusual charges reported in other deductions were partially offset by lower interest expense and higher gross margin.

COMPREHENSIVE INCOME – Continuing Operations

Cash flow hedge activity reported in other comprehensive income from continuing operations included (all amounts after-tax):

| | Year Ended December 31, | | |
|--|--------------------------------|----------------|--------------|
| | 2005 | 2004 | 2003 |
| Net change in fair value of hedges held at end of period – gains/(losses): | | | |
| Commodities | \$ (47) | \$ (75) | \$ (22) |
| Financing – interest rate swaps | <u>—</u> | <u>—</u> | <u>(63)</u> |
| | <u>(47)</u> | <u>(75)</u> | <u>(85)</u> |
| Losses related to settled hedges – effects reported in net income: | | | |
| Commodities | 64 | 21 | 46 |
| Financing – interest rate swaps | <u>13</u> | <u>23</u> | <u>76</u> |
| | <u>77</u> | <u>44</u> | <u>122</u> |
| Effect of cash flow hedges reported in other comprehensive income related to continuing operations | <u>\$ 30</u> | <u>\$ (31)</u> | <u>\$ 37</u> |

TXU Corp. has historically used, and expects to continue to use, derivative instruments that are effective in offsetting future cash flow variability in interest rates and energy commodity prices. The amounts included in accumulated other comprehensive income are expected to offset the impact of rate or price changes on forecasted transactions. Amounts in accumulated other comprehensive income include (i) the value of open cash flow hedges (for the effective portion), based on current market conditions, and (ii) the value of dedesignated and terminated cash flow hedges at the time of such dedesignation, less amortization, unless the hedged transactions become probable of not occurring. The effects of the hedge will be recorded in the statement of income as the hedged transactions are actually settled and affect earnings.

Other comprehensive income also included adjustments related to minimum pension liabilities. Minimum pension liability adjustments were a loss of \$71 million (\$46 million after-tax) in 2005, a gain of \$21 million (\$14 million after-tax) in 2004 and a gain of \$71 million (\$46 million after-tax) in 2003. The minimum pension liability represents the excess of the accumulated benefit obligation over the plans' assets and the liability recorded under SFAS 87. The recording of the minimum pension liability did not affect TXU Corp.'s financial covenants in any of its credit agreements. Changes in minimum pension liability adjustments reflect fluctuating returns on the plans' investment assets. An additional minimum pension liability adjustment of \$66 million was record as a regulatory asset in 2005.

See also Notes 12 and 15 to Financial Statements.

FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows — Cash flows provided by operating activities increased \$1.0 billion, or 59%, to \$2.8 billion in 2005. The increase was driven by higher earnings.

Cash flows provided by operating activities in 2004 decreased \$655 million, or 27%, to \$1.8 billion. The decline was driven by the effect of an income tax refund received in 2003 of approximately \$600 million.

Cash flows used in financing activities were \$1.6 billion in 2005, \$6.5 billion in 2004 and \$1.7 billion in 2003. The drivers of the \$4.9 billion decrease in cash used in financing activities from 2004 to 2005 and the \$4.8 billion increase in cash used in financing activities from 2003 to 2004 are summarized in the table below:

| | Year Ended December 31, | | |
|--|-------------------------|-------------------|-------------------|
| | 2005 | 2004 | 2003 |
| Cash used in financing activities: | | | |
| Net issuances and (repayments) of borrowings, including premiums and discounts | \$ 356 | \$ 155 | \$ (1,474) |
| Net issuances and (repurchases) of common stock | (1,054) | (4,575) | 23 |
| Repurchase of preference stock | (300) | — | — |
| Repurchase of preferred securities of subsidiaries | (38) | (75) | (98) |
| Repurchase of exchangeable preferred membership interests | — | (1,852) | — |
| Payment of common stock dividends | (544) | (150) | (160) |
| Payment of preference stock dividends | (11) | (22) | (22) |
| Excess tax benefit on stock-based compensation | 28 | — | — |
| Total | <u>\$ (1,563)</u> | <u>\$ (6,519)</u> | <u>\$ (1,731)</u> |

Investing activities used cash flows of \$1.0 billion in 2005, provided cash flows of \$4.3 billion in 2004 and used cash flows of \$1.4 billion in 2003. The table below details the business activities impacting investing cash flows.

| | Year Ended December 31, | | |
|---|-------------------------|-----------------|-------------------|
| | 2005 | 2004 | 2003 |
| Cash provided by (used in) investing activities: | | | |
| Capital expenditures, including nuclear fuel | \$ (1,104) | \$ (999) | \$ (765) |
| Sale of TXU Australia | — | 1,885 | — |
| Disposition of TXU Gas | — | 1,905 | — |
| Sale of TXU Fuel | — | 500 | — |
| Sale of telecommunications business | — | 524 | — |
| Sale of retail gas business | — | — | 14 |
| Acquisition of partners' interest in telecommunications joint venture | — | — | (150) |
| Proceeds from sale of assets | 70 | 27 | 10 |
| Return of investment (investment) in trust to support a credit facility | — | 525 | (525) |
| Capgemini working capital loan | — | (25) | — |
| Proceeds from sales of nuclear decommissioning trust fund securities | 191 | 88 | 251 |
| Investments in nuclear decommissioning trust fund securities | (206) | (103) | (266) |
| Other, including transaction costs | 11 | (47) | 31 |
| Total | <u>\$ (1,038)</u> | <u>\$ 4,280</u> | <u>\$ (1,400)</u> |

The \$105 million increase in capital expenditures, including nuclear fuel, in 2005 was driven by a \$133 million increase in spending by TXU Electric Delivery to improve system reliability and performance and to support growth, partially offset by \$30 million in decreased expenditures for nuclear fuel in 2005 reflecting timing of expenditures.

The \$234 million increase in capital expenditures, including nuclear fuel, in 2004 was driven by a \$161 million increase at TXU Energy Holdings primarily reflecting increased spending on generation projects.

Depreciation and amortization expense reported in the statement of cash flows exceeds the amount reported in the statement of income by \$60 million, \$66 million and \$67 million for 2005, 2004 and 2003, respectively. This difference represents amortization of nuclear fuel, which is reported as fuel, purchased power costs and delivery fees in the statement of income consistent with industry practice.

