

PART I

Items 1. and 2. BUSINESS AND PROPERTIES

TXU CORP. BUSINESS AND STRATEGY

Business Summary

TXU Corp., a Texas corporation, is a Dallas-based energy company that manages a portfolio of competitive and regulated energy businesses in Texas. TXU Corp.'s revenues totaled \$10.9 billion in 2006. TXU Corp. is a holding company conducting its operations principally through its TXU Energy Company LLC (TXU Energy Company), TXU Electric Delivery Company (TXU Electric Delivery) and TXU Generation Development Company LLC (TXU DevCo) subsidiaries. TXU Energy Company is a holding company whose subsidiaries are engaged in competitive market activities consisting of electricity generation, retail electricity sales to residential and business customers, wholesale energy sales and purchases as well as commodity risk management and trading activities, all largely in Texas. TXU Electric Delivery is engaged in regulated electricity transmission and distribution operations in Texas. TXU DevCo is engaged in the development of new lignite/coal-fueled generation facilities, but is now expected to develop those facilities as a subsidiary of TXU Energy Company.

On February 26, 2007, TXU Corp. announced that it had entered into an Agreement and Plan of Merger, dated February 25, 2007 (Merger Agreement), with Texas Energy Future Holdings Limited Partnership (Merger Sub Parent) and Texas Energy Future Merger Sub Corp (Merger Sub), whereby TXU Corp. would merge with Merger Sub and TXU Corp. would become a wholly-owned subsidiary of Merger Sub Parent. For further details on the proposed transaction, refer to the section entitled "Proposed Merger" below.

TXU Energy Company owns or leases 17,605 megawatts (MW) of generation for its own use in Texas, including 2,300 MW of nuclear-fired capacity, 5,837 MW of lignite/coal-fueled capacity and 9,468 MW of natural gas-fueled capacity. TXU Energy Company provides electricity to more than 2.1 million electricity customers in Texas. As of December 31, 2006, TXU Energy Company's estimated share of the Electric Reliability Council of Texas (ERCOT) retail residential and small business markets was 37% and 26%, respectively. TXU Electric Delivery operates the largest distribution and transmission system in Texas providing power to over 3 million electricity delivery points over more than 100,000 miles of distribution lines and 14,300 miles of transmission lines. At December 31, 2006, TXU Corp. had 7,262 full-time employees, including approximately 1,800 employees under collective bargaining agreements.

TXU Corp. operates primarily within the ERCOT region, which represents approximately 85% of electricity consumption in Texas. ERCOT is the regional reliability coordinating organization for member electricity systems in Texas and the Independent System Operator of the interconnected transmission system of those systems. ERCOT is responsible for ensuring reliability, adequacy and security of the electric systems as well as nondiscriminatory access to transmission service by all wholesale market participants in the ERCOT region. ERCOT's membership consists of approximately 150 members, including electric cooperatives, municipal power agencies, investor-owned independent generators, independent power marketers, electric transmission and distribution utilities and independent REPs.

Gas-fueled generation is the predominant supply resource in the ERCOT region in terms of both the installed capacity and electricity generation, accounting for approximately 75% of the capacity and 50% of the energy produced in the ERCOT region. As a result, natural gas-fueled plant operators are the marginal suppliers in ERCOT, and wholesale electricity prices are highly correlated to natural gas prices.

TXU Corp. believes that the ERCOT region presents an attractive competitive electric service market due to the following factors:

- market rules support fair and robust competition, while providing opportunities to optimize the generation fleet operations and purchased power requirements;
- peak demand is expected to grow at an average rate of 2.3% per year;
- it is a sizeable market with 62 gigawatts (GW) of peak demand and approximately 33 GW of average demand; and
- as projected by ERCOT, in the absence of generation additions, annual reserve margins are expected to fall below ERCOT's desired margin of 12.5% as early as 2009, thus providing opportunities for generation owners and developers. Reserve margin is defined as the excess of system capability over peak load expressed as a percentage of peak load.

Proposed Merger

Summary Description of Merger Agreement and Proposed Merger

On February 25, 2007, TXU Corp. entered into the Merger Agreement with Merger Sub Parent and Merger Sub, whereby TXU Corp. would merge with Merger Sub and TXU Corp. would become a wholly-owned subsidiary of Merger Sub Parent. Merger Sub Parent and Merger Sub are entities directly and indirectly owned by a private investment group consisting of entities advised by or affiliated with Kohlberg Kravis Roberts & Co. and Texas Pacific Group (Sponsors).

Under the terms of the Merger Agreement, the Sponsors will acquire all of the outstanding shares of TXU Corp. for \$69.25 per share, representing a transaction value of approximately \$32 billion in addition to the assumption by the Sponsors and the Merger Sub Parent of approximately \$12 billion of debt. The Merger Agreement contemplates that upon the merger of Merger Sub with TXU Corp., each outstanding share of TXU Corp. common stock will be cancelled and converted into the right to receive \$69.25 in cash, without interest, except for shares held by either TXU Corp. or the Sponsors or their affiliates, or by dissenting shareholders until their rights to dispute are satisfied.

The Merger Agreement contains a "go-shop" provision pursuant to which TXU Corp. has the right to solicit and engage in discussions and negotiations with respect to competing proposals through April 16, 2007. TXU Corp.'s board of directors, with the assistance of its independent advisors, intends to solicit proposals during this go-shop period. After April 16, 2007, TXU Corp. may continue discussions with certain persons who have made proposals prior to the end of the go-shop period. After the go-shop period, TXU Corp. is not permitted to solicit additional proposals and may not share information or have discussions regarding alternative proposals, except in certain circumstances. There can be no assurances that the solicitation of proposals will result in an alternative transaction. TXU Corp. does not intend to disclose developments with respect to this solicitation process unless and until its board of directors has made a decision regarding any alternative proposals.

The Merger Agreement contains certain operating covenants with respect to TXU Corp. and its subsidiaries pending the consummation of the proposed merger. Generally, unless the parties have otherwise agreed with respect to specified business activities or TXU Corp. obtains the Merger Sub Parent's prior written consent, which consent cannot be unreasonably withheld, conditioned or delayed by the Merger Sub Parent, TXU Corp. and its subsidiaries must carry on their businesses in a manner consistent with a business plan that was negotiated between TXU Corp. and Merger Sub Parent and otherwise in the ordinary course of business and use reasonable best efforts to preserve their present business organizations intact and maintain existing relationships and goodwill with governmental entities, customers, suppliers, employees and business organizations. In addition, the Merger Agreement contains certain specific restrictions or limitations on the activities of each of TXU Corp. and its subsidiaries, subject to the receipt of the Merger Sub Parent's prior written consent, which consent cannot be unreasonably withheld, conditioned or delayed by the Merger Sub Parent, including the issuance or repurchase of capital stock, the amendment of its charter and bylaws, acquisitions and dispositions of assets in excess of specified amounts, capital expenditures in excess of specified amounts, incurrence of certain indebtedness, modification of certain employee compensation and benefits arrangements, discharging of liabilities and changes to TXU Corp.'s trading policies, as well as executing specified trading transactions; however, TXU Corp. is permitted to declare and pay its regular quarterly dividend at the current rate of \$0.4325 per quarter.

TXU Corp. may terminate the Merger Agreement under certain circumstances, including if its board of directors determines in good faith that it has received a superior proposal, and otherwise complies with certain terms of the Merger Agreement. In connection with a termination, TXU Corp. would have to pay a fee of \$1 billion to Merger Sub Parent, unless such termination is in connection with a superior proposal submitted by certain persons who made such a proposal prior to the end of the go-shop period, in which case the fee will be \$375 million. In certain other circumstances, the Merger Agreement provides for Merger Sub Parent to pay to TXU Corp. a fee of \$1 billion upon termination of the Merger Agreement.

Consummation of the proposed merger is subject to various conditions, including approval of the merger by a vote of two-thirds of the outstanding shares of TXU Corp. common stock, expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, approval of the Federal Energy Regulatory Commission (FERC) and the Nuclear Regulatory Commission (NRC), and the Federal Communication Commission and other customary closing conditions. In addition, Merger Sub Parent and Merger Sub will not be obligated to consummate the proposed merger unless the representations and warranties of TXU Corp. set forth in the Merger Agreement are true and correct as of the closing date, except where any failures of any the representations and warranties to be true and correct, individually or in the aggregate, would not reasonably be expected to have a material adverse effect on TXU Corp. TXU Corp. also expects to seek approval of the Federal Communications Commission in connection with the closing of the proposed merger. TXU Corp. currently expects that the proposed merger will occur in the second half of 2007; however, there can be no assurance that the proposed merger will be consummated.

In connection with the proposed merger, TXU Corp. has agreed to a strategy that modifies TXU DevCo's previously disclosed plans to build new generation facilities and provides for revisions to TXU Energy's pricing and marketing initiatives.

The Merger Agreement was filed with the US Securities and Exchange Commission (SEC) on a Form 8-K on February 26, 2007. The foregoing descriptions of the Merger Agreement and the proposed merger do not purport to be complete and are subject to, and qualified in their entirety by, the full text of the Merger Agreement.

Financing in Connection with the Proposed Merger

In connection with the proposed merger, Merger Sub has received a debt commitment letter from a group of lenders (Debt Financing Sources) to provide funds for the purpose of financing the proposed merger (collectively, the Merger Funds). In addition to the equity financing to be provided by the Sponsors, it is expected that the Merger Funds will be funded by approximately \$24.6 billion in indebtedness provided by the Debt Financing Sources, the substantial majority of which is anticipated to be incurred by TXU Energy Company, secured by substantially all of the assets of TXU Energy Company and its subsidiaries, and guaranteed by substantially all of the subsidiaries of TXU Energy Company. It is expected that a portion of the Merger Funds will be funded with unsecured debt issued at TXU Corp. In addition to the Merger Funds, the debt commitments provide for funds to repay some outstanding indebtedness of TXU Corp. and its subsidiaries, and to pay fees and expenses incurred in connection with the proposed merger. Significant liquidity facilities will be made available to 1) TXU Energy Company to provide for ongoing working capital and other general corporate purposes of the surviving corporation and its subsidiaries after the consummation of the proposed merger and 2) TXU Electric Delivery to provide for ongoing working capital and for other general corporate purposes for TXU Electric Delivery and its subsidiaries. None of the new debt to be incurred (other than the TXU Electric Delivery liquidity facility) will be raised at, guaranteed by, or secured by the assets of, TXU Electric Delivery. While Merger Sub Parent has advised TXU Corp. that there is significant uncertainty as to the various details of the ultimate structure of the debt financing (including whether TXU Corp. will guarantee any of the debt of TXU Energy Company) and the outstanding debt securities that may be repaid or refinanced, the proposed merger is not conditioned on the receipt of such debt financing and the availability of the debt financing from the Debt Financing Sources is subject only to documentary and other customary closing conditions.

Operating Segments

TXU Corp. has aligned and reports its business activities as two operating segments: TXU Energy Holdings and TXU Electric Delivery. (See Note 24 to Financial Statements).

TXU Energy Holdings segment includes the activities of TXU Energy Company and TXU DevCo. This segment also includes the activities of a lease trust holding certain natural gas-fueled combustion turbines.

TXU Electric Delivery segment includes the activities of TXU Electric Delivery and its wholly owned bankruptcy-remote financing subsidiary.

Corporate and Other represents the remaining nonsegment operations consisting primarily of discontinued operations, general corporate expenses, interest on debt at the TXU Corp. level and activities involving mineral interest holdings.

Overview of Business Growth Strategies

In 2004, TXU Corp. 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.
- 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 but remains ongoing as a basis for continuous process improvement.
- Phase three included development and implementation of the growth strategy for TXU Corp. and its two operating segments. In 2006, actions were initiated to execute this strategy by way of several key initiatives launched during the year, including planned development of new generation facilities. TXU Corp. has agreed to reevaluate this strategy in connection with the proposed merger.

TXU Corp.'s growth strategy is based on three core principles, as it believes they are essential to success in the electricity industry: 1) access to structurally advantaged assets, 2) an industrial skill set and 3) building and leveraging quality scale.

- Access to structurally advantaged assets – TXU Corp. believes that long-term success in the electricity industry is based upon having access to structurally advantaged assets. TXU Corp. expects that energy markets will continue to go through cycles and believes that assets with a structural cost advantage are best positioned to succeed in the long term. TXU Corp. believes that its business segments are well-positioned across the electricity value chain.
- Industrial skill set – TXU Corp. believes an industrial skill set is crucial for high performance and sustained high returns in asset-intensive businesses. The transition from regulation to competition in the electricity sector amplifies the importance of this skill set, and will likely create a significant performance advantage for those who successfully transform their operations. TXU Corp. will continue to focus on upgrading four critical skill sets: operational excellence, market leadership, a systematic risk/return mindset applied to all key decisions and rigorous performance management. A key driver of this effort is an overall program called the TXU Operating System, which is a program to drive ongoing productivity improvements through application of lean operating techniques and deployment of an industrial skill set.
- Building and leveraging quality scale – TXU Corp. believes that building and leveraging quality scale enables sustained value creation. Scale allows companies to eliminate duplicative costs, better manage supply costs and build and standardize distinctive process expertise. Scale also allows companies to take part in large capital investments, such as new generation facilities, with a smaller fraction of overall capital at risk and with an enhanced ability to streamline costs.

Quality scale is derived from structurally advantaged regional positions and enables companies to develop a deep understanding of regional wholesale markets and distinctive insights into market dynamics and regulatory frameworks, enabling better execution in today's volatile commodity environment. Regional scale can also create access to advantaged development opportunities.

Given the pending merger, TXU Corp. will reevaluate its strategies, in particular its growth strategies.

TXU ENERGY HOLDINGS OPERATING SEGMENT
STRATEGY AND BUSINESS ACTIVITIES

Business Organization

The TXU Energy Holdings segment is managed as an integrated business; however, for purposes of operational accountability and performance management, the segment has been divided into electricity generation operations (TXU Power), retail electricity sales operations (TXU Energy), wholesale energy markets operations (TXU Wholesale) and generation facility development activities (TXU DevCo). Each of these operations is conducted through separate legal entities.

TXU Power

Strategy

The goal of TXU Power is to become the safest and most productive operator of generation facilities in the US. TXU Power intends to achieve industry leading safety and top decile reliability and operating cost performance and sustain year-over-year real productivity improvements of 5% across all operations. TXU Power continues to utilize the TXU Operating System to capture opportunities to drive lean operations throughout its operations. TXU Power believes that the execution of this process has helped it further enhance an advantaged lignite/coal-fueled generation operating capability.

