
Texas Competitive Electric Holdings Company LLC

Delaware
(State of organization)

75-2967817
(I.R.S. Employer Identification No.)

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(Address of principal executive offices)

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(Telephone number)

Quarterly Report

For the Quarterly Period Ended September 30, 2008

Texas Competitive Electric Holdings Company LLC is not required to file reports with the Securities and Exchange Commission (SEC) and therefore has not filed this quarterly report with the SEC. While this quarterly report has been prepared in substantial conformity with Form 10-Q under the Securities Exchange Act of 1934, it does not include all of the information contemplated by Form 10-Q.

As of November 4, 2008, all outstanding common membership interests in Texas Competitive Electric Holdings Company LLC were held by Energy Future Competitive Holdings Company.

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This Quarterly Report and other reports of Texas Competitive Electric Holdings Company LLC and its subsidiaries occasionally make references to TCEH, TXU Energy or Luminant when describing actions, rights or obligations of their respective subsidiaries. These references reflect the fact that the subsidiaries are consolidated with their respective parent companies for financial reporting purposes. However, these references should not be interpreted to imply that the parent company is actually undertaking the action or has the rights or obligations of the relevant subsidiary company or that the subsidiary company is undertaking an action or has the rights or obligations of its parent company or any other affiliate.

GLOSSARY

When the following terms and abbreviations appear in the text of this report, they have the meanings indicated below.

2007 Annual Report	TCEH's Second Amended and Restated Annual Report for the year ended December 31, 2007
Adjusted EBITDA	Adjusted EBITDA means EBITDA adjusted to exclude non-cash items, unusual items and other adjustments allowable under certain debt arrangements of TCEH. See the definition of EBITDA below. Adjusted EBITDA and EBITDA are not recognized terms under GAAP and, thus, are non-GAAP financial measures. TCEH is providing Adjusted EBITDA in this Quarterly Report (see reconciliation in Appendix B) solely because of the important role that Adjusted EBITDA plays in respect of the certain covenants contained in TCEH's debt arrangements. TCEH does not intend for Adjusted EBITDA (or EBITDA) to be an alternative to net income as a measure of operating performance or an alternative to cash flows from operating activities as a measure of liquidity or an alternative to any other measure of financial performance presented in accordance with GAAP. Additionally, TCEH does not intend for Adjusted EBITDA (or EBITDA) to be used as a measure of free cash flow available for management's discretionary use, as the measure excludes certain cash requirements such as interest payments, tax payments and other debt service requirements. Because not all companies use identical calculations, TCEH's presentation of Adjusted EBITDA (and EBITDA) may not be comparable to similarly titled measures of other companies.
Capgemini	Capgemini Energy LP, a subsidiary of Cap Gemini North America Inc. that provides business process support services to TCEH
EBITDA	Refers to earnings (net income) before interest expense, income taxes, depreciation and amortization. See the definition of Adjusted EBITDA above.
EFC Holdings	Refers to Energy Future Competitive Holdings Company, a direct, wholly-owned subsidiary of EFH Corp. and the direct parent of TCEH, and/or its consolidated subsidiaries, depending on context.
EFH Corp.	Refers to Energy Future Holdings Corp., a holding company, and/or its consolidated subsidiaries, depending on context. Its major subsidiaries include TCEH and Onco.
EPA	US Environmental Protection Agency
EPC	engineering, procurement and construction
ERCOT	Electric Reliability Council of Texas, the independent system operator and the regional coordinator of various electricity systems within Texas
FASB	Financial Accounting Standards Board, the designated organization in the private sector for establishing standards for financial accounting and reporting
FERC	US Federal Energy Regulatory Commission

FIN	Financial Accounting Standards Board Interpretation
FIN 39-1	FASB Staff Position No. FIN 39-1, "Amendment of FASB Interpretation No. 39," (Offsetting of Amounts Related to Certain Contracts — an Interpretation of APB Opinion No. 10 and FASB Statement No. 105)
FIN 48	FIN No. 48 (as Amended), "Accounting for Uncertainty in Income Taxes"
Fitch	Fitch Ratings, Ltd. (a credit rating agency)
FSP	FASB Staff Position
FSP SFAS 157-3	FASB Staff Position SFAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active"
GAAP	generally accepted accounting principles
GWh	gigawatt-hours
historical service territory	the territory, largely in north Texas, being served by EFH Corp.'s regulated electric utility subsidiary at the time of entering retail competition on January 1, 2002
Intermediate Holding	Refers to Energy Future Intermediate Holding Company LLC, a direct, wholly-owned subsidiary of EFH Corp. and the direct parent of Oncor Holdings
kWh	kilowatt-hours
LIBOR	London Interbank Offered Rate. An interest rate at which banks can borrow funds, in marketable size, from other banks in the London interbank market.
Luminant	Refers to wholly-owned subsidiaries of TCEH engaged in competitive market activities consisting of electricity generation, development and construction of new generation facilities, wholesale energy sales and purchases as well as commodity risk management and trading activities, all largely in Texas. These entities include Luminant Construction, Luminant Energy and Luminant Power.
Luminant Construction	Refers to the operations of TCEH established for the purpose of developing and constructing new generation facilities.
Luminant Energy	Luminant Energy Company LLC, an indirect, wholly-owned subsidiary of TCEH that engages in certain wholesale markets activities
Luminant Power	Refers to subsidiaries of TCEH engaged in electricity generation activities
market heat rate	Heat rate is a measure of the efficiency of converting a fuel source to electricity. The market heat rate is based on the price offer of the marginal supplier in Texas (generally natural gas plants) in generating electricity and is calculated by dividing the wholesale market price of electricity by the market price of natural gas.
Merger	The transaction referred to in "Merger Agreement" (defined immediately below) that was completed on October 10, 2007.
Merger Agreement	Agreement and Plan of Merger, dated February 25, 2007, under which Texas Holdings agreed to acquire EFH Corp.

Merger Sub	Texas Energy Future Merger Sub Corp, a Texas corporation and a wholly-owned subsidiary of Texas Holdings that was merged into EFH Corp. on October 10, 2007
MMBtu	million British thermal units
Moody's	Moody's Investors Services, Inc. (a credit rating agency)
MW	megawatts
MWh	megawatt-hours
NO_x	nitrogen oxide
NRC	US Nuclear Regulatory Commission
Oncor	Refers to Oncor Electric Delivery Company LLC, a direct subsidiary of Oncor Holdings and indirect subsidiary of EFH Corp., and/or its consolidated bankruptcy-remote financing subsidiary, Oncor Electric Delivery Transition Bond Company LLC, depending on context, that is engaged in regulated electricity transmission and distribution activities.
Oncor Holdings	Refers to Oncor Electric Delivery Holdings Company LLC, a direct, wholly-owned subsidiary of Intermediate Holding and a direct parent of Oncor.
OPEB	other postretirement employee benefit
PUCT	Public Utility Commission of Texas
PURA	Texas Public Utility Regulatory Act
Purchase accounting	The purchase method of accounting for a business combination as prescribed by SFAS 141 whereby the cost or "purchase price" of a business combination, including the amount paid for the equity and direct transaction costs are allocated to identifiable assets and liabilities (including intangible assets) based upon their fair values. The excess of the purchase price over the fair values of assets and liabilities is recorded as goodwill.
REP	retail electric provider
RRC	Railroad Commission of Texas, which has oversight of lignite mining activity
S&P	Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies Inc. (a credit rating agency)
SEC	US Securities and Exchange Commission
Securities Act	Securities Act of 1933, as amended
SFAS	Statement of Financial Accounting Standards issued by the FASB
SFAS 34	SFAS No. 34, "Capitalization of Interest Cost"
SFAS 123R	SFAS No. 123 (revised 2004), "Share-Based Payment"
SFAS 133	SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended and interpreted
SFAS 140	SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125"
SFAS 141	SFAS No. 141, "Business Combinations"