Capital Allocation — TXU Corp. has a capital allocation model that governs the allocation of operating cash flow and the deployment of growth capital. Under the current model, TXU Corp. intends to prioritize cash flows from operations and asset sales in the following order:

- First, to preserve and enhance the quality of customer service and production and delivery reliability. Capital expenditures for 2006 are expected to total \$830 million for increased investment in TXU Electric Delivery's transmission and distribution infrastructure and \$1.1 billion for TXU Energy Holdings' construction cost of two new lignite/coal-fired generation facilities and ongoing upgrades to its generation fleet;
- Second, to consider growth capital, or reinvestments, in the business, but in each case, subject to strict investment criteria;
- Third, to maintain balance sheet strength, financial flexibility and strong credit metrics;
- Fourth, to pay regular cash dividends targeting a payout equal to 30-40 percent of earnings adjusted for the effects of discontinued operations and unusual charges and credits; and
- Fifth, to pay cash distributions to shareholders in the form of share repurchases or special cash dividends.

New Generation Plants — In July 2005, TXU Energy Holdings filed an application for an air permit with the TCEQ for a proposed 1,720-MW lignite/coal-fired power plant in Robertson County, Texas approximately 30 miles northwest of the Bryan-College Station area. TXU Energy Holdings currently expects to proceed with the project, with construction beginning as early as 2006, and the facility operational around 2009 or 2010. Total cost of the project is estimated to be \$1.9 billion over the next four to five years. In October 2005, the Governor of the State of Texas issued Executive Order RP49 that instructed the TCEQ to prioritize and expedite the processing of environmental permits for power plants using Texas natural resources and that the subsequent administrative hearing and proposal for decision must be completed in no more than six months. In addition, TXU Energy Holdings signed a letter of intent for the development of a new 600 MW lignite/coal-fired unit adjacent to the site of TXU Power's current Sandow generation plant in Texas. Total cost of the project, which is projected to be operational in 2008 or 2009, is estimated to be \$700 million over the next three to five years.

Capital Resources — During 2006, TXU Corp. will need to fund ongoing working capital requirements and \$1.3 billion of debt maturities. TXU Corp. has funded or intends to fund these requirements through cash on hand, cash flows from operations, short-term credit facilities, commercial paper and the issuance of long-term debt or other securities.

Long-term Debt Activity — During 2005, TXU Corp. and its subsidiaries issued, reacquired, or made scheduled principal payments on long-term debt as follows (all amounts presented are principal):

| | <u>Issuances (a)</u> | <u>Retirements</u> |
|--------------------------------------|----------------------|--------------------|
| TXU Corp.: | | |
| Equity-linked..... | \$ — | \$ 106 |
| Other long-term debt..... | — | 11 |
| TXU Energy Holdings: | | |
| Pollution control revenue bonds..... | 180 | 39 |
| Other long-term debt..... | — | 32 |
| TXU Electric Delivery: | | |
| First Mortgage Bonds..... | — | 92 |
| Transition bonds..... | — | 90 |
| US Holdings: | | |
| Long-term debt..... | — | 5 |
| Total..... | <u>\$ 180</u> | <u>\$ 375</u> |

(a) Excludes \$91 principal amount of debt assumed in connection with the consolidation of the combustion turbine lease trust (see Note 5 to Financial Statements) and \$95 million capital lease liability related to a rail spur lease entered into in 2005.

See Note 7 to Financial Statements for further detail of debt issuances and retirements and financing arrangements.

Dividends — TXU Corp. has declared common stock dividends payable in cash every year since 1945. In November of 2005, TXU Corp.'s board of directors revised TXU Corp.'s dividend and cash distribution policy, setting the common stock dividend at an annual rate of \$1.65 per share, a 47 percent increase over the previous quarter's annualized rate, with an expectation of a high performance annual dividend growth rate thereafter. While the level of a high performance dividend growth rate may change, TXU Corp. believes the rate is currently in the 5% annual growth rate range. The dividend rate and annual dividend growth rate will be subject to regular review by TXU Corp.'s board of directors and may be changed based upon a number of factors. Consistent with the revised policy, on November 4, 2005, TXU Corp.'s board of directors declared a common stock dividend of 41.25 cents per share that was paid on January 3, 2006 to shareholders of record as of December 19, 2005. At its February 2006 meeting, the TXU Corp.'s board of directors declared a common stock dividend of 41.25 cents per share that will be paid on April 3, 2006 to shareholders of record as of March 3, 2006.

Common Stock Repurchase — In November of 2005, the TXU Corp. board of directors authorized the repurchase of up to 34 million shares of common stock through the end of 2006. Also, TXU Corp. repurchased and retired in November 2005 12 million of the authorized 34 million shares of its outstanding common stock at an average price of \$49.51 per share (including related fees and expenses). As of February 22, 2006, TXU Corp. has repurchased an additional 8,097,526 shares of the authorized 34 million shares of its common stock at an average price of \$50.31 per share (including related fees and expenses).

Credit Facilities — At March 1, 2006, TXU Corp. had access to credit facilities totaling \$5.0 billion of which \$3.8 billion was unused. The facilities expire on various dates between June 2008 and June 2010. The maximum amount TXU Energy Holdings and TXU Electric Delivery can directly access under the facilities is \$5.0 billion and \$3.6 billion, respectively. These credit facilities are used for working capital and general corporate purposes. See Note 6 to Financial Statements for details of the arrangements.

Registered Financing Arrangements — TXU Corp. currently has an effective shelf registration statement on file with the SEC for issuances of up to \$2.0 billion of equity securities, equity-linked debt securities, debt securities and/or preferred securities of subsidiary trusts.

Other Capital Transactions — See Note 8 to Financial Statements for share activity related to certain savings and investment plans.

Capitalization — The capitalization ratios of TXU Corp. at December 31, 2005, consisted of 1.5% equity-linked debt securities, 94.5% other long-term debt, less amounts due currently and 4.0% common stock equity. Total debt to capitalization, including short-term debt, was 96% and 95% at December 31, 2005 and 2004, respectively.

Short-term Borrowings — At December 31, 2005, TXU Corp. had outstanding short-term borrowings consisting of bank borrowings under the credit facilities of \$440 million and commercial paper of \$358 million at a weighted average interest rate of 4.69%. At December 31, 2004, TXU Corp. had outstanding short-term borrowings consisting of bank borrowings of \$210 million at a weighted average interest rate of 5.25%.

In November 2005, TXU Energy Holdings and TXU Electric Delivery reentered the commercial paper market through their existing commercial paper programs. The commercial paper programs fund short-term liquidity requirements and allow TXU Energy Holdings and TXU Electric Delivery to issue up to \$2.4 billion and \$1.0 billion of commercial paper, respectively. These programs are supported by existing credit facilities.