Overview of Generation Assets

TXU Power's electricity generation fleet consists of 19 plants in Texas with total generating capacity as shown in the table below:

<u>Fuel Type</u>	<u>Capacity (MW)</u>	<u>Number of Plants</u>	<u>Number of Units (a)</u>
Nuclear.....	2,300	1	2
Lignite/coal.....	5,837	4	9
Natural gas (b)(c).....	9,468	14	35
Total.....	<u>17,605</u>	<u>19</u>	<u>46</u>

- (a) Leased units consist of six natural gas-fueled units totaling 390 MW of capacity. All other units are owned.
- (b) Includes 1,679 MW representing seven units mothballed and not currently available for dispatch.
- (c) Excludes 585 MW representing nine combustion turbine units currently operated for an unaffiliated party's benefit.

The generation plants are located primarily on land owned in fee simple. Nuclear and lignite/coal-fueled (baseload) plants are generally scheduled to run at capacity except for periods of backdown due to low periods of demand or scheduled major maintenance activities. The natural gas-fueled generation units supplement the baseload generation capacity in meeting variable consumption as production from these units can more readily be ramped up or down as demand warrants.

One of TXU Power's key competitive strengths is its ability to produce electricity at low variable costs in a market in which power prices are set by natural gas-fueled generation. New natural gas-fueled capacity, while generally more efficient to operate than existing natural gas-fueled capacity due to technological advances, is subject to the volatile cost of natural gas fuel. On the other hand, baseload nuclear and lignite/coal-fueled plants currently have lower variable generation costs than new natural gas-fueled plants at current average market natural gas prices.

Nuclear Generation Assets

TXU Power operates two generation units at the Comanche Peak plant, each of which is designed for a capacity of 1,150 MW. Comanche Peak's Unit 1 and Unit 2 went into commercial operation in 1990 and 1993, respectively, and are generally operated at full capacity to meet the load requirements in ERCOT. Refueling (nuclear fuel assembly replacement) outages for each unit are scheduled to occur every eighteen months during the spring or fall off-peak demand periods. Every three years, the refueling cycle results in a two-unit outage in one year, with the next scheduled to occur in 2008. While one unit is undergoing a refueling outage, the remaining unit is intended to operate at full capacity. During a refueling outage, other maintenance, modification and testing activities are completed that cannot be accomplished when the unit is in operation. Over the last 3 years, the refueling outage period per unit has ranged from a high of 38 days in 2004 to a low of 18 days in 2006. The Comanche Peak plant operated at a capacity factor of 98.8% in 2006, which represents top decile performance of US nuclear generation facilities.

TXU Power has contracts in place for nuclear fuel conversion services through 2007. In addition, TXU Power has contracts for the acquisition of raw uranium and for nuclear fuel enrichment services through mid-2008, as well as for nuclear fuel fabrication services through 2018.

Contracts for the acquisition of raw uranium and nuclear fuel conversion services through 2012 and 2009, respectively, are being finalized. Additional contracts to ensure a portion of nuclear fuel enrichment services through 2020 are being finalized. TXU Power does not anticipate any issues with finalizing these contracts by the end of 2007 and does not anticipate any difficulties in acquiring raw uranium and contracting for associated services in the foreseeable future.

TXU Power's on-site used nuclear fuel storage capability is sufficient for five to ten years. The nuclear industry is continuing to review ways to enhance security of used-fuel storage with the US Nuclear Regulatory Commission (NRC) to fully utilize physical storage capacity.

The Comanche Peak nuclear 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 generation reactors. Based on these extensions and expectations of industry practice, in 2003 the estimated useful life of the Comanche Peak nuclear generation units was revised to 60 years. TXU Power expects to file a license extension request in accordance with timing and other provisions established by the NRC.

With license extensions, plant decommissioning activities would be scheduled to begin in 2050 for Comanche Peak Unit 1 and 2053 for Unit 2 and common facilities. Decommissioning costs are fully recoverable from TXU Electric Delivery's customers through an ongoing delivery surcharge.

Lignite/Coal-Fueled Generation Assets

TXU Power's lignite/coal-fueled generation fleet has a capacity of 5,837 MW and consists of the Big Brown (2 units), Monticello (3 units), Martin Lake (3 units) and Sandow (1 unit) plants. These plants are generally operated at full capacity to meet the load requirements in ERCOT. Maintenance outages are scheduled during off-peak demand periods. Over the last three years, the total annual scheduled and unscheduled outages per unit averaged 33 days. TXU Power's lignite/coal-fueled generation fleet operated at a capacity factor of 89.1% in 2006, which represents top decile performance of US coal-fueled generation facilities.

Approximately 67% of the fuel used at TXU Power's lignite/coal-fueled generation plants in 2006 was supplied from owned in fee or leased proven surface-minable lignite reserves dedicated to the Big Brown, Monticello and Martin Lake plants, which were constructed adjacent to the reserves. TXU Energy Company owns in fee or has under lease an estimated 595 million tons of proven reserves dedicated to its generation plants, and also owns in fee or has under lease in excess of 119 million tons of proven reserves not currently dedicated to specific generation plants. In 2006, over 22 million tons of lignite were recovered to fuel TXU Power's plants. TXU Energy Company utilizes owned and/or leased equipment to remove the overburden and recover the lignite. As part of an agreement to supply power to an adjacent aluminum smelting plant, the Sandow plant is fueled from lignite deposits controlled and mined by Alcoa, Inc.

Lignite mining operations include extensive reclamation activities that return the land to productive uses such as wildlife habitats, commercial timberland and pasture land. In 2006 alone, regulatory authorities approved TXU Power's release from further reclamation obligation approximately 8,000 acres of reclaimed land; TXU Power planted more than 1.2 million trees as part of this reclamation.

TXU Power supplements its lignite fuel at Big Brown, Monticello and Martin Lake with western coal from the Powder River Basin (PRB) in Wyoming. The coal is purchased from multiple suppliers under contracts of various lengths and is transported from the Powder River Basin to TXU Power's generating plants by railcar. Based on its current usage, TXU Power believes that it has sufficient lignite reserves for the foreseeable future and has contracted 76% of its western coal resources and 100% of the related transportation through 2009.

Security Interest — A first-lien security interest has been placed on the two lignite/coal-fueled generation units at TXU Energy Company's Big Brown plant to support commodity hedging transactions.

Natural Gas-Fueled Generation Assets

TXU Power also operates a fleet of natural gas-fueled generation units, which includes 28 units with a total 7,789 MW of currently available capacity, as dispatched by TXU Wholesale. A significant number of the natural gas-fueled units have the ability to switch between natural gas and fuel oil. As discussed above, these units predominantly serve as peaking units that can be more readily ramped up or down as demand warrants. See TXU Wholesale discussion below under "Portfolio Management".

Regulation

TXU Power is an exempt wholesale generator under the Energy Policy Act of 2005 and is subject to the jurisdiction of the NRC with respect to its nuclear generation plant. NRC regulations govern the granting of licenses for the construction and operation of nuclear generation plants and subject such plants to continuing review and regulation. TXU Power also holds a power marketer license from the FERC.

TXU Energy

Strategy

TXU Energy's strategy is to achieve industry-leading customer service, continue to develop innovative customer solutions and offerings and achieve a 40% market share in the residential retail market in ERCOT. In addition, TXU Energy's strategy includes initiatives to improve both out-of-territory customer acquisition rates and small business customer acquisition and winbacks within Texas.

TXU Energy believes that the scale derived from a large retail portfolio provides the platform for a profitable operation by, among other things, reducing the costs of service and billing per customer. TXU Energy has invested in customer-related infrastructure and capabilities. Together with its business support services vendor, Capgemini Energy LP, a subsidiary of Cap Gemini North America Inc. that provides business support services to TXU Corp. and its subsidiaries (Capgemini), TXU Energy uses its customer relationships, customer service operations, technology operating platforms, commercial operations, marketing and customer loyalty to actively compete to retain its customer base and to add customers.

Market Territory

TXU Energy serves more than 2.1 million retail electricity customers, of which 1.9 million are in its historical service territory, which was the territory, largely in north Texas, being served by TXU Corp.'s regulated electric utility subsidiary at the time of entering retail competition on January 1, 2002. This territory, which is located in the north-central, eastern and western parts of Texas, has an estimated population in excess of 7 million, about one-third of the population of Texas, and comprises 92 counties and 370 incorporated municipalities, including Dallas/Fort Worth and surrounding suburbs, as well as Waco, Wichita Falls, Odessa, Midland, Tyler and Killeen.

Texas is one of the fastest growing states in the nation with a diverse and resilient economy and, as a result, has attracted a number of competitors into the deregulated retail electricity market. As a result, competition is expected to continue to be robust. TXU Energy, as an active participant in this competitive market, provides retail electric service to the other areas of ERCOT now open to competition including the Houston, Corpus Christi, and lower Rio Grande Valley areas of Texas. TXU Energy continues to market its services in Texas to add new customers and to retain its existing customers. As of January 2007, there are approximately 60 REPs certified to compete within the state of Texas.

Price-to-Beat Rates

As a result of the legislation that restructured the electric utility industry in Texas to provide for retail competition (1999 Restructuring Legislation), effective January 1, 2002, REPs affiliated with electricity delivery utilities were required to charge price-to-beat rates, established by the Public Utility Commission of Texas (the Commission), to residential and small business customers located in their historical service territories. The price-to-beat mechanism was intended to spur competition as the rates were set such that competing REPs could profitably offer lower rates. TXU Energy, as a REP affiliated with an electricity delivery utility, was required to charge the price-to-beat rate, adjusted for fuel factor changes, to these classes of customers until the earlier of January 1, 2005 or the date on which 40% of the electricity consumed by customers in that class was supplied by competing REPs. TXU Energy met the 40% threshold target calculation for its small business customers in December 2003 and began offering rates other than the price-to-beat rate to this customer class. Since January 1, 2005, TXU Energy has offered rates different from the price-to-beat rate to all customer classes, but was required to make the price-to-beat rate available for residential and small business customers in its historical service territory until January 1, 2007.

Under amended Commission rules, effective April 2003 through December 2006, affiliated REPs of electricity delivery utilities were allowed to petition the Commission twice a year for a change in the fuel factor component of their price-to-beat rates if the average forward price of natural gas increased or decreased more than 5% (10% if the petition was filed after November 15 of any year) from the level used to set the existing fuel factor component of its price-to-beat rate. Because of rising natural gas prices, TXU Energy petitioned and received approval from the Commission for price-to-beat rate increases that were implemented in each of the years 2003 through 2006. As of January 1, 2007, TXU Energy is no longer required to offer the price-to-beat rate to any of its customer classes.

Pricing and Marketing Initiatives

In 2006, TXU Energy launched its “Pick Your Plan” initiative that provides savings to customers of up to 15 percent and announced plans to expand TXU Energy’s demand-side management program, which provides opportunities for further savings through lower consumption or changes in consumption by time of day. TXU Energy currently offers ten price plans in the North Texas market (historical service territory) and four plans in other competitive markets. In anticipation of the transition to full competition in the Texas marketplace on January 1, 2007, in the fourth quarter of 2006 TXU Energy announced the following initiatives to give customers greater savings, peace of mind, flexibility and price certainty:

- a one-time customer appreciation bonus of \$100 to residential customers who were receiving service from TXU Energy on October 29, 2006 and living in areas where TXU Energy offered its price-to-beat rate. The bonus is expected to be paid out in the form of credits on customer bills and is expected to be fully settled in 2007;
- price protection from any future price increases due to volatile commodity prices for its residential price-to-beat and other month-to-month customers paying a rate that is equal to the price-to-beat rate as of December 31, 2006 who choose to remain on their existing plan and meet certain other criteria, for a period of three years or until at least January 1, 2010;
- a limited-time incentive of \$25 to customers switching to one of the many pricing plans other than the basic month-to-month plan; and
- extension through September 1, 2007 of TXU Energy’s unique 10 percent low-income-customer discount program, as TXU Energy continues to work with elected officials to restore state funding for this important program.

TXU Corp. has announced that in connection with the proposed merger, effective with March 27, 2007 meter reads, it will provide a six percent price discount to those customers in the historical service territory that have month-to-month service plans with a rate equivalent to the former price-to-beat rate. Further, upon closing of the proposed merger, TXU Energy intends to provide an additional four percent discount and also provide price protection through September of 2008 to those customers. The aggregate 10% price discounts are expected to provide total annual savings of more than \$300 million to those customers.

TXU Wholesale

Strategy

TXU Wholesale's goal is to deliver best-in-class energy management services to internal and external customers. The ongoing strategy of TXU Wholesale includes optimizing value and managing risk across TXU Corp.'s native unregulated assets, developing and expanding its wholesale market presence and providing proprietary commodity insights to capture, retain and add value for TXU Corp.

Portfolio Management

TXU Wholesale plays a pivotal role in supporting TXU Power and TXU Energy by optimizing the performance of the generation assets and sourcing the electricity requirements for TXU Energy's customers. TXU Wholesale manages commodity price exposure across the complementary generation and retail businesses on a portfolio basis. Under this approach, TXU Wholesale manages the risks of imbalances between generation supply and sales load, which primarily represent exposures to natural gas price movements and market heat rate changes (variations in the relationships between natural gas prices and wholesale electricity prices), through wholesale markets activities that include physical purchases and sales and transacting in financial instruments.

TXU Wholesale manages the commodity exposure of the generation and retail portfolio through asset management and hedging activities. TXU Wholesale provides TXU Energy with the electricity and related services to meet retail customer demand and the operating requirements of ERCOT. TXU Wholesale also supports TXU Power in selling forward generation and seeking to maximize the economic value of the fleet. In consideration of operational production and customer consumption levels that can be highly variable as well as opportunities for long-term purchases and sales with large wholesale electricity market participants, TXU Wholesale buys and sells electricity in the spot and short-term market and executes longer-term forward electricity purchase and sales agreements.