SFAS 142	SFAS No. 142, “Goodwill and Other Intangible Assets”
SFAS 144	SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"
SFAS 157	SFAS No. 157, “Fair Value Measurements”
SFAS 161	SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement 133"
SG&A	selling, general and administrative
SO₂	sulfur dioxide
Sponsor Group	Collectively, the investment funds affiliated with Kohlberg Kravis Roberts & Co. L.P., TPG Capital, L.P. and GS Capital Partners, an affiliate of Goldman Sachs & Co. (See Texas Holdings below.)
TCEH	Refers to Texas Competitive Electric Holdings Company LLC, a direct, wholly-owned subsidiary of EFC Holdings and an indirect, wholly-owned subsidiary of EFH Corp., and/or its consolidated subsidiaries, depending on context, that are engaged in electricity generation, wholesale and retail energy markets and development and construction activities. Its major subsidiaries include Luminant and TXU Energy.
TCEH Finance	Refers to TCEH Finance, Inc., a direct, wholly-owned subsidiary of TCEH, formed for the sole purpose of serving as co-issuer with TCEH of certain debt securities.
TCEH Senior Secured Facilities	Refers collectively to the TCEH Initial Term Loan Facility, TCEH Delayed Draw Term Loan Facility, TCEH Revolving Credit Facility, TCEH Letter of Credit Facility and TCEH Commodity Collateral Posting Facility. See Note 7 to the Financial Statements for details of these facilities.
TCEQ	Texas Commission on Environmental Quality
Texas Holdings	Refers to Texas Energy Future Holdings Limited Partnership, a Delaware limited partnership controlled by the Sponsor Group that is the direct parent of EFH Corp.
TXU Energy	Refers to TXU Energy Retail Company LLC, a direct, wholly-owned subsidiary of TCEH engaged in the retail sale of electricity to residential and business customers. TXU Energy is a REP in competitive areas of ERCOT.
US	United States of America

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC
CONDENSED STATEMENTS OF CONSOLIDATED INCOME (LOSS)
(Unaudited)
(millions of dollars)**

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Operating revenues	\$ 3,258	\$ 2,572	\$ 7,809	\$ 6,624
Fuel, purchased power costs and delivery fees	(1,923)	(1,184)	(4,646)	(3,086)
Net gain (loss) from commodity hedging and trading activities	6,045	462	(248)	(607)
Operating costs	(157)	(138)	(501)	(452)
Depreciation and amortization	(296)	(84)	(827)	(245)
Selling, general and administrative expenses	(172)	(150)	(496)	(436)
Franchise and revenue-based taxes	(26)	(25)	(74)	(78)
Other income (Note 5)	2	8	8	19
Other deductions (Note 5)	(531)	34	(550)	20
Interest income	20	97	45	260
Interest expense and related charges (Note 14)	<u>(581)</u>	<u>(117)</u>	<u>(1,756)</u>	<u>(310)</u>
Income (loss) before income taxes	5,639	1,475	(1,236)	1,709
Income tax (expense) benefit	<u>(2,010)</u>	<u>(501)</u>	<u>425</u>	<u>(529)</u>
Net income (loss)	<u>\$ 3,629</u>	<u>\$ 974</u>	<u>\$ (811)</u>	<u>\$ 1,180</u>

See Notes to Financial Statements

**CONDENSED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(millions of dollars)**

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Net income (loss)	\$ 3,629	\$ 974	\$ (811)	\$ 1,180
Other comprehensive income (loss), net of tax effects:				
Cash flow hedges:				
Net increase (decrease) in fair value of derivatives (net of tax benefit (expense) of \$75, \$(5), \$98 and \$155)	(139)	7	(182)	(290)
Derivative value net (gains) losses related to hedged transactions recognized during the period and reported in net income (net of tax (expense) benefit of \$22, \$(6), \$45 and \$(46))	<u>41</u>	<u>(9)</u>	<u>83</u>	<u>(84)</u>
Total effect of cash flow hedges	<u>(98)</u>	<u>(2)</u>	<u>(99)</u>	<u>(374)</u>
Comprehensive income (loss)	<u>\$ 3,531</u>	<u>\$ 972</u>	<u>\$ (910)</u>	<u>\$ 806</u>

See Notes to Financial Statements

TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS
(Unaudited)
(millions of dollars)

	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Cash flows — operating activities:		
Net income (loss)	\$ (811)	\$ 1,180
Adjustments to reconcile income (loss) to cash provided by operating activities:		
Depreciation and amortization	1,153	294
Deferred income tax benefit – net	(390)	(99)
Impairment of emission allowances intangible assets	501	—
Charge related to Lehman bankruptcy	26	—
Unrealized net losses from mark-to-market valuations	221	703
Unrealized net gains from mark-to-market valuations of interest rate swaps	(36)	—
Credit related to impaired leases	—	(48)
Bad debt expense	57	42
Stock-based compensation expense	7	6
Other, net	27	17
Changes in operating assets and liabilities:		
Margin deposits - net	(236)	(768)
Other	344	(596)
Cash provided by operating activities	<u>863</u>	<u>731</u>
Cash flows — financing activities:		
Issuances of securities:		
Pollution control revenue bonds	242	—
Other long-term debt	1,035	1,000
Retirements/repurchases of long-term debt		
Pollution control revenue bonds	(242)	(143)
Other long-term debt	(155)	(15)
Change in short-term borrowings:		
Commercial paper	—	(623)
Banks	2,032	1,630
Distributions paid to parent	—	(851)
Decrease in income tax-related note payable to Oncor	(25)	(24)
Advances from affiliates	7	—
Debt premium, discount, financing and reacquisition expenses – net	(4)	(8)
Other	33	—
Cash provided by financing activities	<u>2,923</u>	<u>966</u>
Cash flows — investing activities:		
Net (advances to) repayments from affiliates	(388)	322
Capital expenditures	(1,402)	(1,408)
Nuclear fuel purchases	(112)	(54)
Investments held in money market fund (Note 14)	(242)	—
Purchase of mining-related assets	—	(122)
Proceeds from sale of assets	3	2
Reduction of restricted cash related to pollution control revenue bonds	29	197
Transfer of cash collateral to custodian account	(20)	—
Proceeds from sale of environmental allowances and credits	30	—
Purchases of environmental allowances and credits	(18)	—
Proceeds from sales of nuclear decommissioning trust fund securities	747	402
Investments in nuclear decommissioning trust fund securities	(758)	(413)
Other	2	(2)
Cash used in investing activities	<u>(2,129)</u>	<u>(1,076)</u>
Net change in cash and cash equivalents	1,657	621
Cash and cash equivalents — beginning balance	215	7
Cash and cash equivalents — ending balance	<u>\$ 1,872</u>	<u>\$ 628</u>

See Notes to Financial Statements

TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(millions of dollars)

	Successor	
	September 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,872	\$ 215
Investments held in money market fund (Note 14)	242	—
Restricted cash	20	—
Trade accounts receivable — net (Note 6)	1,006	827
Notes receivable from parents	413	25
Income taxes receivable from parent	259	190
Inventories	341	352
Commodity and other derivative contractual assets (Note 10)	1,538	1,126
Accumulated deferred income taxes	6	17
Margin deposits related to commodity positions (Note 10)	766	513
Other current assets	<u>65</u>	<u>70</u>
Total current assets	<u>6,528</u>	<u>3,335</u>
Restricted cash	1,250	1,279
Investments	538	612
Property, plant and equipment — net	21,143	20,545
Goodwill (Note 3)	18,033	18,060
Intangible assets — net (Note 3)	3,351	4,137
Commodity and other derivative contractual assets (Note 10)	340	244
Unamortized debt issuance costs and other noncurrent assets	<u>824</u>	<u>848</u>
Total assets	<u>\$ 52,007</u>	<u>\$ 49,060</u>
LIABILITIES AND MEMBERSHIP INTERESTS		
Current liabilities:		
Short-term borrowings (Note 7)	\$ 2,470	\$ 438
Advances from parent	6	—
Long-term debt due currently (Note 7)	299	195
Trade accounts payable – nonaffiliates	1,099	754
Trade accounts and other payables to affiliates	190	207
Commodity and other derivative contractual liabilities (Note 10)	1,956	1,108
Margin deposits related to commodity positions (Note 10)	22	5
Accrued taxes other than income	87	56
Accrued interest	529	349
Other current liabilities	<u>243</u>	<u>239</u>
Total current liabilities	<u>6,901</u>	<u>3,351</u>
Accumulated deferred income taxes	5,413	5,919
Commodity and other derivative contractual liabilities (Note 10)	2,456	2,452
Notes or other liabilities due affiliates	263	289
Long-term debt, less amounts due currently (Note 7)	29,210	28,409
Other noncurrent liabilities and deferred credits	<u>2,432</u>	<u>2,424</u>
Total liabilities	<u>46,675</u>	<u>42,844</u>
Commitments and Contingencies (Note 8)		
Membership interests (Note 9):		
Capital account	5,608	6,393
Accumulated other comprehensive loss	<u>(276)</u>	<u>(177)</u>
Total membership interests	<u>5,332</u>	<u>6,216</u>
Total liabilities and membership interests	<u>\$ 52,007</u>	<u>\$ 49,060</u>

See Notes to Financial Statements

TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business

TCEH is a Dallas-based holding company for subsidiaries engaged in competitive electricity market activities largely in Texas, including Luminant, which is engaged in electricity generation, development and construction of new generation facilities, wholesale energy sales and purchases and commodity risk management and trading activities, and TXU Energy, which is engaged in retail electricity sales. Commodity risk management and allocation of financial resources are performed at the TCEH level; therefore, there are no reportable business segments. TCEH is a wholly-owned subsidiary of EFC Holdings, which is a wholly-owned subsidiary of EFH Corp. While TCEH is a wholly-owned subsidiary of EFH Corp. and EFC Holdings, TCEH is a separate legal entity from EFH Corp. and EFC Holdings and all of their other affiliates with its own assets and liabilities.