Sale of Receivables — TXU Corp. has had an accounts receivable securitization program in place for a number of years. The activity under this program is accounted for as a sale of accounts receivable in accordance with SFAS 140. Under the program, subsidiaries of TXU Corp. (originators) sell trade accounts receivable to TXU Receivables Company, a consolidated wholly-owned bankruptcy remote direct subsidiary of TXU Corp., which sells undivided interests in the purchased accounts receivable for cash to special purpose entities established by financial institutions. Effective June 2005, the program was extended until June 2008. All new trade receivables under the program generated by the originators are continuously purchased by TXU Receivables Company with the proceeds from collections of receivables previously purchased. Funding under the program at December 31, 2005 and 2004 totaled \$671 million and \$474 million, respectively. See Note 6 to Financial Statements for a more complete description of the program including the impact on the financial statements for the periods presented and the contingencies that could result in termination of the program.

Commodity Price Risk Management Program — As discussed in Management's Discussion & Analysis above under "Key Challenges and Initiatives," TXU Corp. has been supplementing its hedging and risk management portfolio with market instruments that are expected to reduce exposure to changes in natural gas prices over the next five years. This program could result in an increased demand on liquidity due to the potential need to post collateral with commodity contract counterparties in the event natural gas prices increase. Such collateral can be in the form of cash or letters of credit. As part of its ongoing credit and cash management practices, TXU Corp. seeks to optimize the deployment of cash and/or letters of credit in managing this program. For each \$1.00 per MMBtu increase in natural gas prices and assuming all the transactions in the program relied on cash-based collateral, TXU Corp. could be required to post up to approximately \$400-450 million in additional cash collateral.

Commodity Contract Collateral Received — TXU Energy Holdings has the contractual right, but not the obligation, to request collateral from certain counterparties based on the value of the contract and the credit worthiness of the counterparty. This collateral is typically held by TXU Energy Holdings in the form of cash or letters of credit. Collateral received in cash is used for working capital and other corporate purposes, including reducing short-term borrowings under its credit facilities. As of December 31, 2005, TXU Energy Holdings held collateral from counterparties in the form of cash of \$357 million. Counterparties may elect to convert the cash collateral to letters of credit at their discretion.

Income Tax Payments — In 2005, TXU Corp. paid federal income taxes totaling approximately \$90 million, of which \$30 million related to tax audits of discontinued operations. Absent the effects of any potential transactions, income tax payments in 2006 are estimated to be between \$100 and \$200 million. This estimate reflects an approximate net \$600 million cash tax benefit arising primarily from a deduction TXU Corp. expects to report on its 2005 federal income tax return for market value losses related to a power sales agreement. The relatively small tax payments in 2005 related to continuing operations reflect usage of net operating loss carryforwards and an approximate \$200 million benefit related to the market value loss deduction.

This market value adjustment for tax purposes will be remeasured at the end of each year and will reverse within the remaining 33 years of the agreement. However, because the market value is dependent on forward power prices, the tax benefit to be realized on the 2005 tax return could reverse rapidly with declines in power prices from levels assumed in forward price curves as of year-end 2005. Conversely, additional tax benefits could be realized within the remaining term of the agreement if forward power prices increase. Any such downward or upward changes in price curves would impact cash tax payments in years after 2006.

This deduction is subject to future audit by the IRS, as with all positions taken on the tax return, which may result in the deduction being disallowed in part or in total.

Purchase of Lease Trust Interest — In December 2005, TXU Corp. agreed to purchase, for \$69 million in cash, the owner participants interest in a trust established to lease combustion turbines to TXU Corp. The transaction is expected to close in March 2006. See Note 5 to Financial Statements.

Credit Ratings — Current credit ratings for TXU Corp. and certain of its subsidiaries are presented below:

| | TXU Corp. (Senior Unsecured) | US Holdings (Senior Unsecured) | TXU Electric Delivery (Senior Unsecured) | TXU Energy Holdings (Senior Unsecured) |
|---------------|---------------------------------|-----------------------------------|--|--|
| S&P | BB+ | BB+ | BBB- | BBB- |
| Moody's | Ba1 | Baa3 | Baa2 | Baa2 |
| Fitch..... | BBB- | BBB- | BBB+ | BBB |

In October 2005, TXU Electric Delivery invoked the lien provision of the indenture of its Senior Secured Notes. With this action the liens associated with its outstanding secured debt have been released resulting in such debt becoming unsecured and equally ranked with its other unsecured obligations. Subsequently, Moody's lowered its rating of TXU Electric Delivery's Senior Secured Notes to the same rating as its existing senior unsecured debt. Moody's currently maintains a stable outlook for TXU Corp., US Holdings, TXU Energy Holdings and TXU Electric Delivery. Fitch changed its outlook to negative for TXU Corp., US Holdings and TXU Energy Holdings and reaffirmed its stable outlook for TXU Electric Delivery in May 2005.

In June 2005, S&P lowered its rating of the senior unsecured debt of TXU Corp., US Holdings and TXU Energy Holdings one notch. S&P also changed its rating outlook for TXU Corp. and all of its rated subsidiaries to stable from "CreditWatch Negative." The one level downgrade of TXU Energy Holdings by S&P resulted in approximately \$50 million of cash collateral requirements.

These ratings are investment grade, except for Moody's and S&P's rating of TXU Corp.'s senior unsecured debt and S&P's rating of US Holdings' senior unsecured debt, which are one notch below investment grade.

A rating reflects only the view of a rating agency, and is not a recommendation to buy, sell or hold securities. Any rating can be revised upward or downward at any time by a rating agency if such rating agency decides that circumstances warrant such a change.

Financial Covenants, Credit Rating Provisions and Cross Default Provisions — The terms of certain financing arrangements of subsidiaries of TXU Corp. contain financial covenants that require maintenance of specified fixed charge coverage ratios and leverage ratios and/or contain minimum net worth covenants. As of December 31, 2005, TXU Corp. was in compliance with all such applicable covenants.

Material Credit Rating Covenants

TXU Energy Holdings has provided a guarantee of the obligations under TXU Corp.'s lease of its headquarters building. In the event of a downgrade of TXU Energy Holdings' credit rating to below investment grade, a letter of credit of approximately \$109 million at December 31, 2005 would need to be provided within 30 days of any such rating decline.

Under the terms of a rail car lease with \$53 million in remaining lease payments (principal amount as of December 31, 2005), if TXU Energy Holdings' credit rating were downgraded to below investment grade by any specified rating agency, TXU Energy Holdings could be required to sell the interest in the lease, assign the lease to a new obligor that is investment grade, post a letter of credit or defease the lease.