In its hedging activities, TXU Wholesale enters into contracts for the physical delivery of electricity and natural gas, exchange traded and "over-the-counter" financial contracts and bilateral contracts with producers, generators and end-use customers. In October 2005, TXU Wholesale commenced a long-term hedging program designed to reduce exposure to changes in future electricity prices due to changes in the price of natural gas. As of February 28, 2007 a net outstanding 1.95 billion million British thermal units (MMBtu) of natural gas (an equivalent of over 220,000 GWh) over the period 2007 to 2012 has effectively been sold forward principally utilizing natural gas-related financial instruments. See "Natural Gas Price and Market Heat-Rate Exposure" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

TXU Wholesale also dispatches the gas-fueled generation fleet owned and operated by TXU Power. TXU Wholesale's dispatching activities are performed through a centrally managed real-time operational staff that synthesizes operational activities across the fleet and interfaces with various wholesale market channels. TXU Wholesale coordinates the overall commercial strategy for these plants working closely with TXU Power. In addition, TXU Wholesale manages the fuel procurement requirements for the natural gas-fueled generation plants.

Commercial Wholesale Market Activities

TXU Wholesale engages in commercial operations such as physical purchases, storage and sales of natural gas, electricity and natural gas trading and third-party asset management. TXU Wholesale's natural gas operations include well-head production contracts, transportation agreements, storage leases and retail sales. TXU Wholesale currently manages approximately 18 billion cubic feet of natural gas storage capacity and has a presence outside of Texas in both electricity and natural gas commodity trading.

Risk Management Practices

TXU Wholesale manages exposure to wholesale commodity and credit related risk within established transactional risk management policies and limits. TXU Wholesale targets best practices in risk management and risk control by employing proven principles used by financial institutions. These controls have been structured so that they are practical in application and consistent with stated business objectives. Risk management processes include capturing transactions, performing and validating valuations and reporting exposures on a daily basis using commodity information systems designed to support a large transactional portfolio. A risk management forum meets regularly to ensure that business practices comply with approved transactional limits, commodities, instruments, exchanges and markets. Transactional risks are monitored and limits are enforced to comply with the established risk policy. TXU Wholesale has a strict disciplinary program to address any violations of the risk management policies and periodically reviews these policies to ensure they are responsive to changing market and business conditions.

Renewable Energy Activities

TXU Wholesale is one of the largest purchasers of wind-generated electricity in Texas and the fifth largest in the US. TXU Wholesale currently purchases electricity from wind projects with approximately 704 MW of capacity located in West Texas. In June 2006, TXU Wholesale launched a renewable energy initiative involving the purchase of electricity from, and/or investment in, wind-generated power facilities that is expected to double its renewable energy portfolio to 1,500 MW.

TXU DevCo

Strategy

TXU DevCo's objective is to satisfy the need to replace aging generation facilities and meet growing electricity demand through the development of economical, reliable and environmentally responsible baseload technologies in Texas. Successful execution is expected to result in increased energy efficiency, lower prices, reduced emissions and less dependence on foreign energy sources.

Texas Generation Facilities Development

The first step in meeting these challenges has been to provide a solution for Texas consumers, who face shrinking reserve margins and potential supply shortfalls over the next five years absent new generation facilities. In 2006, TXU Corp. announced that it intended to develop and construct up to 11 lignite/coal-fueled generation units in central and east Texas, with a total estimated capacity of up to 9,300 MW. In connection with the proposed merger, TXU Corp. has modified its strategy and has reduced the number of lignite/coal-fueled generation units that it intends to develop and construct in Texas from 11 to three units with total estimated capacity of approximately 2,200 MW.

The three units proposed to be developed consist of one new generation unit at an existing TXU Corp. lignite/coal-fueled generation plant site (Sandow) and two units at a site (Oak Grove) owned by TXU Corp. that was originally slated for the construction of a generation plant a number of years ago. Aggregate capital expenditures for these three units are expected to total approximately \$3.2 billion, including all construction, site preparation and mining development costs.

The development program includes up to \$450 million for investments in state-of-the-art emissions controls for the three proposed new units. Further, TXU Corp. expects additional capital expenditures for environmental control systems at existing generation facilities to total up to \$400 million. See discussion below under "Environmental Regulations and Related Considerations".

Developmental activities are well underway for the three proposed units. TXU Corp. subsidiaries have executed engineering, procurement and construction (EPC) agreements for these units with Bechtel Power Corporation and Fluor Enterprises, Inc. In addition, to facilitate meeting the expected timeline for the start-up of the new facilities, TXU DevCo or the EPC contractors have placed orders for critical, long lead-time equipment, including boilers, turbine generators and air quality control systems.

TXU Corp. expects the Texas Commission on Environmental Quality (TCEQ) to issue final air permits for the Oak Grove units by year-end 2007. Construction of Oak Grove is expected to commence immediately following the issuance of the related air permit. The expected on-line dates of the units are as follows: Sandow in 2009 and Oak Grove's two units in 2009 and 2010.

If the merger closes, TXU Corp. does not intend to apply or reapply for permits to build additional generation units utilizing current pulverized coal-fueled technology in Texas or in any other US region.

Potential Nuclear Generation Development

As previously disclosed, TXU Corp. also planned to develop applications to file for combined construction and operating licenses for 2,000 to 6,000 MW of new nuclear generation capacity at one to three sites in Texas. TXU Corp. currently plans to develop an application to file for combined licenses for at least one site (up to 3,400 MW of new nuclear generation capacity) at its existing Comanche Peak nuclear generation facility. The Comanche Peak application is expected to be submitted in 2008, which could facilitate bringing the new capacity on-line between 2015 and 2020. Because of regulatory and supply chain uncertainties, TXU Corp. believes that nuclear generation capital costs and development times are currently not competitive with other technologies. TXU Corp. is continuing its ongoing process to resolve these uncertainties and is employing a technical and economic feasibility process with original equipment manufacturers to design a safe and reliable nuclear generation facility and seek to achieve per kilowatt capital costs that are up to 30 to 40 percent lower than current average publicly-announced industry estimates.

TXU ELECTRIC DELIVERY OPERATING SEGMENT **STRATEGY AND BUSINESS ACTIVITIES**

Business Organization

TXU Electric Delivery provides the essential service of delivering electricity safely, reliably and economically to end-use consumers through its distribution systems, as well as providing transmission grid connections to merchant power plants and interconnections to other transmission grids in Texas. Operating assets of the segment are located principally in the north-central, eastern and western parts of Texas.

TXU Electric Delivery is not a buyer or seller of power. It provides transmission services to other electricity distribution companies, cooperatives and municipalities. It provides distribution services to REPs, which sell power to retail customers. Most of TXU Electric Delivery's power lines have been constructed over lands of others pursuant to easements or along public highways, streets and rights-of-way as permitted by law.

TXU Electric Delivery's transmission and distribution rates are regulated by the Commission.

Strategy

TXU Electric Delivery's goal is to achieve top decile reliability, service levels and cost performance through efficient capital and technology deployment. In its core service territory, TXU Electric Delivery is redesigning the model that it uses for network and technology investments, driving standardization and significantly enhancing efficiency. TXU Electric Delivery expects to increase its investments in the transmission and distribution network and in new technologies such as advanced meter reading and remote system monitoring as discussed below under "Technology Initiatives." Capital investment over the next five years is expected to average more than \$700 million per year, an increase of more than 30 percent relative to the previous 10-year annual average. This expanded program is expected to reduce congestion costs, enhance network integrity and improve reliability and customer service standards in North Texas by the end of the decade. TXU Electric Delivery expects to improve the efficiency and lower the cost of utility facilities construction, power restoration and maintenance activities through a new business services arrangement discussed below under "New Utility Services Joint Venture".

TXU Electric Delivery also intends to seek opportunities to scale its operating advantage and technology program regionally, looking to achieve operating efficiencies, leverage its asset management capabilities over a larger grid and execute a coordinated technology and infrastructure investment program to improve reliability. TXU Electric Delivery believes that the infrastructure and technology investment needs in the electricity transmission and delivery sector are going to increase significantly over the coming years both regionally and nationally. TXU Electric Delivery believes it is well-positioned to participate in this build-out on a broader basis as an operator capable of coordinating and managing large-scale investment programs. Given the pending merger, TXU Electric Delivery will reevaluate its strategies, particularly its growth strategies.

Electricity Transmission

TXU Electric Delivery's electric transmission business is responsible for the safe and reliable operations of its transmission network and substations. These responsibilities consist of the construction and maintenance of transmission facilities and substations and the monitoring, controlling and dispatching of high-voltage electricity over TXU Electric Delivery's transmission facilities in coordination with ERCOT.

TXU Electric Delivery is a member of ERCOT, and the transmission business actively supports the operations of ERCOT and market participants. The transmission business participates with ERCOT and other member utilities to plan, design, construct and operate new transmission lines, with regulatory approval, necessary to maintain reliability, interconnect to merchant power plants, increase bulk power transfer capability and minimize limitations and constraints on the ERCOT transmission grid.

Transmission revenues are provided under tariffs approved by either the Commission or, to a small degree, the FERC. Network transmission revenues compensate TXU Electric Delivery for delivery of power over transmission facilities operating at 60 kilovolts (kV) and above. Transformation service revenues compensate TXU Electric Delivery for substation facilities that transform power from high-voltage transmission to distribution voltages below 60 kV. Other services offered by the transmission business include, but are not limited to: system impact studies, facilities studies and maintenance of transformer equipment, substations and transmission lines owned by other nonretail parties.

Provisions of the 1999 Restructuring Legislation allow TXU Electric Delivery to annually update its transmission rates to reflect changes in invested capital. These provisions encourage investment in the transmission system to help ensure reliability and efficiency by allowing for timely recovery of and return on new transmission investments.

TXU Electric Delivery's transmission facilities include 4,680 circuit miles of 345-kV transmission lines and 9,684 circuit miles of 138- and 69-kV transmission lines. In 2006, 198 circuit miles of new 345-kV transmission lines were constructed. Forty-five generating plants totaling 32,699 MW are directly connected to TXU Electric Delivery's transmission system, and 710 distribution substations are served from TXU Electric Delivery's transmission system.

TXU Electric Delivery's transmission facilities have the following connections to other transmission grids in Texas:

Grid Connections	Number of Interconnected Lines		
	345 kV	138 kV	69 kV
Centerpoint Energy Inc.	8	—	—
American Electric Power Company, Inc (a)	4	7	12
Lower Colorado River Authority	6	20	3
Texas Municipal Power Agency	8	9	—
Texas New Mexico Power	2	9	11
Brazos Electric Power Cooperative.....	4	94	21
Rayburn Country Electric Cooperative.....	—	27	7
City of Georgetown	—	2	—
Other small systems operating wholly within Texas	—	10	3

(a) One of the four 345-kV lines is an asynchronous high voltage direct current interconnection with the Southwest Power Pool.

Electricity Distribution

TXU Electric Delivery's electricity distribution business is responsible for the overall safe and efficient operation of distribution facilities, including power delivery, power quality and system reliability. The TXU Electric Delivery distribution system includes over 3 million points of delivery. The electricity distribution business consists of the ownership, management, construction, maintenance and operation of the distribution system within TXU Electric Delivery's certificated service area. Over the past five years, the number of TXU Electric Delivery's distribution system points of delivery served has been growing an average of 2% per year, adding approximately 43,000 points of delivery in 2006.

TXU Electric Delivery's distribution system receives electricity from the transmission system through substations and distributes electricity to end-users and wholesale customers through approximately 3,000 distribution feeders.

The TXU Electric Delivery distribution system consists of 56,102 miles of overhead primary conductors, 21,879 miles of overhead secondary and street light conductors, 14,578 miles of underground primary conductors and 9,114 miles of underground secondary and street light conductors. The majority of the distribution system operates at 25-kV and 12.5-kV.

Customers

TXU Electric Delivery's transmission customers consist of municipalities, electric cooperatives and other distribution companies. TXU Electric Delivery's distribution customers consist of approximately 60 REPs in TXU Electric Delivery's certificated service area, including TXU Energy Company's retail subsidiaries. For the year ended December 31, 2006, distribution revenues from TXU Energy Company represented 52% of TXU Electric Delivery's distribution revenues and 46% of TXU Electric Delivery's total revenues. The retail customers who purchase and consume electricity delivered by TXU Electric Delivery are free to choose their electricity supplier from REPs who compete for their business.

Technology Initiatives

In 2006, TXU Electric Delivery finalized an agreement with CURRENT Communications Group, LLC (CURRENT), to utilize TXU Electric Delivery's power distribution network as a broadband-enabled "Smart Grid." CURRENT plans to design, build and operate the "broadband over power line" (BPL) network covering the majority of the TXU Electric Delivery certificated service area. Build-out of the BPL network began in 2006 with the installation of fiber optic cable and additional investment in advanced data management systems. This modernized grid is expected to enhance TXU Electric Delivery's ability to deliver top decile electric service reliability and provide the potential for additional products and services from REPs that will enable businesses and consumers to manage their electricity usage and costs. Under the terms of the agreement with CURRENT, TXU Electric Delivery expects to incur service fees totaling approximately \$150 million over a 10 year period commencing in 2007 to utilize the Smart Grid capabilities of CURRENT's BPL network.

Overlaid on the existing electric distribution network, the CURRENT BPL network will incorporate advanced digital communication and computing capabilities that provide real-time monitoring through the electric distribution network, which is expected to enable TXU Electric Delivery to:

- increase network reliability and power quality;
- prevent, detect and restore customer outages more effectively; and
- implement advanced meter monitoring more efficiently.

Additionally, CURRENT will leverage the same BPL network to provide homes and businesses high-performance broadband and wireless services, including voice, video and high-speed Internet access, delivered over existing electrical lines by having customers plug into any electrical outlet.

To take full advantage of the BPL network, TXU Electric Delivery has initiated replacement of existing meters with advanced digital metering technology. Installation of these advanced meters is expected to speed connects/disconnects where applicable and ultimately facilitate the creation of new products and service offerings by REPs, including time-of-use options and various new billing methods. TXU Electric Delivery has installed 285,000 advanced meters as of December 31, 2006 and plans to install up to 500,000 additional advanced meters in 2007. TXU Electric Delivery expects to replace all of its 3 million meters with advanced meters under this technology initiative by 2012, for a total investment of approximately \$450 million. Texas legislation provides for a special surcharge that includes the recovery of and return on a utility's investment related to advanced metering technology to incent electricity delivery utilities to invest in this new technology.

New Utility Services Joint Venture

In the second quarter of 2006, TXU Corp. and InfrastruX Group announced the formation of a joint venture, InfrastruX Energy Services, that expects to provide utility construction, power restoration, maintenance and other services nationwide. TXU Corp. also announced an agreement between TXU Electric Delivery and InfrastruX Energy Services under which TXU Electric Delivery will receive such services from the joint venture. The contractual amount of the services agreement is \$8.7 billion over the ten-year term.