On October 10, 2007, EFH Corp. completed its Merger with Merger Sub. As a result of the Merger, EFH Corp. became a subsidiary of Texas Holdings, which is controlled by the Sponsor Group.

In connection with the Merger, certain wholly-owned subsidiaries of EFH Corp. established for the purpose of developing and constructing new generation facilities became subsidiaries of TCEH, and certain assets and liabilities of other such subsidiaries were transferred to TCEH and its subsidiaries. Those subsidiaries holding impaired construction work-in-process assets related to eight canceled coal-fueled generation units did not become subsidiaries of TCEH. In addition, a wholly-owned subsidiary of EFC Holdings representing a lease trust holding certain combustion turbines became a subsidiary of TCEH. Because these transactions were between entities under the common control of EFH Corp., TCEH accounted for the transactions in a manner similar to a pooling of interests. As a result, historical operations, financial position and cash flows of TCEH and the entities and other net assets contributed are presented on a combined basis for all periods presented. See Note 4 for additional information.

Basis of Presentation

The condensed consolidated financial statements of TCEH have been prepared in accordance with US GAAP and on the same basis as the audited financial statements included in its 2007 Annual Report, with the exception of a change in classification to report the results of commodity hedging and trading activities on a separate line item in the income statement instead of within operating revenues, as discussed below and certain reclassifications in the condensed statements of comprehensive income (loss) to conform to current period presentation. All adjustments (consisting of normal recurring accruals) necessary for a fair presentation of the results of operations and financial position have been included therein. All intercompany items and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with US GAAP have been omitted pursuant to the rules and regulations of the SEC. Because the condensed consolidated interim financial statements do not include all of the information and footnotes required by US GAAP, they should be read in conjunction with the audited financial statements and related notes included in the 2007 Annual Report. The results of operations for an interim period may not give a true indication of results for a full year. All dollar amounts in the financial statements and tables in the notes are stated in millions of US dollars unless otherwise indicated.

The accompanying condensed statements of consolidated income (loss) and comprehensive income (loss) for the three and nine months ended September 30, 2008 and September 30, 2007 and consolidated cash flows for the nine months ended September 30, 2008 and September 30, 2007 are presented as the "Successor" and the "Predecessor," and relate to periods succeeding and preceding the Merger, respectively. The consolidated financial statements of the Successor reflect the application of purchase accounting in accordance with the provisions of SFAS 141.

Change in Classification of Results from Commodity Hedging and Trading Activities — Effective April 1, 2008, TCEH changed its classification of realized and unrealized net gains and losses from commodity hedging and trading activities such that the results from these activities are reported as a separate line on the income statement. Prior to April 1, 2008, such amounts were included within operating revenues. TCEH believes this change in classification provides users of the financial statements better transparency of underlying revenue trends. Results from commodity hedging and trading activities are volatile as a substantial majority of the activity involves natural gas financial instruments, which are used to economically hedge future cash flows from electricity sales and are marked-to-market in net income. Comparative financial statements of prior periods reflect this reclassification. The following table presents TCEH's operating revenues as previously reported and reflects the change in classification. There is no effect on reported earnings, the balance sheet or the statement of cash flows as a result of this change in presentation.

	Predecessor			
	As Originally Reported	As Reclassified	As Originally Reported	As Reclassified
	Three Months Ended September 30, 2007	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Operating revenues.....	\$ 3,034	\$ 2,572	\$ 6,017	\$ 6,624
Net gain (loss) from commodity hedging and trading activities.....	n/a	462	n/a	(607)
Net income	974	974	1,180	1,180

Use of Estimates

Preparation of TCEH's financial statements requires management to make estimates and assumptions about future events that affect the reporting of assets and liabilities at the balance sheet dates and the reported amounts of revenue and expense, including fair value measurements. In the event estimates and/or assumptions prove to be different from actual amounts, adjustments are made in subsequent periods to reflect more current information. No material adjustments, other than those disclosed elsewhere herein, were made to previous estimates or assumptions during the current year.

Purchase Accounting

The Merger has been accounted for under purchase accounting, whereby the total purchase price of the transaction was allocated to EFH Corp.'s identifiable tangible and intangible assets acquired and liabilities assumed based on their fair values, and the excess of the purchase price over the fair value of net assets acquired was recorded as goodwill. The allocation resulted in a significant amount of goodwill, an increase in the carrying value of property, plant and equipment and deferred income tax liabilities as well as new identifiable intangible assets and liabilities. Purchase accounting impacts, including goodwill recognition, have been “pushed down”, resulting in the assets and liabilities of TCEH being recorded at their respective fair values as of October 10, 2007. Reported earnings in periods subsequent to the Merger reflect increases in interest, depreciation and amortization expense. See Note 2 for details regarding the effect of purchase accounting.

Changes in Accounting Standards

Effective January 1, 2008, TCEH adopted FSP FIN 39-1, "Amendment of FASB Interpretation No. 39." This FSP provides additional guidance regarding the offsetting in the balance sheet of cash collateral and derivative fair value asset and liability amounts. As provided for by this new rule, for balance sheet presentation, TCEH elected to not adopt netting of cash collateral, and further to discontinue netting of derivative assets and liabilities under master netting agreements.

In March 2008, the FASB issued SFAS 161, "Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement 133." SFAS 161 enhances required disclosures regarding derivatives and hedging activities to enable investors to better understand their effects on an entity's financial position, financial performance and cash flows. This statement is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. TCEH is evaluating the impact of this statement on its financial statement disclosures.

In October 2008, the FASB issued FSP SFAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active." The FSP clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP does not change the fair value measurement principles in SFAS 157. The FSP is effective upon issuance, including prior periods for which financial statements have not been issued. TCEH has determined this FSP does not change its approach for measuring fair value of financial assets.

2. FINANCIAL STATEMENT EFFECTS OF THE MERGER

EFH Corp. accounted for the Merger under purchase accounting in accordance with the provisions of SFAS 141, whereby the total purchase price of the transaction was allocated to EFH Corp.'s identifiable tangible and intangible assets acquired and liabilities assumed based on their fair values as of October 10, 2007. The fair values were determined based upon assumptions related to future cash flows, discount rates, and asset lives as well as factors more unique to EFH Corp., its industry and the competitive wholesale power market that include forward natural gas price curves and market heat rates, retail customer attrition rates, generation plant operating and construction costs, and the effect on generation facility values of lignite fuel reserves and mining capabilities using currently available information. The excess of the purchase price over the fair value of net assets acquired was recorded by EFH Corp. as goodwill, which totaled \$22.9 billion at September 30, 2008.

Purchase accounting impacts, including goodwill recognition, have been "pushed down", resulting in the assets and liabilities of TCEH being recorded at their fair values as of October 10, 2007. The assignment of purchase price was based on the relative estimated enterprise value of TCEH's operations as of the date of the Merger using discounted cash flow methodologies and resulted in TCEH recording \$18.0 billion of goodwill.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (billions of dollars):

Purchase price assigned to TCEH		\$ 28.3
Property, plant and equipment	20.3	
Intangible assets	4.4	
Other assets	<u>3.8</u>	
Total assets acquired	28.5	
Short-term borrowings and long-term debt	5.9	
Deferred tax liabilities	6.9	
Other liabilities	<u>5.4</u>	
Total liabilities assumed	18.2	
Net identifiable assets acquired		<u>10.3</u>
Goodwill		<u>\$ 18.0</u>

Management believes the drivers of the goodwill amount include the incremental value of the future cash flow potential of the baseload generation facilities, including facilities under construction, over the values assigned to those assets under purchase accounting rules, considering the market-pricing mechanisms and growth potential in the ERCOT market, as well as the value derived from the scale of the retail business.

The purchase price allocation at September 30, 2008 is substantially complete; however, additional analysis with respect to the value of certain assets, contractual arrangements and contingent liabilities could result in a change in the total amount of goodwill. SFAS 141 requires that the purchase price allocation be completed no later than one year from the date of the Merger. In September 2008, additional exit liabilities totaling \$10 million related to termination pursuant to the Merger of certain contractual agreements were recorded. This amount is expected to be paid by the first quarter of 2009.

3. GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

Goodwill

TCEH's goodwill as of September 30, 2008 totaled \$18.0 billion and as of December 31, 2007 totaled \$18.1 billion, representing the allocated portion of the Merger purchase price over the fair value of TCEH's assets and liabilities, as discussed in Note 2. None of this goodwill balance is being deducted for tax purposes.