TXU Energy Holdings has entered into certain commodity contracts that in some instances give the other party the right, but not the obligation, to request TXU Energy Holdings to post collateral in the event that its credit rating falls below investment grade. Based on its current commodity contract positions, in the event TXU Energy Holdings were downgraded to one level below investment grade by specified rating agencies, counterparties would have the option, based on reduced credit thresholds, to request TXU Energy Holdings to post \$145 million in addition to existing collateral requirements as of December 31, 2005. Should TXU Energy Holdings be downgraded two levels below investment grade, counterparties would have the option to request additional collateral of up to approximately \$54 million at December 31, 2005. The amount TXU Energy Holdings could be required to post under these transactions depends in part on the value of the contracts at that time.

ERCOT also has rules in place to assure adequate credit worthiness for parties that schedule power on the ERCOT System. Under those rules, if TXU Energy Holdings' credit rating was downgraded to below investment grade by any specified rating agency, TXU Energy Holdings could be required to post collateral, but as of December 31, 2005 there was no exposure and no requirement to post collateral.

Other arrangements of TXU Corp., including credit facilities and certain leases, contain terms pursuant to which the interest rates charged under the agreements may be adjusted depending on credit ratings.

Material Cross Default Provisions

Certain financing arrangements contain provisions that would result in an event of default if there were a failure under other financing arrangements to meet payment terms or to observe other covenants that would result in an acceleration of payments due. Such provisions are referred to as "cross default" provisions.

A default by TXU Energy Holdings or TXU Electric Delivery or any subsidiary thereof in respect of indebtedness in a principal amount in excess of \$50 million would result in a cross default under joint credit facilities totaling \$4.5 billion. Under these credit facilities, a default by TXU Energy Holdings or any subsidiary thereof would cause the maturity of outstanding balances under such facility to be accelerated as to TXU Energy Holdings but not as to TXU Electric Delivery. Also, under these credit facilities, a default by TXU Electric Delivery or any subsidiary thereof would cause the maturity of outstanding balances under such facility to be accelerated as to TXU Electric Delivery but not as to TXU Energy Holdings.

The accounts receivable securitization program also contains a cross default provision with a threshold of \$50 million applicable to each of the originators under the program. TXU Receivables Company and TXU Business Services Company each have a cross default threshold of \$50 thousand. If either an originator, TXU Business Services or TXU Receivables Company defaults on indebtedness of the applicable threshold, the facility could terminate.

TXU Corp. enters into energy-related and financial contracts, the master forms of which contain provisions whereby an event of default or acceleration of settlement would occur if TXU Corp. were to default under an obligation in respect of borrowings in excess of thresholds, which vary, stated in the contracts.

Other arrangements, including leases, have cross default provisions, the triggering of which would not result in a significant effect on liquidity.

Long-term Contractual Obligations and Commitments — The following table summarizes TXU Corp.'s contractual cash obligations as of December 31, 2005 (see Notes 7 and 9 to Financial Statements for additional disclosures regarding these obligations).

| <u>Contractual Cash Obligations</u> | <u>Less Than One Year</u> | <u>One to Three Years</u> | <u>Three to Five Years</u> | <u>More Than Five Years</u> | <u>Total</u> |
|--|-------------------------------|-----------------------------------|------------------------------------|-------------------------------------|------------------|
| Long-term debt – principal | \$ 1,249 | \$ 1,085 | \$ 1,264 | \$ 8,946 | \$ 12,544 |
| Long-term debt – interest (a) | 717 | 1,310 | 1,172 | 6,418 | 9,617 |
| Operating and capital leases (b)..... | 57 | 115 | 106 | 408 | 686 |
| Obligations under commodity purchase and services agreements (c) ... | <u>3,094</u> | <u>2,454</u> | <u>924</u> | <u>1,333</u> | <u>7,805</u> |
| Total contractual cash obligations (d)..... | <u>\$ 5,117</u> | <u>\$ 4,964</u> | <u>\$ 3,466</u> | <u>\$ 17,105</u> | <u>\$ 30,652</u> |

- (a) Includes net amounts payable under interest rate swaps. Variable interest payments and net amounts payable under interest rate swaps are calculated based on interest rates in effect at December 31, 2005.
- (b) Includes short-term noncancelable leases.
- (c) Includes capacity payments, gas take-or-pay contracts, coal contracts, business services outsourcing and other purchase commitments. Amounts presented for variable priced contracts assumed the year-end 2005 price remained in effect for all periods except where contractual price adjustment or index-based prices were specified.
- (d) Table does not include estimated 2006 funding of the pension and other postretirement benefits plans totaling approximately \$51 million.

The following contractual obligations were excluded from the table above:

- contracts between affiliated entities and intercompany debt;
- individual contracts that have an annual cash requirement of less than \$1 million (however, multiple contracts with one counterparty that are more than \$1 million on an aggregated basis have been included);
- contracts that are cancelable without payment of a substantial cancellation penalty;
- Cities rate settlement agreement, which is discussed below; and
- employment contracts with management.

Guarantees — See Note 9 to Financial Statements for details of guarantees.

OFF BALANCE SHEET ARRANGEMENTS

TXU Corp. has established an accounts receivable securitization program. See discussion above under “Sale of Receivables” and in Note 6 to Financial Statements.

TXU Corp. has an ownership interest in the Capgemini outsourcing business. See Note 13 to Financial Statements.

Also see Note 9 to Financial Statements regarding guarantees.

COMMITMENTS AND CONTINGENCIES

See Note 9 to Financial Statements for discussion of commitments and contingencies.

REGULATION AND RATES

See Note 16 to Financial Statements for discussion of price-to-beat rates and other matters related to the Texas electric industry restructuring legislation.

Price-to-Beat Rates — TXU Corp. implemented two retail price-to-beat rate increases in 2005. The first was implemented in May and raised the average monthly residential bill by 10%.