Under the terms of the joint venture arrangement, over 2,000 current TXU Electric Delivery employees are expected to become employees of the joint venture. These employees represent essentially all of TXU Electric Delivery's field operations personnel, consisting primarily of construction, maintenance and engineering staff. InfrastruX Group expects to contribute all its operations to the joint venture, including its 3,000 current employees. These operations generated revenues of approximately \$400 million in 2005.

TXU Corp. anticipates closing the transaction in the second half of 2007; however, the Commission recently expressed its desire to gather further information regarding the joint venture. TXU Corp. cannot predict the ultimate outcome of this process, including its possible effect on the timing of closing of the transaction.

Regulation and Rates

As its operations are wholly within Texas, TXU Electric Delivery believes that it is not a public utility as defined in the Federal Power Act and has been advised by its counsel that it is not subject to general regulation under such act.

The Commission has original jurisdiction over transmission and distribution rates and services in unincorporated areas and in those municipalities that have ceded original jurisdiction to the Commission and has exclusive appellate jurisdiction to review the rate and service orders and ordinances of municipalities. Generally, the Public Utility Regulatory Act (PURA) prohibits the collection of any rates or charges by a public utility (as defined by PURA) that does not have the prior approval of the appropriate regulatory authority (Commission or municipality with original jurisdiction).

At the state level, PURA, as amended, requires owners or operators of transmission facilities to provide open-access wholesale transmission services to third parties at rates and terms that are nondiscriminatory and comparable to the rates and terms of the utility's own use of its system. The Commission has adopted rules implementing the state open-access requirements for utilities that are subject to the Commission's jurisdiction over transmission services, such as TXU Electric Delivery.

ENVIRONMENTAL REGULATIONS AND RELATED CONSIDERATIONS

Climate Change and Carbon Dioxide

TXU Corp. participates in a voluntary electric utility industry sector climate change initiative in partnership with the US Department of Energy. This initiative supports the Bush Administration's greenhouse gas emissions intensity reduction program, Climate VISION. In addition, TXU Corp. continues to participate in a voluntary greenhouse gas emission reduction program under the Energy Policy Act of 1992 and since 1995 has reported the results of its program annually to the US Department of Energy.

In conjunction with the merger agreement, TXU Corp. announced its commitment to reduce carbon dioxide (CO₂) emissions and intent to join the US Climate Action Partnership (USCAP), which is a broad-based group of businesses and leading environmental groups organized to work with the President, the Congress and all other stakeholders to enact environmentally effective and economically sustainable climate change programs. As part of its support of USCAP, TXU Corp. is also pledging to support a mandatory cap and trade program to reduce CO₂ emissions.

TXU Corp.'s approach to addressing global climate change is based upon the following principles:

- Climate change is a global issue requiring a comprehensive solution addressing all greenhouse gases, sources and economic sectors in all countries;
- Development of US energy and environmental policy should seek to ensure US energy security and independence;
- Solutions should encourage investment in a diverse supply of new generation to meet US needs to maintain adequate reserve margins and support economic growth, as well as address customers' needs for affordable and reliable energy;
- Policies should encourage significant investments in research and development and deployment of a broad spectrum of solutions, including energy efficiency, renewable energy and coal, natural gas and nuclear-fueled generation technologies; and
- Any mandate to reduce greenhouse gas emissions should be developed under a market-based framework that is consistent with expected technology development timelines and supports the displacement of old, inefficient power generation technology with advanced, more efficient technology.

TXU Corp.'s strategies for lowering greenhouse gas emissions include:

- Investing in technology — TXU Corp. expects to invest up to \$2 billion over the next five to seven years for the development and commercialization of cleaner power plant technologies, including integrated gasification combined cycle, the next generation of more efficient ultra-supercritical coal and pulverized coal emissions technology to reduce CO₂ emission intensity. A number of actions, including research and development investments and partnerships, have already been initiated to advance next-generation technologies.
- Providing electricity from renewable sources — TXU Corp. intends to become a leader in providing electricity from renewable sources by more than doubling its purchases of wind power to more than 1,500 MW. TXU Corp. also intends to promote solar power through solar/photovoltaic rebates.
- Committing to demand side management initiatives — TXU Corp. intends to invest \$400 million over the next five years in programs designed to encourage customer electricity demand efficiencies.
- Reducing CO₂ emissions by increasing production efficiency — TXU Corp. expects to increase production efficiency of its existing generation facilities by up to 2 percent.
- Developing a nuclear generation facility — TXU Corp. plans to develop an application to file with the NRC for combined construction and operating licenses for up to 3,400 MW of new nuclear generation capacity at its Comanche Peak nuclear generation plant. TXU Corp. expects to submit the application in 2008. Nuclear generation is the lowest emission source of baseload generation available.

Late in 2006, several bills addressing climate change were introduced in the US Congress, and TXU Corp. expects that more will follow. These bills differ in certain critical aspects pertaining to CO₂ emissions trading, allocation of CO₂ emissions allowances, the economic sectors covered and timing of future emissions limits or restrictions. TXU Corp. continues to assess the financial and operational risks posed by possible future legislative changes pertaining to greenhouse gas emissions, but because these proposals are in the formative stages, TXU Corp. is unable to predict any future impacts on its financial condition and operations.

Sulfur Dioxide, Nitrogen Oxide and Mercury Air Emissions

The federal Clean Air Act includes provisions which, among other things, place limits on the sulfur dioxide (SO₂), nitrogen oxide (NOx), and mercury emissions produced by certain generation plants. In addition to the new source performance standards applicable to SO₂ (associated with acid rain) and NOx (associated with smog), the Clean Air Act requires that fossil-fueled plants have sufficient SO₂ emission allowances and meet certain NOx emission standards. TXU Corp.'s generation plants meet the SO₂ allowance requirements and NOx emission rates.

In 2005, the US Environmental Protection Agency (EPA) issued a final rule to further reduce SO₂ and NOx emissions from power plants. The SO₂ and NOx reductions required under the Clean Air Interstate Rule (CAIR) are based on a cap and trade approach (market-based) in which a cap is put on the total quantity of emissions allowed in 28 eastern states (including Texas), emitters are required to have allowances for each ton emitted, and emitters are allowed to trade emissions under the cap. The CAIR reductions are proposed to be phased in between 2009 and 2015.

Also in 2005, the EPA published a final rule requiring reductions of mercury emissions from coal-fueled generation plants. The Clean Air Mercury Rule (CAMR) is based on a cap and trade approach on a nationwide basis. The mercury reductions are proposed to be phased in between 2010 and 2018.

SO₂ reductions required under the proposed regional haze/visibility rule (or so-called BART rule) only apply to units built between 1962 and 1977. The reductions would be required on a unit-by-unit basis. The EPA provides the option for states to use CAIR to satisfy the BART reductions for electric generating units and Texas has chosen this option.

TXU Corp. expects that upon completion of its plan to develop three new lignite/coal-fueled generation units in Texas, emissions of NO_x, SO₂ and mercury from its entire lignite/coal-fueled generation fleet, including both the new and existing units, will be reduced by 20% from 2005 levels. This reduction is expected to be accomplished through the installation of best-available emissions control equipment in both the new and existing units and fuel blending. These efforts, which will involve incremental equipment investments, including up to \$400 million at existing generation facilities, as well as additional costs for facility operations and maintenance in the future, will be coordinated with the CAIR, CAMR and BART rules for the most cost-effective compliance plan options.

The Clean Air Act also requires each state to monitor air quality for compliance with federal health standards. The standards for ozone are not being achieved in several areas of Texas. The TCEQ proposed new State Implementation Plan rules in December 2006 to deal with 8-hour ozone standards. These rules, if adopted, would require further NO_x emission reductions from certain TXU Corp. facilities in the Dallas-Fort Worth area.

Water

The TCEQ and/or the EPA have jurisdiction over water discharges (including storm water) from Texas and US facilities, respectively. Facilities of TXU Corp. are presently in compliance with applicable state and federal requirements relating to discharge of pollutants into water. TXU Corp. holds all required waste water discharge permits from the TCEQ for facilities in operation and has applied for or obtained necessary permits for facilities under construction. TXU Corp. believes it can satisfy the requirements necessary to obtain any required permits or renewals. Recent changes to federal rules pertaining to Spill Prevention, Control and Countermeasure Plans (SPCC) for oil-filled electrical equipment and bulk storage facilities for oil will require updating of certain plants and facilities. TXU Corp. has determined that SPCC plans will be required for certain substations, work centers and distribution systems by July 1, 2009. The company is currently compiling data for development of these plans. Clean Water Act Section 316(b) regulations pertaining to existing water intake structures were published by the EPA in 2004. As prescribed in the regulations, TXU Corp. is implementing a monitoring program to determine the future actions that might need to be taken to comply with these regulations. The results of this program will determine the impact on TXU Corp., which cannot be predicted at this time.

Diversion, impoundment and withdrawal of water for cooling and other purposes are subject to the jurisdiction of the TCEQ. TXU Corp. possesses all necessary permits for these activities from the TCEQ for its present operations.

Radioactive Waste

Under the federal Low-Level Radioactive Waste Policy Act of 1980, as amended, the State of Texas is required to provide, either on its own or jointly with other states in a compact, for the disposal of all low-level radioactive waste generated within the state. The State of Texas has agreed to a compact for a disposal facility that would be located in Texas. That compact was ratified by Congress and signed by the President in 1998. In 2003, the State of Texas enacted legislation allowing a private entity to be licensed to accept low-level radioactive waste for disposal, and in 2004 the State received a license application from such an entity for review. TXU Corp. intends to continue to ship low-level waste material off-site for as long as an alternative disposal site is available. Should existing off-site disposal become unavailable, the low-level waste material will be stored on-site. TXU Corp.'s on-site storage capacity at the Comanche Peak plant is expected to be adequate until other off-site facilities become available. (See discussion under "Nuclear Generation Assets" above).

Solid Waste, including Fly Ash Associated with Lignite/Coal-Fueled Generation

Treatment, storage and disposal of solid and hazardous waste are regulated at the state level under the Texas Solid Waste Disposal Act and at the federal level under the Resource Conservation and Recovery Act of 1976, as amended, and the Toxic Substances Control Act. The EPA has issued regulations under the Resource Conservation and Recovery Act of 1976 and the Toxic Substances Control Act, and the TCEQ has issued regulations under the Texas Solid Waste Disposal Act applicable to facilities of TXU Corp. TXU Corp. is in compliance with all applicable solid waste rules and regulations. In addition, TXU Corp. has registered solid waste disposal sites and has obtained or applied for permits required by such regulations.

Environmental Capital Expenditures

Capital expenditures for TXU Corp.'s environmental projects totaled \$48 million in 2006 and are expected to total approximately \$190 million in 2007, exclusive of emissions control equipment investment planned as part of the three-unit Texas generation development program, which is expected to total up to \$450 million over the construction period.

Item 1A. RISK FACTORS

Some important factors, in addition to others specifically addressed in Management's Discussion and Analysis of Financial Condition and Results of Operations, that could have a material negative impact on TXU Corp.'s operations, financial results and financial condition, and could cause TXU Corp.'s actual results or outcomes to differ materially from any projected outcome contained in any forward-looking statement in this report, include:

Risks Relating to TXU Corp.'s Businesses

TXU Corp.'s businesses are subject to ongoing complex governmental regulations and legislation that have impacted, and may in the future impact, TXU Corp.'s business and/or results of operations.

TXU Corp.'s businesses operate in changing market environments influenced by various state and federal legislative and regulatory initiatives regarding the restructuring of the energy industry, including competition in the generation and sale of electricity. TXU Corp. will need to adapt to these changes. For example, the Texas retail electricity market became competitive as of January 1, 2002, and the introduction of competition has resulted in, and may continue to result in, declines in customer counts and sales volumes.

TXU Corp.'s businesses are subject to changes in state and federal laws (including PURA, the Federal Power Act, the Atomic Energy Act, the Public Utility Regulatory Policies Act of 1978, the Clean Air Act and the Energy Policy Act of 2005) and changing governmental policy and regulatory actions (including those of the Commission, the Texas Railroad Commission, the TCEQ, the FERC, the EPA and the NRC) with respect to matters including, but not limited to, market structure and design, operation of nuclear generation facilities, construction and operation of other generation facilities, construction and operation of transmission facilities, acquisition, disposal, depreciation and amortization of regulated assets and facilities, recovery of costs and investments, decommissioning costs, and return on invested capital for TXU Corp.'s regulated businesses, and present or prospective wholesale and retail competition. TXU Energy Holdings, along with other market participants, is subject to electricity pricing constraints and market behavior and other competition-related rules and regulations under PURA that are administered by the Commission. Changes in, revisions to, or reinterpretations of existing laws and regulations (particularly with respect to prices at which TXU Corp. may sell electricity) may have an adverse effect on TXU Corp.'s businesses.

The Texas Legislature convened in its regular biennial session beginning January 9, 2007. Public statements by key legislators, including the current Chairman of the House Committee on Regulated Industries, which has jurisdiction over electric industry issues in the House, and the Chairman of the Senate Committee on Business and Commerce, which has jurisdiction over electric industry issues in the Senate, indicate a high likelihood that various measures pertaining to the electric industry will be considered. Potential measures that have been or could be introduced and potentially debated or voted upon include initiatives that could affect the competitive framework of the retail electricity market, encourage energy conservation, restore state funding for the low-income customer discount under the "system benefit fund" mechanism, encourage construction of new infrastructure, or enhance customer education regarding the market. TXU Corp. is unable to predict the outcome of the 2007 legislative process, including any impacts relating to the announcement of the merger. Any new laws and regulations may have an adverse effect on TXU Corp.'s businesses and, in some limited circumstances, the ability to close the proposed merger.

The litigation environment in which TXU Corp. operates poses a significant risk to its business.

TXU Corp. and its subsidiaries are involved in the ordinary course of business in a number of lawsuits involving employment, commercial, environmental and injuries and damages issues, among other matters. Judges and juries in the state of Texas have demonstrated a willingness to grant large verdicts, including punitive damages, to plaintiffs in personal injury, property damage, and business tort cases. TXU Corp. and its subsidiaries use legal and appropriate means to contest litigation threatened or filed against them, but the litigation environment in the state of Texas poses a significant business risk.

TXU Corp. may lose a significant number of retail customers in its historical service territory due to competitive REP marketing activity and faces competition from incumbent providers outside its historical service territory.