Potential Impairment of Goodwill

Key measures in assessing the fair value of TCEH, including equity values of comparable companies and forward natural gas prices, experienced significant volatility and general declines in the third quarter as the credit crisis has impacted worldwide markets. As a result of these market movements, management considered whether an assessment of the carrying value of goodwill, in accordance with the provisions of SFAS 142, should be performed as of September 30, 2008.

In consideration of long-term valuation drivers and trends specific to TCEH and recently completed and proposed relevant transactions, management believes that the fundamental value of the business has not changed materially, and considering the volatility in the markets during September 2008, determined that it would be premature to conclude that market declines as of the end of the third quarter are other than temporary. Management intends to reassess market conditions prior to the issuance of TCEH's year-end financial statements. TCEH's annual goodwill assessment date under SFAS 142 falls in the fourth quarter.

Under the SFAS 142 goodwill impairment analysis, if at the assessment date, TCEH's book value exceeded its estimated enterprise value, then the estimated enterprise value would be compared to the estimated fair values of TCEH's operating assets (including identifiable intangible assets) and liabilities at the assessment date, and the resultant implied goodwill amount would then be compared to the recorded goodwill amount. Any excess of the recorded goodwill amount over the implied goodwill amount would be written off as an impairment charge. Because any decline in enterprise value would likely be accompanied by a decline in the fair value of assets, particularly generation plants, it is possible that implied goodwill would approximate recorded goodwill, and no impairment would arise as a result of this analysis.

Identifiable Intangible Assets

Identifiable intangible assets are comprised of the following:

	Successor					
	As of September 30, 2008			As of December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Retail customer relationship	\$ 463	\$ 118	\$ 345	\$ 463	\$ 79	\$ 384
Favorable purchase and sales contracts	715	197	518	702	68	634
Capitalized in-service software	50	10	40	41	3	38
Environmental allowances and credits	984	96	888	1,525	19	1,506
Mining development costs	<u>11</u>	<u>1</u>	<u>10</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total intangible assets subject to amortization ..	<u>\$2,223</u>	<u>\$ 422</u>	1,801	<u>\$2,731</u>	<u>\$ 169</u>	2,562
Trade name (not subject to amortization)			1,436			1,436
Mineral interests (not currently subject to amortization)			<u>114</u>			<u>139</u>
Total intangible assets			<u>\$3,351</u>			<u>\$4,137</u>

Amortization expense related to identifiable intangible assets consisted of:

	Successor Three Months Ended September 30, 2008	Predecessor Three Months Ended September 30, 2007	Successor Nine Months Ended September 30, 2008	Predecessor Nine Months Ended September 30, 2007
Retail customer relationship	\$ 13	\$ —	\$ 39	\$ —
Favorable purchase and sales contracts	9	—	115	—
Capitalized in-service software	2	2	8	4
Environmental allowances and credits	<u>28</u>	<u>—</u>	<u>77</u>	<u>—</u>
Total amortization expense	<u>\$ 52</u>	<u>\$ 2</u>	<u>\$ 239</u>	<u>\$ 4</u>

As discussed in Note 2, purchase accounting impacts have been “pushed down”, resulting in the assets and liabilities of TCEH being recorded at their fair values as of October 10, 2007. As part of that process, TCEH identified the following separately identifiable and previously unrecognized intangible assets acquired:

- *Retail Customer Relationship* — Retail customer relationship intangible asset represents the value of TXU Energy’s non-contracted customer base and is being amortized using an accelerated method based on customer attrition rates and reflecting the pattern in which economic benefits are realized over their estimated useful life. Amortization expense related to the retail customer relationship intangible asset is reported as part of depreciation and amortization expense in the income statement.
- *Favorable Purchase and Sales Contracts* — Favorable purchase and sales contracts intangible asset primarily represents the above market value of commodity contracts for which: 1) TCEH has made the “normal” purchase or sale election allowed by SFAS 133 or 2) the contracts did not meet the definition of a derivative. The amortization periods of these intangible assets are based on the terms of the contracts, and the expense is reported as part of revenues or fuel and purchased power costs in the income statement as appropriate. Unfavorable purchase and sales contracts are recorded as other noncurrent liabilities and deferred credits (see Note 14).
- *Trade name* — The trade name intangible asset represents the value of the TXU Energy trade name, and as an indefinite-lived asset is not subject to amortization. This intangible asset will be evaluated for impairment at least annually (as of October 1) in accordance with SFAS No. 142, “Goodwill and Other Intangible Assets.”

- *Environmental Allowances and Credits* — This intangible asset represents the fair value of environmental allowances and credits held by TCEH, substantially all of which were expected to be used in its power generation activity. These credits will be amortized to fuel and purchased power costs utilizing a units-of-production method.

Impairment of Certain Intangible Assets

In March 2005, the EPA issued regulations called the Clean Air Interstate Rule (CAIR) for 28 states, including Texas, where TCEH's generation facilities are located. CAIR required reductions of SO₂ and NOx emissions from power generation facilities in such states. The SO₂ reductions were beyond the reductions required under the Clean Air Act's existing acid rain cap-and-trade program (the Acid Rain Program). CAIR also established a new regional cap-and-trade program for NOx emissions reductions.

In July 2008, the US Court of Appeals for the D.C. Circuit (the D.C. Circuit Court) invalidated CAIR. The D.C. Circuit Court did not overturn the existing cap-and-trade program for SO₂ reductions under the Acid Rain Program.

In the second quarter of 2008, TCEH determined that certain of its SO₂ allowances had decreased materially in value, likely driven by litigation that resulted in the July 2008 decision from the D.C. Circuit Court invalidating CAIR. Accordingly, TCEH recorded a \$2 million (before deferred income tax benefit) impairment of certain SO₂ allowances.

Based on the D.C. Circuit Court's ruling, TCEH recorded a non-cash impairment charge to earnings in the third quarter of 2008. TCEH impaired NOx allowances in the amount of \$401 million (before deferred income tax benefit). As a result of the D.C. Circuit Court's decision, as it stands, NOx allowances would no longer be needed, and thus there would not be an actively traded market for such allowances. Consequently, the NOx allowances held by TCEH would likely have very little value absent reversal of the D.C. Circuit Court's decision or promulgation of new rules by the EPA. In addition, TCEH impaired SO₂ allowances in the amount of \$98 million (before deferred income tax benefit). While the D.C. Circuit Court did not invalidate the Acid Rain Program, TCEH would have more SO₂ allowances than it would need to comply with the Acid Rain Program. While there continues to be a market for SO₂ allowances, the D.C. Circuit Court's decision has resulted in a material decrease in the market price of SO₂ allowances.

The impairment amounts recorded in the second and third quarters of 2008 were reported in other deductions.

At this time TCEH cannot predict the final outcome of the D.C. Circuit Court's decision, including whether the D.C. Circuit Court will grant the EPA's request for rehearing or revise its decision to allow CAIR to remain in place during any Court-ordered revision of CAIR by the EPA.

Estimated Amortization of Intangible Assets — The estimated aggregate amortization expense of intangible assets for each of the five succeeding fiscal years from December 31, 2007 is as follows:

<u>Year</u>	<u>Successor</u>
2008	\$ 336
2009	443
2010	258
2011	213
2012	152

4. CONTRIBUTIONS OF ENTITIES AND NET ASSETS TO TCEH

In connection with the Merger, EFH Corp. or EFC Holdings contributed all of the outstanding equity of certain subsidiaries to TCEH, and EFH Corp. subsidiaries contributed certain assets and liabilities to TCEH. These contributions consisted largely of assets and liabilities associated with the three new lignite-fueled generation units currently under development, certain natural gas hedge positions and a lease trust holding certain combustion turbines. Because these transactions were between entities under the common control of EFH Corp., TCEH accounted for the transactions in a manner similar to a pooling of interests. As a result, historical operations, financial position and cash flows of TCEH and the entities and other net assets contributed are presented on a combined basis for all periods presented.

The following table presents the revenues, net losses from commodity hedging and trading activities and net income (loss) of the entities contributed and the combined amounts presented in TCEH's consolidated income statements.

	Predecessor	
	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Revenues:		
TCEH	\$ 2,569	\$ 6,618
Contributed subsidiaries.....	<u>3</u>	<u>6</u>
Combined	<u>\$ 2,572</u>	<u>\$ 6,624</u>
Net gain (loss) from commodity hedging and trading activities (a):		
TCEH	\$ 320	\$ (317)
Contributed subsidiaries.....	<u>142</u>	<u>(290)</u>
Combined	<u>\$ 462</u>	<u>\$ (607)</u>
Net income (loss):		
TCEH	\$ 902	\$ 1,382
Contributed subsidiaries.....	<u>72</u>	<u>(202)</u>
Combined	<u>\$ 974</u>	<u>\$ 1,180</u>

(a) Commodity hedging and trading activities were previously reported within revenues. See Note 1.