Prior to filing for its second 2005 adjustment to its price-to-beat rates, TXU Energy Holdings engaged in extensive informal discussions with commissioners, Commission staff and the statutory consumer advocate Office of Public Counsel (OPC) regarding their perception of a gas price “bubble” resulting from Hurricane Katrina in relation to the Fuel Factor Adjustment within the price-to-beat rate calculation. TXU Energy Holdings was successful in advocating that there was no need for a moratorium on fuel factor adjustments, and reached an agreement with the Commission Staff and OPC that allowed a two-step implementation of a fuel adjustment in its price-to-beat rates. The filing for an increase in the price-to-beat rate was subsequently approved on October 28, 2005. In accordance with the agreement, TXU Energy Holdings voluntarily implemented an across-the-board discount for all price-to-beat rate customers through the end of 2005. The discount resulted in a price equivalent to rates based on natural gas prices in the week prior to Hurricane Katrina making landfall on the Gulf Coast, or \$9.743 per MMBtu. The discounted price-to-beat rate increase raised the average monthly residential bill by 12%. The discount expired on December 31, 2005. The undiscounted price-to-beat rate increase that became effective on January 1, 2006 reflects the commodity price level of \$11.534 per MMBtu as of the October filing and raised the average monthly residential bill by an additional 12%. The January 1, 2006 adjustment, under the terms of the agreement, did not count as one of the two allowed 2006 adjustments because it simply represents the expiration of the discount, not another increase in the fuel factor component of the price-to-beat rate.

In October 2005 TXU Energy Holdings announced a voluntary program to not increase the price-to-beat rate for the entire first quarter of 2006 for all residential and small business customers in TXU Energy Holdings’ historical service territory. This program took effect subsequent to the undiscounted price-to-beat rate increase that became effective in January 2006 as discussed immediately above.

In December 2005, the Commission staff issued an extensive list of questions regarding the price-to-beat rate mechanism, including the transition away from the price-to-beat rate on January 1, 2007. TXU Energy Holdings was instrumental in forming a coalition including almost all of the major retail electric providers in Texas. The coalition drafted and submitted comments to the Commission detailing the public policy and legal reasons that the price-to-beat rate-setting methodology should remain unchanged through 2006 and then expire as scheduled on January 1, 2007. Certain parties have submitted proposals to the Commission for other models, and Commission staff may address the issues over the next several months. In addition, a hearing held in late 2005 by the Texas House Committee on Regulated Industries (Committee) focused on the effects of retail competition in the Texas electric market. Although the testimony generally praised the market structure, Committee members expressed some concern regarding retail electric prices and whether competition is producing better prices than regulation. The commissioners expressed continuing support for competition, as did the major competitive retailers. In February 2006, in response to a Committee member’s request, the Commission released its study of retail electric prices, in which it concluded that competition has provided lower prices than regulation would have in each of the years 2002, 2003, 2004 and 2005. The Commission also concluded that the price-to-beat rates of TXU Energy Holdings and Reliant Energy were lower in each of those years than regulated rates would have been. One or more additional hearings may occur in 2006.

Transmission Rates — In April 2005, the Commission approved TXU Corp.’s February 2005 request for an increase in the interim wholesale transmission rate, which was effective immediately. This resulted in an annualized revenue increase of \$23 million. Approximately \$14 million of this increase is recoverable through transmission rates charged to wholesale customers, and the remaining \$9 million is recoverable from REPs through the retail transmission cost recovery factor (TCRF) component of TXU Electric Delivery’s retail delivery rates charged to REPs.

In February 2006, TXU Electric Delivery filed an application for an interim update of its wholesale transmission rate. If approved, annualized revenues will increase by approximately \$19 million. Approximately \$12 million of this increase is recoverable through transmission rates charged to wholesale customers, and the remaining \$7 million is recoverable from REPs through the TCRF component of TXU Electric Delivery's delivery rates charged to REPs.

Cities Rate Settlements — In 2004, certain cities within TXU Corp.'s historical service territory, acting in their role as a regulatory authority (with original jurisdiction), initiated inquiries to determine if the rates of TXU Electric Delivery, which have been established by the Commission, are just and reasonable. Twenty-three cities passed such resolutions (and eleven passed resolutions supporting the other cities). TXU Electric Delivery entered into an agreement with a steering committee representing these and certain other cities, finalized in February 2005, under which TXU Electric Delivery agreed to file a rate case in 2006 and make settlement payments to all cities served of approximately \$21 million. TXU Electric Delivery recorded a charge of this amount in the fourth quarter of 2004. The final settlement amount, including payments to nonlitigant cities, totaled \$22.3 million resulting in an additional charge of approximately \$1 million in 2005. Through December 31, 2005, TXU Electric Delivery has made payments of approximately \$11.6 million under the terms of the settlement and will make additional payments of \$10.7 million in 2006.

In January 2006, TXU Electric Delivery agreed with the same steering committee to defer the filing of a system-wide rate case with the Commission to no later than June 30, 2008 (based on a test year ending December 31, 2007), unless the Cities and TXU Electric Delivery mutually agree that such a filing is unnecessary. The agreement requires payments to the cities of approximately \$80 million, including incremental franchise fees. The terms of the agreement include:

- approximately \$40 million in cash payments to the Cities from January 2006 through mid-2009;
- an estimated \$28 million aggregate increase in future franchise fee payments to all cities in its service territory over the period from January 2006 through mid-2009; and
- an estimated \$12 million in cash payments to extend the benefits of the agreement to the other cities it serves.

Essentially all of this amount will be recognized ratably in earnings over the period from July 2006 through June 2008. Payments under the agreement are expected to be made until new tariffs are effective, which based upon an assumed June 2008 rate case filing, is projected to be mid-2009. Payments under the agreement will total approximately \$17 million in 2006, \$30 million in 2007, \$21 million in 2008 and \$12 million in 2009.

ERCOT Market Legislative Issues — PURA and the Commission were subject to "sunset review" by the Texas Legislature in the 2005 legislative session, which now stands adjourned. Sunset review entailed, generally, a comprehensive review of the need for and efficacy of an administrative agency (e.g., the Commission), along with an evaluation of the advisability of any changes to that agency's authorizing legislation (e.g., PURA). As part of the sunset review process, the legislative Sunset Advisory Commission recommended that the Legislature reauthorize the Commission for six years, and recommended other changes to PURA. Senate Bill (SB) 408, which was passed by the Texas Legislature, reauthorized the Commission for six years, adjusted the governance of ERCOT, and clarified that the Commission has full oversight of the independent grid operator (ERCOT). The legislation also created a new independent market monitor in ERCOT. TXU Corp. cannot predict the outcome of resultant Commission rulemakings or other regulatory proceedings related to SB 408.