TXU Corp. faces competition for customers within its historical service territory. Such competitors may be larger or better capitalized or have well-known brand recognition. Such competitors may also offer prices that TXU Corp. believes are too low to be sustainable over the long-term, but attract customers away from TXU Corp.

In most retail electric markets outside its historical service territory, TXU Corp.'s principal competitor may be the retail affiliate of the local incumbent utility company. The incumbent retail affiliates have the advantage of long-standing relationships with their customers, including well-known brand recognition. In addition to competition from the incumbent utilities and their affiliates, TXU Corp. may face competition from a number of other energy service providers, or other energy industry participants, who may develop businesses that will compete with TXU Corp. and nationally branded providers of consumer products and services. Some of these competitors or potential competitors may be larger or better capitalized than TXU Corp. If there is inadequate potential margin in these retail electric markets, it may not be profitable for TXU Corp. to enter these markets.

TXU Corp.'s revenues and results of operations may be negatively impacted by decreases in market prices for power, decreases in prices of commodities, such as natural gas, and decreases in market heat rates.

TXU Corp. is not guaranteed any rate of return on its capital investments in competitive businesses. TXU Corp. markets and trades electricity and natural gas, including electricity from its own generation facilities, as part of its wholesale markets management operation. TXU Corp.'s results of operations depend in large part upon market prices for electricity, natural gas and coal in its regional market and other competitive markets and upon prevailing retail rates, which may be impacted by actions of regulatory authorities. Market prices may fluctuate substantially over relatively short periods of time. Demand for electricity can fluctuate dramatically, creating periods of substantial under- or over-supply. During periods of over-supply, prices might be depressed. Also, at times there may be political pressure, or pressure from regulatory authorities with jurisdiction over wholesale and retail energy commodity and transportation rates, to impose price limitations, bidding rules and other mechanisms to address volatility and other issues in these markets. As a result of Hurricane Katrina, such pressures in September and October of 2005 played a role in TXU Energy Holdings' decision to moderate the implementation of a price increase in November and December 2005 and to voluntarily not raise its price-to-beat rate from January 1, 2006 through April 1, 2006. Further, TXU Energy Holdings has agreed to grant price discounts in connection with the proposed merger and provide price protection through September 2008.

Some of the fuel for TXU Corp.'s generation facilities is purchased under short-term contracts or on the spot market. Prices of fuel, including natural gas, may also be volatile, and the price TXU Corp. can obtain for electricity sales may not change at the same rate as changes in fuel costs. In addition, TXU Corp. purchases and sells natural gas and other energy related commodities, and volatility in these markets may affect TXU Corp.'s costs incurred in meeting its obligations.

Volatility in market prices for fuel and electricity may result from the following:

- severe or unexpected weather conditions,
- seasonality,
- changes in electricity and fuel usage,
- illiquidity in the wholesale power or other markets,
- transmission or transportation constraints, inoperability or inefficiencies,
- availability of competitively priced alternative energy sources,
- changes in supply and demand for energy commodities,
- changes in generation efficiency and market heat rates,
- outages at TXU Corp.'s generation facilities or those of its competitors,
- changes in production and storage levels of natural gas, lignite, coal, crude oil and refined products,
- natural disasters, wars, sabotage, terrorist acts, embargoes and other catastrophic events, and
- federal, state and local energy, environmental and other regulation and legislation.

All of TXU Corp.'s generation facilities are located in the ERCOT region, a market with limited interconnections to other markets. Wholesale electricity prices in the ERCOT market generally move with the price of natural gas because marginal demand is generally supplied by natural gas-fueled generation plants. Wholesale electricity prices also move with market heat rates, which could fall if wholesale electricity prices fall relative to natural gas prices or if excess generation facilities are built in ERCOT. Accordingly, the contribution to earnings and the value of TXU Corp.'s baseload (lignite/coal-fueled and nuclear) generation assets, which provided a substantial portion of TXU Corp.'s supply volumes in 2006, is dependent in significant part upon the price of natural gas and market heat rates. As a result, TXU Corp.'s baseload generation assets could significantly decrease in profitability and value if natural gas prices fall or if market heat rates fall.

TXU Corp.'s assets or positions cannot be fully hedged against changes in commodity prices and market heat rates, and its hedging transactions may not work as planned or hedge counterparties may default on their obligations to TXU Corp.

TXU Corp. cannot fully hedge the risk associated with changes in natural gas prices or market heat rates because of the expected useful life of TXU Corp.'s generation assets and the size of its position relative to market liquidity. To the extent TXU Corp. has unhedged positions, fluctuating commodity prices and/or market heat rates can materially impact TXU Corp.'s results of operations and financial position, either favorably or unfavorably.

To manage its financial exposure related to commodity price fluctuations, TXU Corp. routinely enters into contracts to hedge portions of its purchase and sale commitments, weather positions, fuel requirements and inventories of natural gas, lignite, coal, crude oil and refined products, and other commodities, within established risk management guidelines. As part of this strategy, TXU Corp. routinely utilizes fixed-price forward physical purchase and sales contracts, futures, financial swaps and option contracts traded in the over-the-counter markets or on exchanges. Although TXU Corp. devotes a considerable amount of management time and effort to the establishment of risk management procedures as well as the ongoing review of the implementation of these procedures, the procedures in place may not always be followed or may not always function as planned and cannot eliminate all the risks associated with these activities. As a result of these and other factors, TXU Corp. cannot precisely predict the impact that risk management decisions may have on its business, results of operations or financial position.

To the extent TXU Corp. engages in hedging and risk management activities, TXU Corp. is exposed to the risk that counterparties that owe TXU Corp. money, energy or other commodities as a result of market transactions will not perform their obligations. Should the counterparties to these arrangements fail to perform, TXU Corp. might be forced to enter into alternative hedging arrangements or honor the underlying commitment at then-current market prices. In such event, TXU Corp. might incur losses in addition to amounts, if any, already paid to the counterparties. ERCOT market participants are also exposed to risks that another ERCOT market participant may default in its obligations to pay ERCOT for power taken, in which case such costs, to the extent not offset by posted security and other protections available to ERCOT, may be allocated to various non-defaulting ERCOT market participants, including TXU Corp.

In connection with its affiliates' hedging and risk management activities, TXU Energy Company has guaranteed or indemnified the performance of a portion of its affiliates' obligations relating to such activities. TXU Energy Company might not be able to satisfy all of these guarantees and indemnification obligations if they were to come due at the same time. In addition, reductions in credit quality or changes in the market prices of energy commodities could increase the cash collateral required to be posted in connection with hedging and risk management activities, which could materially impact TXU Corp.'s liquidity and financial position.

TXU Corp. may suffer material losses, costs and liabilities due to its ownership and operation of the Comanche Peak nuclear generation plant.

The ownership and operation of a nuclear generation plant involves certain risks. These risks include: unscheduled outages or unexpected costs due to equipment, mechanical, structural or other problems; inadequacy or lapses in maintenance protocols; the impairment of reactor operation and safety systems due to human error; the costs of storage, handling and disposal of nuclear materials; the costs of securing the plant against possible terrorist attacks; limitations on the amounts and types of insurance coverage commercially available; and uncertainties with respect to the technological and financial aspects of decommissioning nuclear facilities at the end of their useful lives. The prolonged unavailability of Comanche Peak could materially affect TXU Corp.'s financial condition and results of operations, particularly when the cost to produce power at Comanche Peak is significantly less than market wholesale power prices. The following are among the more significant of these risks:

- *Operational Risk* – Operations at any nuclear generation plant could degrade to the point where the plant would have to be shut down. If such degradations were to occur, the process of identifying and correcting the causes of the operational downgrade to return the plant to operation could require significant time and expense, resulting in both lost revenue and increased fuel and purchased power expense to meet supply commitments. Rather than incurring substantial costs to restart the plant, the plant could be shut down. Furthermore, a shut-down or failure at any other nuclear generation plant could cause regulators to require a shut-down or reduced availability at Comanche Peak. In 2007, certain equipment at Comanche Peak is expected to be replaced, which will require extended outages. The cost of replacing the equipment is currently expected to be material.
- *Regulatory Risk* – The NRC may modify, suspend or revoke licenses and impose civil penalties for failure to comply with the Atomic Energy Act, the regulations under it or the terms of the licenses of nuclear generation facilities. Unless extended, the NRC operating licenses for Comanche Peak Unit 1 and Unit 2 will expire in 2030 and 2033, respectively. Changes in regulations by the NRC could require a substantial increase in capital expenditures or result in increased operating or decommissioning costs.
- *Nuclear Accident Risk* – Although the safety record of Comanche Peak and other nuclear generation plants generally has been very good, accidents and other unforeseen problems have occurred both in the US and elsewhere. The consequences of an accident can be severe and include loss of life and property damage. Any resulting liability from a nuclear accident could exceed TXU Corp.'s resources, including insurance coverage.

The operation and maintenance of electricity generation and delivery facilities involves significant risks that could adversely affect TXU Corp.'s results of operations and financial condition.

The operation and maintenance of electricity generation and delivery facilities involves many risks, including, as applicable, start up risks, breakdown or failure of facilities, lack of sufficient capital to maintain the facilities, the dependence on a specific fuel source or the impact of unusual or adverse weather conditions or other natural events, as well as the risk of performance below expected levels of output, efficiency or reliability, the occurrence of any of which could result in lost revenues and/or increased expenses. A significant number of TXU Corp.'s facilities were constructed many years ago. In particular, older generating equipment and transmission and distribution equipment, even if maintained in accordance with good engineering practices, may require significant capital expenditures to keep operating at peak efficiency or reliability. The risk of increased maintenance and capital expenditures arises from (a) increased starting and stopping of generation equipment due to the volatility of the competitive market, (b) any unexpected failure to generate electricity, including failure caused by breakdown or forced outage and (c) damage to facilities due to storms, natural disasters, wars, terrorist acts and other catastrophic events. Further, TXU Corp.'s ability to successfully and timely complete capital improvements to existing facilities or other capital projects is contingent upon many variables and subject to substantial risks. Should any such efforts be unsuccessful, TXU Corp. could be subject to additional costs and/or the write-off of its investment in the project or improvement.

Insurance, warranties or performance guarantees may not cover all or any of the lost revenues or increased expenses, including the cost of replacement power. Likewise, TXU Corp.'s ability to obtain insurance, and the cost of and coverage provided by such insurance, could be affected by events outside its control.

TXU Corp.'s cost of compliance with environmental laws and regulations are significant, and the cost of compliance with new environmental laws could materially adversely affect TXU Corp.'s results of operations and financial condition. Recently, federal laws aimed at regulating the emission of greenhouse gases have been proposed and it is likely that additional bills will be introduced in 2007. The future impacts of greenhouse gas legislation on TXU Corp. will depend in large part on the details of the legislation and the timetable for mandatory compliance. TXU Corp. continues to assess the financial and operational risks posed by possible future greenhouse gas legislation at the federal and state levels. TXU Corp. is unable to predict their future impacts on its financial condition and operations.

TXU Corp. is subject to extensive environmental regulation by governmental authorities. In operating its facilities, TXU Corp. is required to comply with numerous environmental laws and regulations, and to obtain numerous governmental permits. TXU Corp. may incur significant additional costs to comply with these requirements. If TXU Corp. fails to comply with these requirements, it could be subject to civil or criminal liabilities and fines. Existing environmental regulations could be revised or reinterpreted, new laws and regulations could be adopted or become applicable to TXU Corp. or its facilities, and future changes in environmental laws and regulations could occur, including potential regulatory and enforcement developments related to air emissions.

TXU Corp. may not be able to obtain or maintain all required environmental regulatory approvals. If there is a delay in obtaining any required environmental regulatory approvals or if TXU Corp. fails to obtain, maintain or comply with any such approval, the operation of its facilities could be stopped or become subject to additional costs.

In addition, TXU Corp. may be responsible for any on-site liabilities associated with the environmental condition of facilities that it has acquired, leased or developed, regardless of when the liabilities arose and whether they are known or unknown. In connection with certain acquisitions and sales of assets, TXU Corp. may obtain, or be required to provide, indemnification against certain environmental liabilities. Another party could fail to meet its indemnification obligations to TXU Corp.

Late in 2006, several bills addressing climate change were introduced in the US Congress and TXU Corp. expects that more will follow. These bills differ in certain critical aspects pertaining to CO₂ emissions allowances trading, allocation of CO₂ emissions allowances, the economic sectors covered and timing of future emissions limits or restrictions. Although TXU Corp. continues to assess the financial and operational risks posed by possible future legislative changes pertaining to greenhouse gas emissions, it is currently unable to predict any future impact on its financial condition and operations.

The rates of TXU Corp.'s electric delivery business are subject to regulatory review.

The rates assessed by TXU Electric Delivery are regulated by the Commission and certain cities and are subject to cost-of-service regulation and annual earnings oversight. This regulatory treatment does not provide any assurance as to achievement of earnings levels. TXU Electric Delivery's rates are regulated based on an analysis of TXU Electric Delivery's costs and capital structure, as reviewed and approved in a regulatory proceeding. While rate regulation is premised on the full recovery of prudently incurred costs and a reasonable rate of return on invested capital, there can be no assurance that the Commission will judge all of TXU Electric Delivery's costs to have been prudently incurred, that the Commission will not reduce the amount of invested capital included in the capital structure that TXU Electric Delivery's rates are based upon or that the regulatory process in which rates are determined will always result in rates that will produce full recovery of TXU Electric Delivery's costs, including regulatory assets reported in the balance sheet, and the return on invested capital allowed by the Commission.

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 TXU Electric Delivery's Commission-established rates were just and reasonable. TXU Electric Delivery has entered into settlements deferring rate action, but TXU Electric Delivery will be required to file a rate case in 2008, based on a 2007 test year, unless TXU Electric Delivery and the cities mutually agree that such a filing is unnecessary. While TXU Corp. believes the rates are just and reasonable, it cannot predict the results of any rate case.

TXU Corp.'s growth strategy, including its investment in lignite/coal-fueled generation facilities, may not be executed as planned which could adversely impact its financial condition and results of operations.

There can be no guarantee that the execution of TXU Corp.'s growth strategy will be successful. As discussed below, TXU Corp.'s growth strategy is dependent upon many factors. Changes in laws, regulations, markets, costs or other factors could negatively impact the execution of TXU Corp.'s growth strategy, including causing management to change the strategy. Even if TXU Corp. is able to execute its growth strategy, it may take longer than expected at costs higher than expected.