5. OTHER INCOME AND DEDUCTIONS

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Other income:				
Mineral rights royalty income	\$ 1	\$ 3	\$ 3	\$ 7
Penalty received for nonperformance under a coal transportation agreement	—	3	—	6
Net gain on sale of assets	—	1	—	1
Other	<u>1</u>	<u>1</u>	<u>5</u>	<u>5</u>
Total other income	<u>\$ 2</u>	<u>\$ 8</u>	<u>\$ 8</u>	<u>\$ 19</u>
Other deductions:				
Impairment of emission allowances intangible assets (Note 3)	\$ 499	\$ —	\$ 501	\$ —
Charge related to Lehman bankruptcy (a)	26	—	26	—
Charge related to termination of rail car lease (b)	—	10	—	10
Credit related to impaired leases (c)	—	(48)	—	(48)
Litigation/regulatory settlements	—	—	7	5
Equity losses - unconsolidated affiliates	3	2	8	5
Other	<u>3</u>	<u>2</u>	<u>8</u>	<u>8</u>
Total other deductions	<u>\$ 531</u>	<u>\$ (34)</u>	<u>\$ 550</u>	<u>\$ (20)</u>

- (a) Represents reserve established against amounts due (excluding termination related costs) from subsidiaries of Lehman Brothers Holdings Inc. arising from commodity hedging and trading activities. There are no open positions with these subsidiaries.
- (b) Represents costs associated with termination and refinancing of a rail car lease.
- (c) In 2004, TCEH recorded a liability of \$157 million for leases of certain natural gas-fueled combustion turbines, net of estimated sublease revenues, that were no longer operated for its own benefit. In the third quarter of 2007, a reduction in the liability was recorded to reflect new subleases entered into in October 2007. The remaining \$59 million liability was eliminated as part of purchase accounting as TCEH operates these assets for its own benefit after the Merger.

6. TRADE ACCOUNTS RECEIVABLE AND SALE OF RECEIVABLES PROGRAM

Sale of Receivables

TCEH participates in an accounts receivable securitization program established by EFH Corp. for its subsidiaries engaged in retail sales of electricity, the activity under which is accounted for as a sale of accounts receivable in accordance with SFAS 140. Under the program, such subsidiaries (originators) sell trade accounts receivable to TXU Receivables Company, a consolidated wholly-owned bankruptcy-remote direct subsidiary of EFH Corp., which sells undivided interests in the purchased accounts receivable for cash to special purpose entities established by financial institutions (the funding entities).

As of September 30, 2008, the program funding to the originators totaled \$700 million, which is the maximum amount currently available under the accounts receivable securitization program. The amount of customer deposits held by the originators can reduce the amount of undivided interests that can be sold, thus reducing funding available under the program, during periods in which TCEH's long-term senior unsecured debt rating is lower than investment grade. Funding availability for all originators can be reduced by 100% of the originators' customer deposits if TCEH's credit rating is lower than Ba3/BB-; 50% if TCEH's credit rating is between Ba3/BB- and Ba1/BB+; and zero % if TCEH's credit rating is at least Baa3/BBB-. Although TCEH's credit ratings were lower than Ba3/BB- as of September 30, 2008, the originators' customer deposits, which totaled \$111 million, did not reduce funding availability at that date since the amount of undivided interests that otherwise could be sold exceeded the \$700 million program limit.

All new trade receivables under the program generated by the originators are continuously purchased by TXU Receivables Company with the proceeds from collections of receivables previously purchased. Changes in the amount of funding under the program, through changes in the amount of undivided interests sold by TXU Receivables Company, reflect seasonal variations in the level of accounts receivable, changes in collection trends as well as other factors such as changes in sales prices and volumes. TXU Receivables Company has issued subordinated notes payable to the originators for the difference between the face amount of the uncollected accounts receivable purchased, less a discount, and cash paid to the originators that was funded by the sale of the undivided interests. The balance of the subordinated notes issued to TCEH, which is reported in trade accounts receivable, totaled \$340 million and \$296 million at September 30, 2008 and December 31, 2007, respectively.

The discount from face amount on the purchase of receivables principally funds program fees paid by TXU Receivables Company to the funding entities. The discount also funds a servicing fee paid by TXU Receivables Company to EFH Corporate Services Company, a direct wholly-owned subsidiary of EFH Corp. The program fees, also referred to as losses on sale of the receivables under SFAS 140, consist primarily of interest costs on the underlying financing. The servicing fee compensates EFH Corporate Services Company for the collection agent services being performed, including the maintenance of detailed accounts receivable collection records. The program and servicing fees represent essentially all the net incremental costs of the program to TCEH and are reported in SG&A expenses. Fee amounts were as follows:

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Program fees	\$ 7	\$ 8	\$ 18	\$ 25
Program fees as a percentage of average funding (annualized).....	4.2%	6.0%	5.2%	6.3%
Servicing fees.....	1	1	3	3

The accounts receivable balance reported in the September 30, 2008 consolidated balance sheet has been reduced by \$1.040 billion face amount of trade accounts receivable sold to TXU Receivables Company, partially offset by the inclusion of \$340 million of subordinated notes receivable from TXU Receivables Company. Funding under the program increased \$337 million and \$47 million for the nine month periods ending September 30, 2008 and 2007, respectively. Funding increases or decreases under the program are reflected as operating cash flow activity in the statement of cash flows. The carrying amount of the retained interests in the accounts receivable balance approximated fair value due to the short-term nature of the collection period.

Activities of TXU Receivables Company related to TCEH were as follows:

	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Cash collections on accounts receivable	\$ 4,881	\$ 5,015
Face amount of new receivables purchased	(5,263)	(5,322)
Discount from face amount of purchased receivables.....	22	28
Program fees paid	(18)	(25)
Servicing fees paid.....	(3)	(3)
Increase in subordinated notes payable	44	260
Operating cash flows provided to TCEH under the program.....	<u>\$ (337)</u>	<u>\$ (47)</u>

The program may be terminated upon the occurrence of a number of specified events, including if the delinquency ratio (delinquent for 31 days) for the sold receivables, the default ratio (delinquent for 91 days or deemed uncollectible), the dilution ratio (reductions for discounts, disputes and other allowances) or the days collection outstanding ratio exceed stated thresholds, and the financial institutions do not waive such event of termination. The thresholds apply to the entire portfolio of sold receivables, not separately to the receivables of each originator. In addition, the program may be terminated if TXU Receivables Company or EFH Corporate Services Company, as collection agent, shall default in any payment with respect to debt in excess of \$50,000 in the aggregate for TXU Receivables Company and EFH Corporate Services Company, or if TCEH, any affiliate of TCEH acting as collection agent under the program other than EFH Corporate Services Company, any parent guarantor of an originator or any originator shall default in any payment with respect to debt (other than hedging obligations) in excess of \$200 million in the aggregate for such entities.

Upon termination of the program, cash flows would be delayed as collections of sold receivables would be used by TXU Receivables Company to repurchase the undivided interests from the funding entities instead of purchasing new receivables. The level of cash flows would normalize in approximately 16 to 30 days.

The subordinated notes issued by TXU Receivables Company are subordinated to the undivided interests of the financial institutions in the purchased receivables.

Trade Accounts Receivable

	Successor	
	September 30, 2008	December 31, 2007
Gross trade accounts receivable.....	\$ 1,767	\$ 1,214
Undivided interests in accounts receivable sold by TXU Receivables Company	(1,040)	(659)
Subordinated notes receivable from TXU Receivables Company.....	340	296
Allowance for uncollectible accounts.....	<u>(61)</u>	<u>(24)</u>
Trade accounts receivable — reported in balance sheet.....	<u>\$ 1,006</u>	<u>\$ 827</u>

Gross trade accounts receivable at September 30, 2008 and December 31, 2007 included unbilled revenues of \$445 million and \$404 million, respectively.

Allowance for Uncollectible Accounts Receivable

	Successor	Predecessor
	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Allowance for uncollectible accounts receivable as of beginning of period.....	\$ 24	\$ 8
Increase for bad debt expense.....	57	42
Decrease for account writeoffs.....	(46)	(45)
Charge related to Lehman bankruptcy	26	—
Changes related to receivables sold.....	<u>—</u>	<u>11</u>
Allowance for uncollectible accounts receivable as of end of period.....	<u>\$ 61</u>	<u>\$ 16</u>

Allowances related to undivided interests in receivables sold totaled \$14 million at September 30, 2007, and this amount was reported in current liabilities.

7. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

Short-Term Borrowings

At September 30, 2008, TCEH had outstanding short-term borrowings of \$2.470 billion at a weighted average interest rate of 5.99%, excluding certain customary fees, at the end of the period. At December 31, 2007, TCEH had outstanding short-term borrowings of \$438 million at a weighted average interest rate of 4.47%, excluding certain customary fees, at the end of the period.

Credit Facilities

TCEH's credit facilities with cash borrowing and/or letter of credit availability at September 30, 2008 are presented below. These are all senior secured facilities.

Authorized Borrowers and Facility	Maturity Date	At September 30, 2008			
		Facility Limit	Letters of Credit	Cash Borrowings	Availability
TCEH Delayed Draw Term Loan Facility (a)	October 2014	\$ 4,100	\$ —	\$ 3,154	\$ 946
TCEH Revolving Credit Facility (b).....	October 2013	2,700	102	1,910	688
TCEH Letter of Credit Facility (c).....	October 2014	<u>1,250</u>	<u>—</u>	<u>1,250</u>	<u>—</u>
Subtotal.....		<u>\$ 8,050</u>	<u>\$ 102</u>	<u>\$ 6,314</u>	<u>\$ 1,634</u>
TCEH Commodity Collateral Posting Facility (d)	December 2012	Unlimited	\$ —	\$ 969	Unlimited

- (a) Facility to be used during the two-year period commencing on October 10, 2007 to fund expenditures for constructing certain new generation facilities and environmental upgrades of existing generation facilities, including previously incurred expenditures not yet funded under this facility. Borrowings are classified as long-term debt.
- (b) Facility to be used for letters of credit and borrowings for general corporate purposes. Borrowings are classified as short-term borrowings.
- (c) Facility to be used for issuing letters of credit for general corporate purposes, including, but not limited to, providing collateral support under hedging arrangements and other commodity transactions that are not eligible for funding under the TCEH Commodity Collateral Posting Facility. The borrowings, all of which were drawn at the closing of the Merger and are classified as long-term debt, have been retained as restricted cash. Letters of credit totaling \$1.131 billion issued as of September 30, 2008 are supported by the restricted cash, and the remaining letter of credit availability totals \$119 million.
- (d) Revolving facility to be used to fund cash collateral posting requirements for specified volumes of natural gas hedges. At September 30, 2008, cash borrowings of \$409 million are classified as long-term debt and \$560 million are classified as short-term borrowings.

The availability amounts shown above include unfunded commitments from a subsidiary of Lehman Brothers Holdings Inc. (Lehman) that has filed for bankruptcy under Chapter 11 of the US Bankruptcy Code. As of September 30, 2008, the aggregate amounts of such unfunded commitments were \$79 million under the TCEH Revolving Credit Facility and \$16 million under the TCEH Delayed Draw Term Facility. In addition, the amount of letters of credit shown above for the TCEH Revolving Credit Facility include approximately \$12 million for the account of the Lehman subsidiary, and the amount of cash borrowings shown above for the TCEH Revolving Credit Facility include approximately \$80 million funded by a fronting bank on behalf of the Lehman subsidiary that had not been reimbursed to the fronting bank as of September 30, 2008.

Pursuant to PUCT rules, TCEH is required to maintain available capacity under its credit facilities in order to permit TXU Energy to return retail customer deposits, if necessary. As a result, at September 30, 2008, the total availability under the TCEH credit facilities should be further reduced by \$120 million.

Long-Term Debt

At September 30, 2008 and December 31, 2007, the long-term debt of TCEH consisted of the following:

	Successor	
	September 30, 2008	December 31, 2007
Pollution Control Revenue Bonds:		
Brazos River Authority:		
5.400% Fixed Series 1994A due May 1, 2029.....	\$ 39	\$ 39
7.700% Fixed Series 1999A due April 1, 2033	111	111
6.750% Fixed Series 1999B due September 1, 2034, remarketing date April 1, 2013 (a)	16	16
7.700% Fixed Series 1999C due March 1, 2032.....	50	50
8.250% Fixed Series 2001A due October 1, 2030.....	71	—
2.300% Floating Series 2001A due October 1, 2030 (b).....	—	71
5.750% Fixed Series 2001C due May 1, 2036, remarketing date November 1, 2011 (a).....	217	217
8.250% Fixed Series 2001D-1 due May 1, 2033	171	—
2.300% Floating Series 2001D-1 due May 1, 2033 (b).....	—	171
8.230% Floating Series 2001D-2 due May 1, 2033 (c)	97	97
8.000% Floating Taxable Series 2001I due December 1, 2036 (c).....	62	62
8.230% Floating Series 2002A due May 1, 2037 (c).....	45	45
6.750% Fixed Series 2003A due April 1, 2038, remarketing date April 1, 2013 (a).....	44	44
6.300% Fixed Series 2003B due July 1, 2032	39	39
6.750% Fixed Series 2003C due October 1, 2038.....	52	52
5.400% Fixed Series 2003D due October 1, 2029, remarketing date October 1, 2014 (a).....	31	31
5.000% Fixed Series 2006 due March 1, 2041	100	100
Sabine River Authority of Texas:		
6.450% Fixed Series 2000A due June 1, 2021.....	51	51
5.500% Fixed Series 2001A due May 1, 2022, remarketing date November 1, 2011 (a).....	91	91
5.750% Fixed Series 2001B due May 1, 2030, remarketing date November 1, 2011 (a).....	107	107
5.200% Fixed Series 2001C due May 1, 2028.....	70	70
5.800% Fixed Series 2003A due July 1, 2022	12	12
6.150% Fixed Series 2003B due August 1, 2022	45	45
Trinity River Authority of Texas:		
6.250% Fixed Series 2000A due May 1, 2028.....	14	14
Unamortized fair value discount related to pollution control revenue bonds (d).....	(165)	(175)
Senior Secured Facilities:		
6.248% TCEH Initial Term Loan Facility maturing October 10, 2014 (e)(f).....	16,286	16,409
6.222% TCEH Delayed Draw Term Loan Facility maturing October 10, 2014 (e)(f).....	3,154	2,150
5.989% TCEH Letter of Credit Facility maturing October 10, 2014 (f).....	1,250	1,250
3.831% TCEH Commodity Collateral Posting Facility maturing December 31, 2012 (g).....	409	382
Other:		
10.25% Fixed Senior Notes due November 1, 2015.....	3,000	3,000
10.25% Fixed Senior Notes Series B due November 1, 2015	2,000	2,000
10.50 / 11.25% Senior Toggle Notes due November 1, 2016	1,750	1,750
6.125% Fixed Senior Notes due March 15, 2008	—	3
7.000% Fixed Senior Notes due March 15, 2013	5	5
7.100% Promissory Note due January 5, 2009	65	65
7.460% Fixed Secured Facility Bonds with amortizing payments through January 2015.....	67	78
Capital lease obligations.....	161	161
Unamortized fair value discount (d).....	(8)	(9)
Total.....	29,509	28,604
Less amount due currently	(299)	(195)
Total long-term debt.....	<u>\$ 29,210</u>	<u>\$ 28,409</u>

- (a) These series are in the multiannual interest rate mode and are subject to mandatory tender prior to maturity on the mandatory remarketing date. On such date, the interest rate and interest rate period will be reset for the bonds.
- (b) Interest rates in effect at March 31, 2008. These series were remarketed in June 2008, resulting in a fixed rate to maturity.
- (c) Interest rates in effect at September 30, 2008. These series are in a weekly interest rate mode and are classified as long-term as they are supported by long-term irrevocable letters of credit.
- (d) Amount represents unamortized fair value adjustments recorded under purchase accounting.
- (e) Interest rates swapped to fixed on \$16.55 billion principal amount.
- (f) Interest rates in effect at September 30, 2008.
- (g) Interest rates in effect at September 30, 2008, excluding quarterly maintenance fee discussed below. See "Credit Facilities" above for more information.

Debt-Related Activity in 2008 — Retirements of long-term debt in 2008 totaling \$397 million represented principal payments at scheduled maturity dates as well as the remarketing of \$242 million principal amount of pollution control revenue bonds discussed below. Payments at scheduled maturity dates included \$123 million repaid under the TCEH Initial Term Loan Facility.

Issuances of long-term debt in 2008 totaling \$1.277 billion represented borrowings under the TCEH Delayed Draw Term Loan Facility of \$1.004 billion to fund expenditures related to the development of new generation facilities and the environmental retrofit program for existing lignite/coal-fueled generation facilities, the remarketing of \$242 million principal amount of pollution control revenue bonds discussed immediately below and \$31 million of additional borrowings under the TCEH Commodity Collateral Posting Facility (under which additional borrowings in 2008 totaling \$122 million are classified as short-term debt).