In addition to the general session, the 79th Texas Legislature completed two special sessions called by the governor to consider school finance and associated tax provisions along with various other matters. During these sessions the Legislature was unable to reach consensus on the school finance matters but acted on several other matters including an extension and expansion of the Renewable Portfolio Standard (RPS) in ERCOT. The existing Texas RPS called for the addition of 2,000 MW of new renewable resources in Texas by 2009. The new RPS passed by the Legislature in special session increases the amount of new renewable resources in Texas by an additional 3,000 MW to 5,000 MW by 2015. At this time, TXU Corp. is unable to quantify the impact of the extension and expansion of the RPS on its future operations. Because the Legislature was not successful in resolving the school finance issues, TXU Corp. anticipates another special session of the Legislature in 2006. Although the primary focus of the special session would again be school finance, it is possible that the Legislature will take up other matters, as it did during the prior special sessions. TXU Corp. cannot predict whether industry-related legislation will be introduced, or whether such legislation, if introduced, would be passed.

Regulatory Recovery of Pension and Other Postretirement Benefit Costs — In the recent Texas legislative session, an amendment to PURA relating to pension and other postretirement benefit costs was enacted. See Note 12 to Financial Statements.

Wholesale Market Design – In August 2003, the Commission adopted a rule that, when implemented, will alter the wholesale market design in ERCOT. The rule requires ERCOT:

- to use a stakeholder process to develop a new wholesale market model;
- to operate a voluntary day-ahead energy market;
- to directly assign all congestion rents to the resources that caused the congestion;
- to use nodal energy prices for resources;
- to provide information for energy trading hubs by aggregating nodes;
- to use zonal prices for loads; and
- to provide congestion revenue rights (but not physical rights).

The Commission has determined that ERCOT will implement a market design that utilizes nodal pricing for resources and that this market design is to be implemented on or about January 1, 2009. In light of this decision, ERCOT has filed a set of Nodal Protocols for Commission approval that describes the operation of an ERCOT wholesale nodal market design. A contested case proceeding to evaluate and either approve these protocols or approve them with revisions is currently underway at the Commission. A decision in this case is expected in early 2006. At this time, TXU Corp. is unable to predict the impact of the proposed nodal wholesale market design on its operations.

Energy Policy Act — The Energy Policy Act of 2005 was passed by both houses of the US Congress and was signed into law by the President on August 8, 2005. The Energy Policy Act, among other things, repealed the Public Utility Holding Company Act (PUHCA) as of February 8, 2006 and extended the Price-Anderson Act for twenty years. Among other matters, PUHCA had limited the operations and ownership of public utilities to contiguous geographical areas in the US and the ability of nonutility companies to own or merge with public utilities. The FERC has been charged with adopting rules regarding certain new authority afforded it that is more limited than the authority conferred upon the SEC by PUHCA. The FERC has adopted rules implementing PUHCA repeal and has initiated additional rulemakings to implement various other provisions of the Energy Policy Act. The Price-Anderson Act provides financial protection for the public in the event of a significant power plant incident by setting the statutory limit of public liability for a single nuclear incident and requiring nuclear power plant operators to provide financial protection for that limit. As rules are enacted with respect to implementation and interpretation of the new law, TXU Corp. will assess the expected effects of the bill on its businesses.

Summary — Although TXU Corp. cannot predict future regulatory or legislative actions or any changes in economic and securities market conditions, no changes are expected in trends or commitments, other than those discussed in this report, which might significantly alter its basic financial position, results of operations or cash flows.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Market risk is the risk that TXU Corp. may experience a loss in value as a result of changes in market conditions affecting commodity prices and interest rates, which TXU Corp. is exposed to in the ordinary course of business. TXU Corp.'s exposure to market risk is affected by a number of factors, including the size, duration and composition of its energy and financial portfolio, as well as the volatility and liquidity of markets. TXU Corp. enters into financial instruments such as interest rate swaps to manage interest rate risks related to its indebtedness, as well as exchange traded, over-the-counter contracts and other contractual commitments to manage commodity price risk as part of its wholesale activities.

RISK OVERSIGHT

TXU Corp.'s wholesale business manages the market, credit and operational risk related to commodity prices of the unregulated energy business within limitations established by senior management and in accordance with TXU Corp.'s overall risk management policies. Interest rate risks are managed centrally by the corporate treasury function. Market risks are monitored daily by risk management groups that operate and report independently of the wholesale operations, utilizing industry accepted practices and analytical methodologies. These techniques measure the risk of change in value of the portfolio of contracts and the hypothetical effect on this value from changes in market conditions and include, but are not limited to, Value at Risk (VaR) methodologies.

TXU Corp. has a corporate risk management organization that is headed by a Chief Risk Officer. The Chief Risk Officer, through his designees, enforces all applicable risk limits, including the respective policies and procedures to ensure compliance with such limits and evaluates the risks inherent in the various businesses of TXU Corp. and their associated transactions. Key risk control activities include, but are not limited to, credit review and approval, operational and market risk measurement, validation of transaction capture, portfolio valuation and daily portfolio reporting, including mark-to-market valuation, VaR and other risk measurement metrics.

COMMODITY PRICE RISK

TXU Corp. is subject to the inherent risks of market fluctuations in the price of electricity, natural gas and other energy-related products marketed and purchased. TXU Corp. actively manages its portfolio of owned generation assets, fuel supply and retail sales load to mitigate the near-term impacts of these risks on its results of operations. TXU Corp., as well as any participant in the market, cannot fully manage the long-term value impact of structural declines or increases in natural gas, power and oil prices and spark spreads (differences between the market price of electricity and its cost of production).

In managing energy price risk, TXU Corp. enters into a variety of market transactions including, but not limited to, short- and long-term physical contracts, exchange traded and over-the-counter financial contracts and bilateral contracts with customers. TXU Corp.'s wholesale operations incorporate hedging activities, the structuring of long-term contractual arrangements as well as proprietary trading. The operation continuously monitors the valuation of identified risks and adjusts the portfolio based on current market conditions. Valuation adjustments or reserves are established in recognition that certain risks exist until full delivery of energy has occurred, counterparties have fulfilled their financial commitments and related contracts have either matured or are closed out. TXU Corp. strives to use consistent assumptions regarding forward market price curves in evaluating and recording the effects of commodity price risk.

Natural Gas Price & Market Heat Rate Exposure — See discussion in Management's Discussion & Analysis above under "Key Challenges and Initiatives."

VaR Methodology — A VaR methodology is used to measure the amount of market risk that exists within the portfolio under a variety of market conditions. The resultant VaR produces an estimate of a portfolio's potential for loss given a specified confidence level and considers among other things, market movements utilizing standard statistical techniques given historical and projected market prices and volatilities. Stress testing of market variables is also conducted to simulate and address abnormal market conditions.