With respect to TXU Corp.'s lignite/coal-fueled generation development program, there can be no guarantee that the execution of such program will be successful. While TXU Corp. has experience in operating lignite/coal-fueled generation facilities, TXU Corp. has limited experience in developing and constructing such facilities. To the extent construction is not managed efficiently and to a timely conclusion, cost overruns may occur resulting in the overall program costing significantly more than anticipated. This may also result in delays in the expected online dates for the facilities resulting in less overall income than projected. While TXU Corp. believes it can acquire the resources needed to effectively execute this program, TXU Corp. is exposed to the risk that it may not be able to attract and retain skilled labor, at projected rates, for developing and constructing these new facilities.

TXU Corp.'s lignite/coal-fueled generation development program is subject to permitting risks. TXU Corp. may not be able to obtain in a timely manner, if at all, the permits necessary to develop and operate these new facilities. Obtaining all permits necessary for the program, and the timely issuance of such permits, could be impeded by litigation against TXU Corp. and/or the applicable regulatory agencies. In addition, obtaining all permits necessary for the program, and the timely issuance of such permits, is subject to the regulatory approval process. The Oak Grove permit has been opposed and is the subject of a contested case hearing that resulted in an unfavorable recommendation from the State Office of Administrative Hearings. The engineering, procurement and construction agreement related to the Oak Grove project provides that if full notice to proceed has not been given to the EPC contractor by March 1, 2007, the terms of the agreement related to cost and guaranteed schedule will be subject to change. TXU Corp. does not intend to give a full notice to proceed until approval of the air permit for the Oak Grove project. There can be no assurances that the delay in providing a full notice to proceed with respect to the Oak Grove project will not result in an adverse impact to the cost or guaranteed delivery schedule of the Oak Grove project.

In addition, while there is an existing air permit for the Sandow project under which the project is being constructed, it was issued to Alcoa pursuant to a consent decree issued by a federal court that contains certain provisions that create risks to the project including a provision that requires the project to be commercially operational by April 25, 2007, an unachievable deadline. TXU has reached a negotiated settlement with the US Department of Justice and the Environmental Protection Agency that would resolve the consent decree issues related to the unachievable commercial operations deadline. On February 28, 2007, the federal court approved the settlement agreement between TXU Corp., the US Department of Justice and the Environmental Protection Agency. Based in part on the district court's ruling, TXU Corp. intends to continue development of the Sandow project. The judgment of the federal court is subject to appeal. If the court ruling is appealed, TXU Corp. would vigorously defend. There can be no assurance that an appeals court would not overturn the district court's ruling, which would result in an adverse impact on the Sandow project.

TXU Corp.'s lignite/coal-fueled generation development program is subject to changes in laws, regulations and policies that are beyond TXU Corp.'s control. Changes in law, regulation or policy regarding commodity prices, power prices, electric competition or solid-fuel generation facilities or other related matters could adversely impact this program. In recent months, global warming has received significant media attention, which has resulted in legislators focusing on environmental laws, regulations and policies. Changes in any environmental law, regulation or policy, such as regulations of emissions of CO₂, if not implemented in a manner that focuses on technology, incentives and a functioning wholesale market, could adversely impact this program.

TXU Corp.'s lignite/coal-fueled generation development program is subject to changes in the electricity market, primarily ERCOT for its new build program in Texas, that are beyond TXU Corp.'s control. If demand growth is less than expected or if other generation companies build new generation assets in markets in which TXU Corp. intends to build generation assets, TXU Corp.'s program could impact market prices of power such that the new generation capacity becomes uneconomical. In addition, any unanticipated reduction in wholesale electricity prices, market heat rates and natural gas prices, which could occur for a variety of reasons, could adversely impact this program. Even if TXU Corp. enters into hedges to reduce such exposures, TXU Corp. would still be subject to the credit risk of its counterparties.

TXU Corp.'s lignite/coal-fueled generation development program is subject to other risks that are beyond TXU Corp.'s control. For example, TXU Corp. is exposed to the risk that a change in technology for electricity generation facilities and/or emissions control technologies may make other generation facilities less costly and more attractive than TXU Corp.'s new lignite/coal-fueled generation facilities. TXU Corp. is subject to risks relating to transmission capabilities and constraints. TXU Corp. is also exposed to the risk that its contractors may default on their obligations to TXU Corp. and compensation for damages received, if any, will not cover TXU Corp.'s losses.

The ability to finance the construction of the new generation facilities is subject to a variety of risks. As a result of the proposed merger, TXU Corp. expects that the three units being developed will be financed using short-term debt or operating cash flows until the proposed merger closes, at which time the funding will continue under financings arranged by the Sponsors. In the event the proposed merger does not close, TXU Corp. may find it difficult to finance the new facilities in a timely basis.

With respect to TXU Corp.'s capital deployment program for its electric delivery facilities, there can be no guarantee that the execution of such program will be successful. There can be no assurance that the capital investments TXU Corp. intends to make in connection with its electric delivery business will produce the desired reductions in cost and improvements to service and reliability.

TXU Corp.'s retail business is subject to the risk that sensitive customer data may be compromised, which could result in an adverse impact to its reputation and/or results of operations of the retail business.

TXU Corp.'s retail business requires access to sensitive customer data in the ordinary course of business. Examples of sensitive customer data are names, addresses, account information, payment history, credit bureau data, credit and debit card account numbers, drivers license numbers, social security numbers and bank account information. The retail business may need to provide sensitive customer data to vendors and service providers who require access to this information in order to provide services, such as call center operations, to the retail business. A security breach may occur, despite security measures taken by the retail business and required of vendors. If a significant or widely publicized breach occurred, the reputation of the retail business may be adversely affected, customer confidence may be diminished, or the retail business may be subject to legal claims, any of which may contribute to customer attrition and have a negative impact on the business and/or results of operations of the retail business.

InfrastruX Energy Services faces challenges to transition into a consolidated and independent business. It may not be able to provide TXU Electric Delivery sufficient services.

TXU Corp. has agreed to form a joint venture with InfrastruX Group. This joint venture, InfrastruX Energy Services, will have to undertake significant actions to integrate the legacy operations of InfrastruX Group, Inc. with the functions required under the services agreement with TXU Electric Delivery prior to the commencement of InfrastruX Energy Services' operations. InfrastruX Energy Services may not have sufficient resources to adequately complete these actions on a timely basis. If these actions cannot be accomplished, the operational performance of InfrastruX Energy Services and its ability to provide services to TXU Electric Delivery could be affected.

It is intended that, under the services agreement between InfrastruX Energy Services and TXU Electric Delivery, TXU Electric Delivery will receive sufficient services to provide service to its customers. In the event InfrastruX Energy Services fails to provide sufficient services, TXU Electric Delivery will have to identify an alternative means to acquire sufficient services. TXU Electric Delivery may not be able to readily find replacement services and such services may be more costly than those to be provided by InfrastruX Energy Services. Should TXU Electric Delivery wish to terminate or materially modify the services agreement, InfrastruX Energy Services and TXU Electric Delivery would also incur transition costs. Failure to obtain sufficient services and costs to acquire replacement services (including transition costs) could adversely affect the financial condition and results of operations of TXU Electric Delivery.

The Commission has requested to review the proposed joint venture transaction. TXU Corp. cannot predict the timing and results of the Commission's review. Such review has delayed the closing of the transaction.

Ongoing performance improvement initiatives may not achieve desired cost reductions and may instead result in significant additional costs if unsuccessful.

The implementation of performance improvement initiatives identified by management may not produce the desired reduction in costs and may result in disruptions arising from employee displacements and the rapid pace of changes to organizational structure and operating practices and processes. Specifically, TXU Corp. is subject to the risk that the joint venture outsourcing arrangement with Capgemini or other similar arrangements may not produce the desired cost savings. Should TXU Corp. wish to terminate or modify the arrangements with Capgemini or other providers, or if Capgemini or those other providers become financially unable to perform their obligations, TXU Corp. would incur transition costs, which would likely be significant, to switch to another vendor.

TXU Corp. relies on the infrastructure of local utilities or independent transmission system operators to provide electricity to, and to obtain information about, their customers. Any infrastructure failure could negatively impact customer satisfaction and could have a material negative impact on TXU Corp.'s business and results of operations.

TXU Corp. depends on transmission and distribution facilities owned and operated by other utilities, as well as its own such facilities, to deliver the electricity it produces and sells to consumers, as well as to other REPs. If transmission capacity is inadequate, TXU Corp.'s ability to sell and deliver electricity may be hindered, it may have to forgo sales or it may have to buy more expensive wholesale electricity that is available in the capacity-constrained area. For example, during some periods, transmission access is constrained in some areas of the Dallas-Fort Worth metroplex, where TXU Corp. has a significant number of customers. The cost to provide service to these customers may exceed the cost to provide service to other customers, resulting in lower profits. In addition, any infrastructure failure that interrupts or impairs delivery of electricity to TXU Corp.'s customers could negatively impact the satisfaction of its customers with its service.

TXU Corp. offers bundled services to its retail customers, with some bundled services offered at fixed prices and for fixed terms. If TXU Corp.'s costs for these bundled services exceed the prices paid by its customers, TXU Corp.'s results of operations could be materially adversely affected.

TXU Corp. offers its customers a bundle of services that include, at a minimum, the electricity itself plus transmission, distribution and related services. The prices TXU Corp. charges for this bundle of services or for the various components of the bundle, any of which may be fixed by contract with the customer for a period of time, could fall below TXU Corp.'s underlying cost to provide the components.

TXU Corp.'s retail business is subject to the risk that it will not be able to profitably serve its customers given the announced price protection and price cuts, which could result in an adverse impact to its reputation and/or results of operations of the retail business.

In connection with the proposed merger, TXU Energy announced a 10 percent price reduction for residential customers in its historical service territory who have not already switched to one of the many pricing plans other than the basic month-to-month plan. Customers will receive a six percent reduction beginning in late March and an additional four percent reduction at the closing of the proposed merger. In addition, TXU Energy announced that, upon closing of the proposed merger, it will provide price protection through September 2008, ensuring that these customers receive the benefits of these savings through two summer seasons of peak energy usage. The prices TXU Energy charges during this period could fall below TXU Energy underlying cost to provide electricity.

Changes in technology may reduce the value of TXU Corp.'s generation plants and/or electric delivery facilities and may significantly impact its business in other ways as well.

Research and development activities are ongoing to improve existing and alternative technologies to produce electricity, including gas turbines, fuel cells, microturbines and photovoltaic (solar) cells. It is possible that advances in these or other technologies will reduce the costs of electricity production from these technologies to a level that will enable these technologies to compete effectively with the traditional generation plants owned by TXU Corp. While demand for electric energy services is generally increasing throughout the US, the rate of construction and development of new, more efficient generation facilities may exceed increases in demand in some regional electric markets. Consequently, where TXU Corp. has facilities, the profitability and market value of TXU Corp.'s generation assets could be significantly reduced. Also, electricity demand could be reduced by increased conservation efforts and advances in technology, which could likewise significantly reduce the value of TXU Corp.'s generation assets and electric delivery facilities. Changes in technology could also alter the channels through which retail electric customers buy electricity. To the extent self-generation facilities become a more cost-effective option for certain customers, TXU Corp.'s revenues could be reduced.

TXU Corp.'s future results of operations may be negatively impacted by settlement adjustments determined by ERCOT related to prior periods.

ERCOT is the independent system operator that is responsible for maintaining reliable operation of the bulk electric power supply system in the ERCOT region. Its responsibilities include the clearing and settlement of electricity volumes and related ancillary services among the various participants in the deregulated Texas market. Settlement information is due from ERCOT within two months after the operating day, and true-up settlements are due from ERCOT within six months after the operating day. As a result, TXU Corp. is subject to settlement adjustments from ERCOT related to prior periods, which may result in charges or credits impacting future reported results of operations.

TXU Corp.'s results of operations and financial condition could be negatively impacted by any development or event beyond its control that causes economic weakness in the ERCOT region.

TXU Corp. derives substantially all of its revenues from its operations in the ERCOT region. As a result, regardless of the state of the economy in areas outside the ERCOT region, economic weakness in the ERCOT region could lead to reduced demand for electricity in the ERCOT region. Such a reduction could have a material negative impact on TXU Corp.'s results of operations and financial condition.

A downgrade in TXU Corp.'s (or an applicable subsidiary's) credit ratings could negatively affect TXU Corp.'s (or the pertinent subsidiary's) ability to access capital and could require TXU Corp. or its subsidiaries to post collateral or repay certain indebtedness.

In connection with the announcement of the proposed merger, Fitch Ratings, Ltd. (Fitch) downgraded TXU Corp.'s and its subsidiaries' long-term debt ratings and Standard & Poor's Rating Services (S&P) and Moody's Investor Services, Inc. (Moody's) warned that they might do the same. Downgrades in TXU Corp.'s or any of its subsidiaries' long-term debt ratings generally cause borrowing costs to increase and the potential pool of investors and funding sources to decrease and might trigger liquidity demands pursuant to the terms of a number of commodity contracts, leases and other agreements.

Most of TXU Corp.'s large customers, suppliers and counterparties require an expected level of creditworthiness in order for them to enter into transactions. As TXU Corp.'s (or an applicable subsidiary's) credit ratings decline, particularly below investment grade, the costs to operate TXU Corp.'s business would increase because counterparties may require the posting of collateral in the form of cash-related instruments, or counterparties may decline to do business with TXU Corp.

In addition, as discussed under Material Credit Rating Covenants included in Appendix A to this report, the terms of certain of TXU Corp.'s and its subsidiaries' financing and other arrangements contain provisions that are directly or indirectly affected by changes in credit ratings and could require the posting of collateral, the repayment of indebtedness or the payment of other amounts.

TXU Corp. is a holding company, and its obligations are structurally subordinated to existing and future liabilities and preferred stock of its subsidiaries.

TXU Corp. is a holding company. Substantially all of TXU Corp.'s consolidated assets are held by subsidiaries. Accordingly, TXU Corp.'s cash flows and ability to meet its obligations and to pay dividends are largely dependent upon the earnings of its subsidiaries and the payment of such earnings to TXU Corp. in the form of distributions, loans or advances, and repayment of loans or advances from TXU Corp. These subsidiaries are separate and distinct legal entities and have no obligation to provide TXU Corp. with funds for its payment obligations, whether by dividends, distributions, loans or otherwise.