In June 2008, TCEH remarketed the Brazos River Authority Pollution Control Revenue Bonds Series 2001A due in October 2030 and Series 2001D-1 due in May 2033 with aggregate principal amounts of \$71 million and \$171 million, respectively. The bonds were previously in a floating rate mode that reset weekly and were backed by two letters of credit in an aggregate amount of \$247 million. As a result of the remarketing, the bonds were fixed to maturity at an interest rate of 8.25%, and the two letters of credit were cancelled. The bonds are redeemable at par beginning July 1, 2018 and are redeemable with a make-whole premium prior to July 1, 2018. These bonds were remarketed with a covenant package similar to the notes discussed below under “TCEH Notes Issued Subsequent to the Merger.”

TCEH Senior Secured Facilities — Borrowings under the TCEH Initial Term Loan Facility, the TCEH Delayed Draw Term Loan Facility, the TCEH Revolving Credit Facility and the TCEH Letter of Credit Facility, which totaled \$22.600 billion at September 30, 2008, bear interest at per annum rates equal to, at TCEH’s option, (i) adjusted LIBOR plus 3.50% or (ii) a base rate (the higher of (1) the prime rate as announced from time to time by the administrative agent of the facilities and (2) the federal funds effective rate plus 0.50%) plus 2.50%. There is a margin adjustment mechanism in relation to term loans, revolving loans and letter of credit fees under which the applicable margins may be reduced based on the achievement of certain leverage ratio levels; there was no such reduction based upon September 30, 2008 levels. The applicable rate on each facility as of September 30, 2008 is provided in the table above and reflects LIBOR-based borrowings.

A commitment fee is payable quarterly in arrears and upon termination of the TCEH Revolving Credit Facility at a rate per annum equal to 0.50% of the average daily unused portion of such facility. The commitment fee is subject to reduction, based on the achievement of certain leverage ratio levels; there was no such reduction based upon September 30, 2008 levels.

With respect to the TCEH Delayed Draw Term Loan Facility, a commitment fee is payable quarterly in arrears and upon termination of the undrawn portion of the commitments of such facility at a rate per annum equal to, prior to October 10, 2008, 1.25% per annum, and thereafter, 1.50% per annum.

Letter of credit fees under the TCEH Revolving Facility are payable quarterly in arrears and upon termination at a rate per annum equal to the spread over adjusted LIBOR under the TCEH Revolving Facility, less the issuing bank’s fronting fee. Letter of credit fees under the TCEH Letter of Credit Facility are equal to the difference between interest paid on each outstanding letter of credit at a rate of LIBOR plus 3.50% per annum and the interest earned on the total \$1.25 billion TCEH Letter of Credit Facility restricted cash at a rate of LIBOR minus 0.12% per annum yielding a currently effective rate of 3.62% per annum on each outstanding letter of credit under that facility.

TCEH will pay a fixed quarterly maintenance fee of approximately \$11 million through maturity for having procured the TCEH Commodity Collateral Posting Facility regardless of actual borrowings under the facility. In addition, TCEH will pay interest at LIBOR on actual borrowed amounts under the TCEH Commodity Collateral Posting Facility partially offset by interest earned on collateral deposits to counterparties.

The TCEH Senior Secured Facilities are unconditionally guaranteed jointly and severally on a senior secured basis, by EFC Holdings, and each existing and subsequently acquired or organized direct or indirect wholly-owned US restricted subsidiary of TCEH (other than certain subsidiaries as provided in the TCEH Senior Secured Facilities), subject to certain other exceptions.

The TCEH Senior Secured Facilities, including the guarantees thereof, certain commodity hedging transactions and the interest rate swaps described under “TCEH Interest Rate Hedges” below are secured by (a) substantially all of the current and future assets of TCEH and TCEH’s subsidiaries who are guarantors of such facilities as described above, and (b) pledges of the capital stock of TCEH and each current and future material wholly-owned restricted subsidiary of TCEH directly owned by TCEH or any guarantor.

The TCEH Senior Secured Facilities contain customary negative covenants, restricting, subject to certain exceptions, TCEH and TCEH’s restricted subsidiaries from, among other things:

- incurring additional debt;
- incurring additional liens;
- entering into mergers and consolidations;
- selling or otherwise disposing of assets;
- making dividends, redemptions or other distributions in respect of capital stock;
- making acquisitions, investments, loans and advances, and
- paying or modifying certain subordinated and other material debt.

In addition, the TCEH Senior Secured Facilities contain a maintenance covenant that prohibits TCEH and its restricted subsidiaries from exceeding a maximum consolidated secured leverage ratio and to observe certain customary reporting requirements and other affirmative covenants.

The TCEH Initial Term Loan Facility is required to be repaid in equal quarterly installments in an aggregate annual amount equal to 1% of the original principal amount of such facility (\$41 million quarterly), with the balance payable on October 10, 2014. The TCEH Delayed Draw Term Loan Facility is required to be repaid in equal quarterly installments beginning on December 31, 2009 in an aggregate annual amount equal to 1% of the actual principal outstanding under the TCEH Delayed Draw Term Loan Facility as of such date, with the balance payable on October 10, 2014. Amounts borrowed under the TCEH Revolving Facility may be reborrowed from time to time from and after the closing date until October 10, 2013. The TCEH Letter of Credit Facility will mature on October 10, 2014. The TCEH Commodity Collateral Posting Facility will mature on December 31, 2012.

The TCEH Senior Secured Facilities contain certain customary events of default for senior leveraged acquisition financings, the occurrence of which would allow the lenders to accelerate all outstanding loans and terminate their commitments.

TCEH Notes Issued Subsequent to the Merger — Pursuant to an indenture entered into in October 2007 (the TCEH Indenture), TCEH and TCEH Finance (the Co-Issuers) issued and sold \$3.0 billion aggregate principal amount of 10.25% Senior Notes due November 1, 2015. In December 2007 under a supplemental indenture, the Co-Issuers issued and sold \$2.0 billion aggregate principal amount of 10.25% Series B Senior Notes due November 1, 2015. Interest on these notes (referred to as the TCEH Cash-Pay Notes) is payable in cash semiannually in arrears on May 1 and November 1 of each year at a fixed rate of 10.25% per annum, and the first interest payment was made on May 1, 2008.

Pursuant to the supplemental indenture, the Co-Issuers also issued and sold \$1.75 billion aggregate principal amount of 10.50%/11.25% Senior Toggle Notes due November 1, 2016. The initial interest payment on these notes (referred to as the TCEH Toggle Notes) was paid in cash. For any interest period thereafter until November 1, 2012, the Issuer may elect to pay interest on the notes, at the Issuer’s option (i) entirely in cash; (ii) by increasing the principal amount of the notes or by issuing new TCEH Toggle Notes (Payment-in-Kind or PIK Interest); or (iii) 50% in cash and 50% in PIK Interest. Interest on the notes is payable semi-annually in arrears on May 1 and November 1 of each year at a fixed rate of 10.50% per annum for cash interest and at a fixed rate of 11.25% per annum for PIK Interest, and the first interest payment was made on May 1, 2008.

The \$6.75 billion principal amount of notes issued under the TCEH Indenture and its supplement (the TCEH Cash-Pay Notes and the TCEH Toggle Notes) are collectively referred to as the TCEH Notes.

The TCEH Notes are fully and unconditionally guaranteed by TCEH's direct parent, EFC Holdings (which owns 100% of TCEH and its subsidiary guarantors), and by each subsidiary that guarantees the TCEH Senior Secured Facilities (the TCEH Guarantors). The TCEH Notes are the Co-Issuers' senior unsecured debt and rank senior in right of payment to any future subordinated indebtedness of the Co-Issuers, equally in right of payment with all of the Co-Issuers' existing and future senior unsecured indebtedness, and structurally subordinated in right of payment to all existing and future indebtedness and other liabilities of the Co-Issuers' non-guarantor subsidiaries, including trade payables (other than indebtedness and liabilities owed to the Co-Issuers or the TCEH Guarantors). The TCEH Notes rank effectively junior in right of payment to all existing and future senior secured indebtedness of the Co-Issuers, including the TCEH Senior Secured Facilities to the extent of the value of the collateral securing such indebtedness.

The guarantees are joint and several guarantees of the TCEH Notes, are the TCEH Guarantors' senior unsecured obligations and rank equal in right of payment with all existing and future senior unsecured indebtedness of the relevant TCEH Guarantor and senior in right of payment to any existing or future subordinated indebtedness of the relevant TCEH Guarantor. The guarantees rank effectively junior to all secured indebtedness of the TCEH Guarantors to the extent of the assets securing that indebtedness. EFC Holdings' guarantee of the TCEH Notes ranks equally with its guarantee of the EFH Corp. Cash-Pay Notes and the EFH Corp. Toggle Notes (discussed below). The guarantees of the TCEH Notes are structurally junior to all indebtedness and other liabilities of the Co-Issuers' subsidiaries that do not guarantee the notes.