The use of this method requires a number of key assumptions, such as use of (i) an assumed confidence level; (ii) an assumed holding period (i.e. the time necessary for management action, such as to liquidate positions); and (iii) historical estimates of volatility and correlation data.

VaR for Energy Contracts Subject to Mark-to-Market Accounting — This measurement estimates the potential loss in economic value, due to changes in market conditions, of all energy-related contracts subject to mark-to-market accounting, based on a specific confidence level and an assumed holding period. Assumptions in determining this VaR include using a 95% confidence level and a five-day holding period. A probabilistic simulation methodology is used to calculate VaR, and is considered by management to be the most effective way to estimate changes in a portfolio's value based on assumed market conditions for liquid markets.

| | December 31, | |
|----------------------------------|--------------|-------|
| | 2005 | 2004 |
| Period-end MtM VaR: | \$ 19 | \$ 20 |
| Average Month-end MtM VaR: | \$ 20 | \$ 20 |

Earnings at Risk (EaR) — EaR measures the estimated potential reduction of expected pretax earnings for the year presented due to changes in market conditions. EaR metrics include the owned generation assets, estimates of retail load and all contractual positions except for accrual positions expected to be settled beyond the fiscal year. Assumptions include using a 95% confidence level over a five-day holding period under normal market conditions.

Cash Flow at Risk (CFaR) — CFaR measures the estimated potential loss of expected cash flow over the next six months, due to changes in market conditions. CFaR metrics include all owned generation assets, estimates of retail load and all contractual positions that impact cash flow during the next six months. Assumptions include using a 99% confidence level over a six-month holding period under normal market conditions.

| | December 31 , | |
|-------------------|---------------|--------|
| | 2005 | 2004 |
| EaR | \$ 32 | \$ 24 |
| CFaR | \$ 71 | \$ 116 |

INTEREST RATE RISK

The table below provides information concerning TXU Corp.'s financial instruments as of December 31, 2005 and 2004 that are sensitive to changes in interest rates, which include debt obligations and interest rate swaps. TXU Corp. has entered into interest rate swaps under which it has agreed to exchange the difference between fixed-rate and variable-rate interest amounts calculated with reference to specified notional principal amounts at dates that generally coincide with interest payments. The weighted average interest rate presented is based on the rate in effect at the reporting date. Capital leases, the effects of unamortized premiums and discounts and fair value hedges are excluded from the table. See Note 7 to Financial Statements for a discussion of changes in debt obligations.

| | Expected Maturity Date | | | | | | There- After | 2005 Total Carrying Amount | 2005 Total Fair Value | 2004 Total Carrying Amount | 2004 Total Fair Value |
|---------------------------|------------------------|--------|--------|---------|--------|----------|-----------------|-------------------------------------|--------------------------------|-------------------------------------|--------------------------------|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | | | | | |
| Equity-linked debt: | | | | | | | | | | | |
| Fixed rate debt amount | — | — | \$ 179 | — | — | — | \$ 179 | \$ 289 | \$ 285 | \$ 339 | |
| Average interest rate | — | — | 5.80% | — | — | — | 5.80% | — | 5.68% | — | |
| All other long-term debt: | | | | | | | | | | | |
| Fixed rate debt | | | | | | | | | | | |
| amount (a) | \$ 849 | \$ 330 | \$ 576 | \$1,129 | \$ 135 | \$ 8,474 | \$11,493 | \$11,735 | \$ 11,560 | \$ 12,227 | |
| Average interest rate | 5.95% | 4.90% | 5.90% | 4.81% | 5.46% | 6.41% | 6.14% | — | 6.17% | — | |
| Variable rate debt amount | | | | | | | | | | | |
| amount | \$ 400 | — | — | — | — | \$ 472 | \$ 872 | \$ 867 | \$ 802 | \$ 764 | |
| Average interest rate | 4.92% | — | — | — | — | 3.81% | 4.32% | — | 2.37% | — | |
| Fixed to variable swaps: | | | | | | | | | | | |
| Debt amount | \$ 600 | \$ 200 | \$ 450 | \$ 450 | — | \$ 1,700 | \$ 3,400 | \$ (71) | \$ 2,300 | \$ (24) | |
| Average pay rate | 8.64% | 6.13% | 7.57% | 5.33% | — | 5.77% | 6.48% | — | 5.18% | — | |
| Average receive rate | 6.38% | 5.00% | 6.24% | 4.80% | — | 6.19% | 5.97% | — | 6.07% | — | |

(a) Reflects the maturity date and not the remarketing date for certain debt that is subject to mandatory tender for remarketing prior to maturity. See Note 7 to Financial Statements for details concerning long-term debt subject to mandatory tender for remarketing.

CREDIT RISK

Credit Risk — Credit risk relates to the risk of loss associated with nonperformance by counterparties. TXU Corp. maintains credit risk policies with regard to its counterparties to minimize overall credit risk. These policies require an evaluation of a potential counterparty's financial condition, credit rating and other quantitative and qualitative credit criteria and specify authorized risk mitigation tools including, but not limited to, use of standardized agreements that allow for netting of positive and negative exposures associated with a single counterparty. TXU Corp. has standardized documented processes for monitoring and managing its credit exposure including methodologies to analyze counterparties' financial strength, measurement of current and potential future credit exposures and standardized contract language that provides rights for netting and set-off. Credit enhancements such as parental guarantees, letters of credit, surety bonds and margin deposits are also utilized. Additionally, individual counterparties and credit portfolios are managed to preset limits and stress tested to assess potential credit exposure. This evaluation results in establishing credit limits or collateral requirements prior to entering into an agreement with a counterparty that creates credit exposure to TXU Corp. Additionally, TXU Corp. has established controls to determine and monitor the appropriateness of these limits on an ongoing basis. Any prospective material adverse change in the payment history or financial condition of a counterparty or downgrade of its credit quality will result in the reassessment of the credit limit with that counterparty. This process can result in the subsequent reduction of the credit limit or a request for additional financial assurances.

Credit Exposure — TXU Corp.'s gross exposure to credit risk related to trade accounts receivable, as well as commodity contract assets and other derivative assets that arise primarily from hedging and commercial activities, totaled \$3.3 billion at December 31, 2005.

A large share of gross assets subject to credit risk represents accounts receivable from the retail sale of electricity to residential and small business customers. The risk of material loss (after consideration of allowances) from nonperformance by these customers is unlikely based upon historical experience. Allowances for uncollectible accounts receivable are established for the potential loss from nonpayment by these customers based on historical experience and market or operational conditions. In addition, TXU Electric Delivery has exposure to credit risk as a result of nonperformance by nonaffiliated REPs.