Because TXU Corp. is a holding company, its obligations to its creditors are structurally subordinated to all existing and future liabilities and existing and future preferred stock of its subsidiaries. Therefore, TXU Corp.'s rights and the rights of its creditors to participate in the assets of any subsidiary in the event that such a subsidiary is liquidated or reorganized are subject to the prior claims of such subsidiary's creditors and holders of its preferred stock. To the extent that TXU Corp. may be a creditor with recognized claims against any such subsidiary, its claims would still be subject to the prior claims of such subsidiary's creditors to the extent that they are secured or senior to those held by TXU Corp. Subject to restrictions contained in financing arrangements, TXU Corp.'s subsidiaries may incur additional indebtedness and other liabilities.

In connection with the proposed merger, TXU Corp. expects that a significant amount of debt will be issued by TXU Energy Company. This debt will be structurally senior to TXU Corp.'s debt.

In the future, TXU Corp. could have liquidity needs that could be difficult to satisfy under some circumstances.

The inability to raise capital on favorable terms, particularly during times of uncertainty in the financial markets, could impact TXU Corp.'s ability to sustain and grow its businesses, which are capital intensive, and would increase its capital costs. TXU Corp. relies on access to financial markets as a significant source of liquidity for capital requirements not satisfied by cash on hand or operating cash flows. TXU Corp.'s access to the financial markets could be adversely impacted by the announcement of the proposed merger and various other factors, such as:

- changes in credit markets that reduce available credit or the ability to renew existing liquidity facilities on acceptable terms;
- inability to access commercial paper markets;
- changes in interest rates;
- a deterioration of TXU Corp.'s credit or the credit of its subsidiaries or a reduction in TXU Corp.'s credit ratings or the credit ratings of its subsidiaries;
- extreme volatility in TXU Corp.'s markets that increases margin or credit requirements;
- a material breakdown in TXU Corp.'s risk management procedures; and
- the occurrence of material adverse changes in TXU Corp.'s businesses that restrict TXU Corp.'s ability to access its liquidity facilities.

A lack of necessary capital and cash reserves could adversely impact the evaluation of TXU Corp.'s creditworthiness by counterparties and rating agencies, and would likely increase its capital costs. Further, concerns on the part of counterparties regarding TXU Corp.'s liquidity and credit could limit its wholesale markets activities. An increase in TXU Corp.'s capital costs or limitations of its wholesale markets activities could have a material negative impact on TXU Corp.'s results of operations and financial condition.

TXU Corp.'s common stock price has been and may continue to be volatile.

The market price of TXU Corp.'s common stock has been volatile in the past, and a variety of factors could cause the price to fluctuate in the future. In addition to the matters discussed above, the following could impact the market price for TXU Corp.'s common stock:

- developments related to the consummation of the proposed merger;
- developments related to TXU Corp.'s businesses;
- commodity prices, in particular natural gas prices;
- market heat rates in the Texas electricity market;
- fluctuations in TXU Corp.'s results of operations;
- the level of dividends and share repurchases;
- TXU Corp.'s credit quality and any significant change in its credit ratings;
- effect of significant events relating to the energy sector in general;
- sales of TXU Corp. securities into the marketplace;
- general conditions in the industry and the energy markets in which TXU Corp. is a participant;
- the worldwide economy;
- an outbreak of war or hostilities;
- a shortfall in revenues or earnings compared to securities analysts' expectations;
- changes in analysts' recommendations or projections; and
- actions by credit rating agencies.

Fluctuations in the market price of TXU Corp.'s common stock may be unrelated to TXU Corp.'s performance. General market declines or market volatility could adversely affect the price of TXU Corp.'s common stock and the current market price may not be indicative of future market prices.

The issues and associated risks and uncertainties described above are not the only ones TXU Corp. may face. Additional issues may arise or become material as the energy industry evolves.

Risks Relating to the Proposed Merger

TXU Corp. cannot make any assurance that the proposed merger will be consummated.

Consummation of the proposed merger is subject to the satisfaction of various closing conditions, including approval of the merger by a vote of two-thirds of the outstanding shares of TXU Corp. common stock, expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, approval of the FERC and the NRC and other customary closing conditions described in the Merger Agreement. TXU Corp. also expects to seek approval of the Federal Communications Commission in connection with the closing of the proposed merger. TXU Corp. cannot guarantee that these closing conditions will be satisfied, that it will receive the approval from the Federal Communications Commission or that the proposed merger will be successfully completed. In the event that the proposed merger is not completed:

- management's attention from TXU Corp.'s day-to-day business may be diverted;
- TXU Corp. may lose key employees;
- TXU Corp.'s relationships with customers and vendors may be disrupted as a result of uncertainties with regard to its business and prospects;
- TXU Corp. may be required to pay significant transaction costs related to the proposed Merger, such as a transaction termination (break-up) fee of up to \$1.0 billion; and
- the market price of shares of TXU Corp. common stock may decline to the extent that the current market price of those shares reflects a market assumption that the proposed merger will be completed.

Any such events could have a material negative impact on TXU Corp.'s results of operations and financial condition and could adversely affect TXU Corp.'s stock price.

TXU Corp. may not be able to attract or retain key management employees.

The announcement of the proposed merger may have a negative impact on TXU Corp.'s ability to attract and retain key management and maintain and attract new third party relationships. Any such events could have a material negative impact on TXU Corp.'s results of operations and financial condition.

TXU Corp. and its subsidiaries (excluding TXU Electric Delivery) will have substantially more debt.

TXU Corp. and TXU Energy Company will have substantial indebtedness if the proposed merger is consummated. There can be no assurance that TXU Corp.'s and TXU Energy Company's businesses will be able to generate sufficient cash flows from operations to meet their debt service obligations. TXU Corp.'s and TXU Energy Company's level of indebtedness has important consequences, including limiting their ability to invest operating cash flow to expand their businesses or execute their strategies, to capitalize on business opportunities and to react to competitive pressures, because TXU Corp. and TXU Energy Company must dedicate a substantial portion of these cash flows to service their debt. In addition, TXU Corp. and TXU Energy Company and their respective subsidiaries could be unable to refinance or obtain additional financing because of market conditions, high levels of debt and the debt restrictions expected to be included in the debt instruments executed in connection with the consummation of the proposed merger. Any of this new indebtedness may contain restrictive covenants, which may adversely affect TXU Corp.'s and TXU Energy Company's and their respective subsidiaries' (other than TXU Electric Delivery, which is not expected to be subject to these restrictive covenants) ability to service existing indebtedness or operate their businesses.

Indebtedness incurred in connection with the proposed merger will cause the subordination of existing indebtedness.

Some or all of the new financing to be incurred in connection with the proposed merger is expected to be issued by TXU Energy Company and secured by its assets or assets of its subsidiaries. Therefore, TXU Corp.'s and its subsidiaries' existing unsecured indebtedness will be effectively subordinated to future secured indebtedness to the extent of the value of the assets securing that indebtedness.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 3. LEGAL PROCEEDINGS

Litigation — On February 28, 2007, a lawsuit was filed in the 160th District Court, Dallas County, Texas seeking compensatory damages and injunctive relief arising out of the Merger Agreement. The suit, filed by putative TXU Corp. shareholder, International Brotherhood of Electrical Workers Local 98 Pension Fund, individually, and as a class action for similarly situated shareholders, alleges that directors of TXU Corp. breached fiduciary duties owed TXU Corp. shareholders by approving the Merger Agreement. Named as defendants are TXU Corp. and directors of its Board, as well as private equity firms and investors involved in the transaction. TXU Corp. believes the claims made in this litigation are without merit and, therefore, intends to vigorously defend this litigation, including demonstrating to the court that the Merger Agreement contains a “go-shop” provision pursuant to which TXU Corp. has the right to solicit and engage in discussions and negotiations with respect to competing proposals through April 16, 2007 and that the transaction is subject to the approval of TXU Corp.’s shareholders. Further, the suit purports to assert claims by shareholders directly against the Board of Directors when TXU Corp. believes that Texas law does not recognize such a cause of action.

On February 27, 2007, a lawsuit was filed in the 68th District Court, Dallas County, Texas arising out of the Merger Agreement. The suit, filed by putative TXU Corp. shareholders Gary and Lon Grady, alleges that directors of TXU Corp., named as defendants, breached fiduciary duties owed TXU Corp. by approving the Merger Agreement. The petition includes claims that directors and/or officers failed to ensure that the transaction was in the best interest of TXU Corp.; that the directors participated in a transaction where their loyalties were divided and where they were to receive a personal financial benefit; and that such alleged conduct constituted a breach of their duties of care, loyalty, good faith, candor and independence owed to TXU Corp. TXU Corp. believes the claims made in this litigation are without merit and, therefore, intends to vigorously defend this litigation, including demonstrating to the court that the Merger Agreement allows TXU Corp. to solicit other proposals from third parties through April 16, 2007 and that the transaction is subject to the approval of TXU Corp.’s shareholders. Further, TXU Corp. believes that the plaintiffs failed to comply with provisions of the Texas Business Organizations Code applicable to filing a derivative proceeding.

On February 27, 2007, a lawsuit was filed in the 162nd District Court, Dallas County, Texas by putative TXU Corp. common stock shareholder, J&B Charitable Remainder Trust, asserting claims individually and as a class action on behalf of allegedly similarly situated shareholders. The suit named the directors of TXU Corp. as defendants as well as two private equity firms. The lawsuit contends that the directors violated various fiduciary duties in connection with the February 25, 2007 execution of the Merger Agreement. Plaintiff seeks to enjoin defendants from consummating the Merger Agreement until such time as a procedure or process is adopted to obtain the highest possible price for TXU Corp. shareholders, as well as a request that the court order the directors of TXU Corp. to exercise their fiduciary duties in order to obtain a transaction in the best interest of TXU Corp. shareholders. The merger agreement allows TXU Corp. to solicit other proposals from third parties through April 16, 2007 and is subject to the approval of TXU Corp.’s shareholders. Further, the suit purports to assert claims by shareholders directly against the Board of Directors when TXU Corp. believes that Texas law does not recognize such a cause of action. TXU Corp. believes the claims made in this litigation are without merit and, therefore, intends to vigorously defend this litigation.

On February 26, 2007, a lawsuit was filed in the 101st District Court, Dallas County, Texas by putative TXU Corp. shareholder, Samuel T. Cohen, asserting claims individually and as a class action on behalf of allegedly similarly situated shareholders. The suit named the directors of TXU Corp. as defendants as well as two private equity firms. The lawsuit contends that the directors violated various fiduciary duties in connection with the February 25, 2007 execution of the Merger Agreement. Plaintiff seeks to enjoin defendants from consummating the transactions contemplated by the Merger Agreement until such time as a procedure or process is adopted to obtain the highest possible price for TXU Corp. shareholders, as well as a request that the court direct the officers and directors of TXU Corp. to exercise their fiduciary duties in order to obtain a transaction in the best interest of TXU Corp. shareholders. The Merger Agreement allows TXU Corp. to solicit other proposals from third parties through April 16, 2007 and is subject to the approval of TXU Corp.’s shareholders. Further, the suit purports to assert claims by shareholders directly against the Board of Directors when TXU Corp. believes that Texas law does not recognize such a cause of action. TXU Corp. believes the claims made in this litigation are without merit and, therefore, intends to vigorously defend this litigation.

On February 26, 2007, a lawsuit was filed in the 192nd District Court, Dallas County, Texas seeking temporary and permanent injunctive relief arising out of the Merger Agreement. The suit, filed by putative TXU Corp. shareholder Brian Gottlieb, individually, and as a class action for similarly situated shareholders, alleges that directors of TXU Corp., named as defendants, breached fiduciary duties owed TXU Corp. shareholders by approving the Merger Agreement. The petition includes claims that directors failed to take steps to properly value or maximize the value of the company and breached their duties of loyalty, good faith, candor and independence owed to TXU Corp. shareholders. TXU Corp. believes the claims made in this litigation are without merit and, therefore, intends to vigorously defend this litigation, including demonstrating to the court that the Merger Agreement allows TXU Corp. to solicit other proposals from third parties through April 16, 2007 and that the transaction is subject to the approval of TXU Corp.'s shareholders. Further, the suit purports to assert claims by shareholders directly against the TXU Corp. Board of Directors when TXU Corp. believes that Texas law does not recognize such a cause of action.

On February 26, 2007, a lawsuit was filed in the 192nd District Court, Dallas County, Texas seeking compensatory damages and injunctive relief arising out of the Merger Agreement. The suit, filed by TXU Corp. shareholder Henry Schipper, individually, and as a class action for similarly situated shareholders, alleges that directors of TXU Corp., named as defendants, breached their fiduciary duty owed TXU Corp. shareholders by approving the Merger Agreement and failing to take all reasonable steps to assure maximization of shareholder value. The petition further claims that directors failed to fully inform themselves about whether greater value could be achieved through the sale of the company to a third party. TXU Corp. believes the claims made in this litigation are without merit and, therefore, intends to vigorously defend this litigation, including demonstrating to the court that the Merger Agreement allows TXU Corp. to solicit other proposals from third parties through April 16, 2007 and that the transaction is subject to the approval of TXU Corp.'s shareholders. Further, the suit purports to assert claims directly against directors when TXU Corp. believes that Texas law does not recognize such a cause of action.

On February 25, 2007, a lawsuit was filed in District Court, Dallas County, Texas by a pension fund against the directors of TXU Corp., asserting claims on behalf of an owner of shares of TXU Corp. common stock as well as seeking to certify a class action on behalf of allegedly similarly situated shareholders. The lawsuit contends that directors of TXU Corp. violated various fiduciary duties owed plaintiff and other shareholders in connection with the February 25, 2007 execution of the Merger Agreement. Plaintiff seeks to enjoin defendants from consummating the Merger Agreement until such time as a procedure or process is adopted to obtain the highest possible price for shareholders, as well as a request that the court direct the officers and directors of TXU Corp. to exercise their fiduciary duties in order to obtain a transaction in the best interest of TXU Corp. shareholders. The Merger Agreement allows TXU Corp. to solicit other proposals from third parties through April 16, 2007 and is subject to the approval of TXU Corp.'s shareholders. Further, the suit purports to assert claims directly against directors when TXU Corp. believes that Texas law does not recognize such a cause of action. Accordingly, TXU Corp. believes the claims made in this litigation are without merit and, therefore, intends to vigorously defend this litigation.