Most of the remaining trade accounts receivable is with large business customers and wholesale counterparties. These counterparties include major energy companies, financial institutions, electric utilities, independent power producers, oil and gas producers, local distribution companies and energy trading and marketing companies. The exposure to credit risk from these customers and counterparties, excluding credit collateral, as of December 31, 2005, is \$2.0 billion net of standardized master netting contracts and agreements that provide the right of set-off of positive and negative credit exposures with individual customers and counterparties. When considering collateral currently held by TXU Corp. (cash, letters of credit and other security interests), the net credit exposure is \$1.4 billion. Of this amount, approximately 78% of the associated exposure is with investment grade customers and counterparties, as determined using publicly available information including major rating agencies' published ratings and TXU Corp.'s internal credit evaluation process. Those customers and counterparties without an S&P rating of at least BBB- or similar rating from another major rating agency are rated using internal credit methodologies and credit scoring models to estimate an S&P equivalent rating. TXU Corp. routinely monitors and manages its credit exposure to these customers and counterparties on this basis.

TXU Corp. is also exposed to credit risk related to the Capgemini put option with a carrying value of \$177 million. Subject to certain terms and conditions, Cap Gemini North America, Inc. and its parent, Cap Gemini S.A., have guaranteed the performance and payment obligations of Capgemini under the services agreements with TXU Energy Holdings and TXU Electric Delivery, as well as the payment in connection with a put option described in Note 13 to Financial Statements. S&P currently maintains a BB+ rating with a negative outlook for Cap Gemini S.A.

The following table presents the distribution of credit exposure as of December 31, 2005, for trade accounts receivable from large business customers, commodity contract assets and other derivative assets that arise primarily from hedging and commercial activities, by investment grade and noninvestment grade, credit quality and maturity.

| | Exposure before Credit Collateral | Credit Collateral | Net Exposure | Net Exposure by Maturity | | | Total |
|---------------------|--|------------------------------|-------------------------|---------------------------------|------------------------------|-------------------------------------|-----------------|
| | | | | 2 years or less | Between 2-5 years | Greater than 5 years | |
| Investment grade | \$1,518 | \$ 457 | \$ 1,061 | \$ 787 | \$ 114 | \$ 160 | \$ 1,061 |
| Noninvestment grade | <u>474</u> | <u>175</u> | <u>299</u> | <u>273</u> | <u>26</u> | <u>—</u> | <u>299</u> |
| Totals | <u>\$ 1,992</u> | <u>\$ 632</u> | <u>\$ 1,360</u> | <u>\$ 1,060</u> | <u>\$ 140</u> | <u>\$ 160</u> | <u>\$ 1,360</u> |
| Investment grade | 76% | 72% | 78% | | | | |
| Noninvestment grade | 24% | 28% | 22% | | | | |

TXU Corp. had credit exposure to three counterparties each having an exposure greater than 10% of the net exposure of \$1.4 billion at December 31, 2005. These three counterparties represent 10%, 12% and 13% of the net exposure, respectively. TXU views its exposure with these three counterparties to be within an acceptable level of risk tolerance. Additionally, approximately 78% of the credit exposure, net of collateral held, has a maturity date of two years or less. TXU Corp. does not anticipate any material adverse effect on its financial position or results of operations due to nonperformance by any customer or counterparty.

FORWARD-LOOKING STATEMENTS

This report and other presentations made by TXU Corp. contain “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts, that are included in this report, or made in presentations, in response to questions or otherwise, that address activities, events or developments that TXU Corp. expects or anticipates to occur in the future, including such matters as projections, capital allocation and cash distribution policy, future capital expenditures, business strategy, competitive strengths, goals, future acquisitions or dispositions, development or operation of power production assets, market and industry developments and the growth of TXU Corp.’s business and operations (often, but not always, through the use of words or phrases such as “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimated,” “projection,” “target,” “outlook”), are forward-looking statements. Although TXU Corp. believes that in making any such forward-looking statement its expectations are based on reasonable assumptions, any such forward-looking statement involves uncertainties and is qualified in its entirety by reference to the discussion of risk factors discussed under “RISK FACTORS THAT MAY AFFECT FUTURE RESULTS” and the following important factors, among others, that could cause the actual results of TXU Corp. to differ materially from those projected in such forward-looking statements:

- prevailing governmental policies and regulatory actions, including those of the Texas Legislature, the Governor of Texas, FERC, the Commission, the RRC and the NRC, with respect to:
 - allowed prices;
 - allowed rates of return;
 - industry, market and rate structure;
 - purchased power and recovery of investments;
 - operations of nuclear generating facilities;
 - acquisitions and disposal of assets and facilities;
 - operation and construction of facilities;
 - decommissioning costs;
 - present or prospective wholesale and retail competition;
 - changes in tax laws and policies; and
 - changes in and compliance with environmental and safety laws and policies;
- continued implementation of the 1999 Restructuring Legislation;
- legal and administrative proceedings and settlements;
- general industry trends;
- power costs (including repair costs) and availability;
- weather conditions and other natural phenomena, and acts of sabotage, wars or terrorist activities;
- unanticipated population growth or decline, and changes in market demand and demographic patterns;
- changes in business strategy, development plans or vendor relationships;
- TXU Corp.’s ability to implement the initiatives that are part of its restructuring, operational improvement and cost reduction program, and the terms upon which those initiatives are executed;
- competition for retail and wholesale customers;
- access to adequate transmission facilities to meet changing demands;
- pricing and transportation of crude oil, natural gas and other commodities;
- unanticipated changes in interest rates, commodity prices, rates of inflation or foreign exchange rates;
- unanticipated changes in operating expenses, liquidity needs and capital expenditures;
- unanticipated changes in market heat rates in the Texas electricity market,
- commercial bank market and capital market conditions;
- competition for new energy development and other business opportunities;
- inability of various counterparties to meet their obligations with respect to TXU Corp.’s financial instruments;

- changes in technology used by and services offered by TXU Corp.;
- significant changes in TXU Corp.'s relationship with its employees, including the availability of qualified personnel, and the potential adverse effects if labor disputes or grievances were to occur;
- significant changes in critical accounting policies material to TXU Corp.; and
- actions by credit rating agencies.

Any forward-looking statement speaks only as of the date on which it is made, and TXU Corp. undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for TXU Corp. to predict all of them; nor can TXU Corp. assess the impact of each such factor or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.