On December 1, 2006, a lawsuit was filed in the United States District Court for the Western District of Texas against TXU Generation Company, LP, Oak Grove Management Company LLC, and TXU Corp. The complaint seeks declaratory and injunctive relief, as well as the assessment of civil penalties, with respect to the permit application for the construction and operation of the Oak Grove generation plant in Robertson County, Texas. The plaintiffs allege violations of the federal Clean Air Act, Texas Health and Safety Code and Texas Administrative Code and seek to temporarily and permanently enjoin the construction and operation of the Oak Grove generation plant. The complaint also asserts that the permit application was deficient in failing to comply with various modeling and analyses requirements relative to the impact of emissions on the environment. Plaintiffs further request that the District Court enter an order requiring the defendants to take other appropriate actions to remedy, mitigate and offset alleged harm to the public health and environment. TXU Corp. believes the Oak Grove air permit, if granted by the TCEQ, will be protective of the environment and that the application for and the processing of the air permit by Oak Grove Management Company LLC with the TCEQ has been in accordance with law. TXU Corp. further believes that the plaintiffs' complaint should be dismissed in response to the Motion to Dismiss, which has been filed in the litigation, and that the claims made in this complaint are without merit and, accordingly, intends to vigorously defend this litigation.

On September 6, 2005 a lawsuit was filed in the US District Court for the Northern District of Texas, Dallas Division against TXU Corp. and C. John Wilder. The plaintiffs' amended complaint asserts claims on behalf of the plaintiffs and a putative class of owners of certain TXU Corp. securities who tendered such securities in connection with a tender offer conducted by TXU Corp. in 2004. The amended complaint alleges violations of the provisions of Sections 14(e), 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 thereunder. The allegations relate to a tender offer conducted in September and October 2004 for certain equity-linked securities in which it was expressly disclosed that TXU Corp. management was evaluating whether it should recommend to the board of directors that the board reevaluate TXU Corp.'s dividend policy. After the tender offer was closed, and consistent with the disclosure, management did make a recommendation to the board to reevaluate the dividend policy and the board elected to increase the quarterly dividend. The plaintiffs contend that such disclosure in connection with the tender offer was inadequate. TXU Corp. maintains that the disclosure provided in connection with the tender offer regarding the evaluation of the dividend policy was complete and accurate at the time the tender offer was initiated as well as when it was closed. A Motion to Dismiss was filed by the defendants, and the District Court entered an order granting the Motion to Dismiss and dismissing this litigation with prejudice on August 30, 2006. The plaintiffs filed a timely notice of appeal and the matter is now before the US Fifth Circuit Court of Appeals with briefing of the appeal completed. While TXU Corp. is unable to estimate any possible loss or predict the outcome of this litigation in the event the Fifth Circuit Court of Appeals reverses the District Court, TXU Corp. believes the claims made in this litigation are without merit and, accordingly, intends to vigorously defend this litigation, including the appeal of the District Court's order dismissing the complaint.

Between October 19, 2004 and October 31, 2005, twelve lawsuits were filed in various California Superior Courts by purported customers against TXU Corp., TXU Energy Trading Company and TXU Energy Services and other marketers, traders, transporters and sellers of natural gas in California. Plaintiffs alleged that beginning at least by the summer of 2000, defendants manipulated and fixed at artificially high levels natural gas prices in California in violation of the Cartwright Act and other California state laws. These lawsuits were coordinated in the San Diego Superior Court with numerous other natural gas actions as "In re Natural Gas Anti-Trust Cases I, II, III, IV and V." On December 28, 2006, an agreement in principle to settle this matter was reached between the TXU defendants and the plaintiffs in the twelve pending lawsuits. Formal settlement documents were signed in February 2007. Notices of Dismissal were filed in the San Diego Superior Court and the case was dismissed with prejudice on February 14, 2007.

In November 2002, February 2003 and March 2003, three lawsuits were filed in the US District Court for the Northern District of Texas, Dallas Division, asserting claims under the Employee Retirement Income Security Act (ERISA) on behalf of a putative class of participants in and beneficiaries of various employee benefit plans of TXU Corp. These ERISA lawsuits were consolidated, and a consolidated complaint was filed in February 2004 against TXU Corp., the directors of TXU Corp. serving during the putative class period as well as certain officers of TXU Corp. who were the members of the TXU Thrift Plan Committee. The plaintiffs seek to represent a class of participants in such employee benefit plans during the period between April 26, 2001 and October 11, 2002. The plaintiffs filed an initial motion for class certification and, after class certification discovery was completed, the District Court denied plaintiffs' initial class certification motion without prejudice and granted plaintiffs' leave to amend their complaint. Plaintiffs' second class certification motion, filed on the basis of their amended complaint, was denied and the case was ordered dismissed without prejudice on September 29, 2005. The plaintiffs filed an appeal of the dismissal to the Fifth Circuit Court of Appeals. While on appeal, the matter was referred to the Fifth Circuit's alternative dispute resolution program and subsequently to mediation. While mediation was unsuccessful, further discussions led to an agreement in principle to settle this litigation on December 24, 2006 for \$7.25 million, before attorney's fees, to be paid by TXU Corp. to the thrift plan pursuant a Court approved allocation. A Memorandum of Understanding confirming the agreement in principle was signed on January 24, 2007 and the settlement is in the process of being confirmed with final settlement documents after which the settlement will be submitted to the District Court for approval. TXU Corp. believes the claims are without merit and, in the event the settlement is not approved, intends to vigorously defend the lawsuit, including the appeal. TXU Corp. is, however, unable to estimate any possible loss or predict the outcome of this action in the event the District Circuit rejects the settlement, the Fifth Circuit reverses the dismissal and remands the case to the District Court or the suit is refiled by the plaintiffs or others seeking to assert similar claims.

In October, November and December 2002 and January 2003, a number of lawsuits were filed in, removed to or transferred to the US District Court for the Northern District of Texas, Dallas Division, against TXU Corp. and certain of its officers and directors. These lawsuits were consolidated and lead plaintiffs were appointed by the Court. The consolidated complaint alleged violations of the Securities Exchange Act of 1934, as amended, Rule 10b-5 thereunder and the Securities Act of 1933, as amended. On January 20, 2005, TXU Corp. executed a memorandum of understanding settling this litigation for \$150 million. After preliminary certification of a settlement class and notice to such class, the District Court conducted a hearing and thereafter on November 8, 2005 granted final approval of the settlement. Certain members of the settlement class who objected to the plan of allocation, the plaintiffs' attorneys' fees and other matters related to the approval of the settlement have appealed the orders approving the settlement to the Fifth Circuit Court of Appeals and the appeal remains pending. TXU Corp. believes that the issues raised on appeal are without merit but cannot predict whether the appeal might result in a remand to the District Court for reconsideration of the notice to the settlement class, the plaintiffs' attorneys' fees or other matters, and while TXU Corp. cannot predict the effect of the appeal being sustained, it does not believe that the appeal will result in reversal of the approval of the settlement.

In addition to the above, TXU Corp. is involved in various other legal and administrative proceedings in the normal course of business the ultimate resolution of which, in the opinion of management, should not have a material effect on its financial position, results of operations or cash flows.

Regulatory Investigations — In October 2006, TXU Portfolio Management Company (TXU Portfolio Management) was notified that the Commission had begun an informal investigation of its 2005 activities in the ERCOT wholesale electricity market as a result of observations noted in the *2005 State of the Market Report for the ERCOT Wholesale Electricity Markets* performed by Potomac Economics, an economic consulting firm. TXU Portfolio Management believes that the investigation will focus on activities involving bids to sell balancing energy and generation unit commitments. Balancing energy represents approximately five to 10 percent of the total energy sold in the ERCOT wholesale market. TXU Portfolio Management is cooperating fully with the Commission in its informal investigation.

On March 18, 2005, TXU Corp. received a subpoena from the US Securities and Exchange Commission (SEC). The subpoena required TXU Corp. to produce documents and other information for the period from January 1, 2001 to March 31, 2003 relating to, among other things, the financial distress at TXU Europe Limited (TXU Europe) during 2002 and the resulting financial condition of TXU Corp. including reduction of TXU Corp.'s quarterly dividend in October 2002. TXU Corp. cooperated with the SEC and completed the production of the documents requested by the subpoena as well as other information requested by the SEC. TXU Corp. received a letter dated February 15, 2007 which stated that the investigation had been terminated and that no enforcement action had been recommended to the Commission. Accordingly, TXU Corp. does not expect any action by the SEC against the company related to the matters which were the subject of the investigation.

In addition to the above, TXU Corp. is involved in various other regulatory investigations in the normal course of business the ultimate resolution of which, in the opinion of management, should not have a material effect on its financial position, results of operations or cash flows.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

EXECUTIVE OFFICERS OF TXU CORP.

<u>Name of Officer</u>	<u>Age</u>	<u>Positions and Offices Presently Held (Current Term Expires on June 14, 2007)</u>	<u>Date First Elected to Present Offices (Current Term Expires on June 14, 2007)</u>	<u>Business Experience (Preceding Five Years)</u>
C. John Wilder	48	Chairman, President and CEO	May 20, 2005	Chairman, President and CEO of TXU Corp. since May 2005; prior thereto President and Chief Executive of TXU Corp. (2004-2005); prior thereto Executive Vice President and Chief Financial Officer of Entergy Corporation.
T. L. Baker	61	Chairman of the Board and Chief Executive of TXU Electric Delivery	July 26, 2004	Chairman of the Board and Chief Executive of TXU Electric Delivery since July 2004; prior thereto Executive Vice President of TXU Corp. and President and Chief Executive of TXU Energy Holdings (2003-2004); prior thereto, Vice Chairman of TXU Electric Delivery (2002-2003); prior thereto, President of TXU Electric Delivery (2001-2002).
James A. Burke	38	Chairman of the Board, President and Chief Executive of TXU Energy	August 16, 2005	Chairman of the Board, President and Chief Executive of TXU Energy since August 2005 and Executive Vice President of TXU Energy Holdings since July 2006; prior thereto, Senior Vice President Consumer Markets of TXU Energy (2004-2005); prior thereto, President and Chief Operating Officer of Gexa Energy; prior thereto, Senior Vice President, Reliant Resources Incorporated.
David A. Campbell	38	Executive Vice President, Planning, Strategy and Risk and Acting Chief Financial Officer of TXU Corp.	May 21, 2004	Executive Vice President, Planning, Strategy and Risk of TXU Corp. since May 2004 and Acting Chief Financial Officer of TXU Corp. since March 2006 and Executive Vice President of TXU Energy Holdings since September 2006; prior thereto, Principal of McKinsey & Company, Inc.
M. Rizwan Chand	43	Senior Vice President of TXU Corp.	August 19, 2005	Senior Vice President of TXU Corp. since August 2005 and Senior Vice President of TXU Energy Holdings, TXU Electric Delivery and TXU Electric Delivery Transition Bond Company, LLC since July 2005; prior thereto, Vice President of Human Resources and Corporate Relations for Kennametal, Inc.

<u>Name of Officer</u>	<u>Age</u>	<u>Positions and Offices Presently Held (Current Term Expires on June 14, 2007)</u>	<u>Date First Elected to Present Offices (Current Term Expires on June 14, 2007)</u>	<u>Business Experience (Preceding Five Years)</u>
Michael P. Childers	45	President and Chief Executive of Generation Development of TXU DevCo	August 28, 2006	President and Chief Executive of Generation Development of TXU DevCo since August 2006 and Executive Vice President and Chief Executive of Generation Development of TXU Energy Holdings since March 2006; prior thereto, President and Chief Executive Officer of DevCo (May 2006-August 2006); prior thereto, Senior Vice President of TXU Business Services and Senior Vice President of TXU Energy Holdings (2005-2006); prior thereto, President of the Engineering, Construction and Maintenance Division and Executive Vice President for The Shaw Group; prior thereto, President of Entergy Asset Management; prior thereto, Chief Operating Officer of Entergy Wholesale Management Operations.
Charles R. Enze	53	President and Chief Executive of Generation Construction of TXU DevCo	August 28, 2006	President and Chief Executive of Generation Construction of TXU DevCo since August 2006 and Executive Vice President and Chief Executive of Generation Construction of TXU Energy Holdings since June 2006; prior thereto, Vice President of Engineering and Projects for Shell International Exploration & Production.
M. S. Greene	61	Chairman of the Board, President and Chief Executive of TXU Energy Holdings and TXU Power	July 26, 2004	Chairman of the Board, President and Chief Executive of TXU Energy Holdings since July 2005 and TXU Power since July 2004; prior thereto, Chairman of the Board, President and Chief Executive of TXU Power and Executive Vice President of TXU Energy Holdings (2004-2005); prior thereto, Vice Chairman and Chief Executive of TXU Electric Delivery (March 2004-July 2004); prior thereto, Vice Chairman of TXU Electric Delivery (2003-2004); prior thereto, President of TXU Electric Delivery (2002-2003); prior thereto, President, Transmission Division of TXU Electric Delivery (2001-2002).

<u>Name of Officer</u>	<u>Age</u>	<u>Positions and Offices Presently Held (Current Term Expires on June 14, 2007)</u>	<u>Date First Elected to Present Offices (Current Term Expires on June 14, 2007)</u>	<u>Business Experience (Preceding Five Years)</u>
Michael T. McCall	49	Chairman of the Board, President and Chief Executive of TXU Wholesale	August 16, 2005	Chairman of the Board, President and Chief Executive of TXU Wholesale since August 2005 and Executive Vice President of TXU Energy Holdings since April 2006; prior thereto, Senior Vice President of TXU Power (2004-2005) prior thereto President of TXU Gas (2003-2004); prior thereto, Vice President of TXU Business Services Company (1999-2003).
David P. Poole	44	Executive Vice President and General Counsel of TXU Corp.	March 16, 2006	Executive Vice President and General Counsel of TXU Corp. since March 2006 and Executive Vice President of TXU Energy Holdings since September 2006; prior thereto, Senior Vice President and Chief Legal Officer of TXU Power (January 2005 - September 2006) and Senior Vice President of TXU Corp. (January 2005 - May 2005); prior thereto, Senior Vice President of TXU Business Services Company (July 2004 - March 2005); prior thereto, Vice President and Associate General Counsel of TXU Business Services Company (May 2004 - July 2004); prior thereto, Managing partner of the Dallas office of Hunton & Williams LLP.
Jonathan A. Siegler	34	Vice President of Strategy, Mergers and Acquisition of TXU Business Services Company	August 30, 2004	Vice President of Strategy, Mergers and Acquisition of TXU Business Services Company since August 2004; prior thereto, Engagement Manager for McKinsey & Company; prior thereto Lieutenant in US Navy.

There is no family relationship between any of the above-named Executive Officers.