The TCEH Indenture contains a number of covenants that, among other things, restrict, subject to certain exceptions, the Co-Issuers' and their restricted subsidiaries' ability to:

- make restricted payments;
- incur debt and issue preferred stock;
- create liens;
- enter into mergers or consolidations;
- sell or otherwise dispose of certain assets;
- permit dividend and other payment restrictions on restricted subsidiaries, and
- engage in certain transactions with affiliates.

The TCEH Indenture also contains customary events of default, including failure to pay principal or interest on the TCEH Notes or the guarantees when due, among others. If an event of default occurs under the TCEH Indenture, the trustee or the holders of at least 30% in principal amount of the Required Debt (as such term is defined in the TCEH Indenture) may declare the principal amount on the TCEH Notes to be due and payable immediately.

The Co-Issuers may redeem the TCEH Cash-Pay Notes, in whole or in part, at any time on or after November 1, 2011, or the TCEH Toggle Notes, in whole or in part, at any time on or after November 1, 2012, at specified redemption prices, plus accrued and unpaid interest, if any. In addition, before November 1, 2010, the Co-Issuers may redeem with the cash proceeds of certain equity offerings up to 35% of the aggregate principal amount of TCEH Cash-Pay Notes from time to time at a redemption price of 110.250% of the aggregate principal amount of the TCEH Cash-Pay Notes, plus accrued and unpaid interest, if any, or 110.500% of the aggregate principal amount of the TCEH Toggle Notes, plus accrued and unpaid interest, if any. The Co-Issuers may also redeem the TCEH Cash-Pay Notes at any time prior to November 1, 2011 or the TCEH Toggle Notes at any time prior to November 1, 2012 at a price equal to 100% of their principal amount, plus accrued and unpaid interest and a "make-whole" premium. Upon the occurrence of a change in control of TCEH, the Co-Issuers must offer to repurchase the TCEH Notes at 101% of their principal amount, plus accrued and unpaid interest, if any.

The TCEH Notes were issued in a private placement and have not been registered under the Securities Act. The Co-Issuers have agreed to use their commercially reasonable efforts to register with the SEC notes having substantially identical terms as the TCEH Notes as part of an offer to exchange freely tradable exchange notes for the TCEH Notes. The Co-Issuers have agreed to use commercially reasonable efforts to cause the exchange offer to be completed or, if required, to have one or more shelf registration statements declared effective, within 360 days after the issue date of the TCEH Notes. If this obligation is not satisfied (a TCEH Registration Default), the annual interest rate on the TCEH Notes will increase by 0.25% per annum for the first 90-day period during which a TCEH Registration Default continues, and thereafter the annual interest rate on the TCEH Notes will increase by 0.50% per annum over the original interest rate for the remaining period during which the TCEH Registration Default continues. If the TCEH Registration Default is cured, the applicable interest rate on such TCEH Notes will revert to the original level.

On September 26, 2008, EFC Holdings and TCEH filed a registration statement with the SEC to register notes to exchange for the TCEH Notes.

Intercreditor Agreement — In October 2007, in connection with the Merger, TCEH entered into an Intercreditor Agreement (the Intercreditor Agreement) with Citibank, N.A. and five secured commodity hedge counterparties (the Secured Commodity Hedge Counterparties). The Intercreditor Agreement provides that the lien granted to the Secured Commodity Hedge Counterparties will rank pari passu with the lien granted with respect to the collateral of the secured parties under the TCEH Senior Secured Facilities. The Intercreditor Agreement also provides that the Secured Commodity Hedge Counterparties will be entitled to share, on a pro rata basis, in the proceeds of any liquidation of such collateral in connection with a foreclosure on such collateral in an amount provided in the TCEH Senior Secured Facilities. The Intercreditor Agreement also provides that the Secured Commodity Hedge Counterparties will have voting rights with respect to any amendment or waiver of any provision of the Intercreditor Agreement that changes the priority of the Secured Commodity Hedge Counterparties' lien on such collateral relative to the priority of lien granted to the secured parties under the TCEH Senior Secured Facilities or the priority of payments to the Secured Commodity Hedge Counterparties upon a foreclosure and liquidation of such collateral relative to the priority of the lien granted to the secured parties under the TCEH Senior Secured Facilities.

TCEH Interest Rate Swap Transactions — In 2007, subsequent to the Merger, TCEH entered into interest rate swap transactions pursuant to which payment of the floating interest rates on an aggregate of \$15.05 billion of senior secured term loans of TCEH were exchanged for interest payments at fixed rates of between 7.3% and 8.3% on debt maturing from 2009 to 2014. Prior to August 29, 2008, the interest rate swaps were being accounted for as cash flow hedges related to variable interest rate cash flows. As of August 29, 2008, these swaps were redesignated as cash flow hedges as a result of the intent to change the variable interest rate terms of the hedged debt (from three-month LIBOR to one-month LIBOR) in connection with the planned execution of interest rate basis swaps (discussed immediately below) to further reduce the fixed borrowing costs. Based on the fair value of the positions, the cumulative unrealized mark-to-market net losses related to these interest rate swaps totaled \$431 million (pre-tax) at August 29, 2008 and was recorded in accumulated other comprehensive income. This balance will be reclassified into net income as interest on the hedged debt is reflected in net income. No ineffectiveness gains or losses were recorded. After August 29, 2008, changes in the fair value of these swap transactions are being reported in the income statement in interest expense and related charges.

In September 2008, TCEH entered into interest rate swap transactions pursuant to which payment of the floating interest rates on an aggregate of an additional \$1.5 billion of senior secured term loans of TCEH were exchanged for interest payments at fixed rates of between 7.3% and 7.6% on debt maturing from 2013 to 2014. These swap transactions are also being marked-to-market in net income as interest expense and related charges. The interest rate swap counterparties are secured proportionally with the lenders under the TCEH Senior Secured Facilities.

In May 2008, TCEH entered into an interest rate swap transaction pursuant to which semiannual payment (settled quarterly) of the floating interest rates at LIBOR on an aggregate of \$2.095 billion of senior secured term loans of TCEH were exchanged for floating interest rates of LIBOR plus 0.21% receivable monthly. In September 2008, TCEH entered into interest rate basis swap transactions pursuant to which quarterly payment of the floating interest rates at LIBOR on an aggregate of \$7.95 billion of senior secured term loans of TCEH were exchanged for floating interest rates of LIBOR plus spreads ranging from 0.076% to 0.145% receivable monthly. The interest rate swap counterparties are secured proportionally with the lenders under the TCEH Senior Secured Facilities.

As of September 30, 2008, all active interest rate swap transactions are being marked-to-market in net income. A total of \$36 million in unrealized mark-to-market net gains related to interest rate swap transactions are included in interest expense and related charges for the quarter and year-to-date 2008 periods.

8. COMMITMENTS AND CONTINGENCIES

Generation Development

EPC agreements have been executed for the development of three lignite-fueled generation units in Texas. In connection therewith, orders have been placed for critical long lead-time equipment, including boilers, turbine generators and air quality control systems for the two units at Oak Grove and one unit at Sandow, and construction of the three units is underway.

In September 2007, a subsidiary of TCEH acquired from Alcoa Inc. the air permit related to the Sandow facility that had been previously issued by the TCEQ. However, the air permit is the subject of litigation as discussed below under "Litigation Related to Generation Development."

A subsidiary of TCEH has received the air permit for the Oak Grove units, which was approved by the TCEQ in June 2007. However, the air permit is the subject of litigation as discussed below under "Litigation Related to Generation Development."

Construction work-in-process assets balances for the three generation units totaled approximately \$3.75 billion as of September 30, 2008, which includes the effects of the fair value adjustments related to purchase accounting and capitalized interest. If construction-related agreements for the three generation units had been cancelled as of that date, subsidiaries of EFH Corp., including TCEH, would have incurred an estimated termination obligation of up to approximately \$350 million. This estimated gross cancellation exposure of approximately \$4.10 billion at September 30, 2008 excludes any potential recovery values for assets acquired to date and for assets already owned prior to executing such agreements that are intended to be utilized for these projects.

Litigation Related to Generation Development

An administrative appeal challenging the order of the TCEQ issuing the air permit for construction and operation of the Oak Grove generation facility in Robertson County, Texas to a subsidiary of EFH Corp. was filed in September 2007 in the State District Court of Travis County, Texas. Plaintiffs asked that the District Court reverse TCEQ's approval of the Oak Grove air permit and the TCEQ's adoption and approval of the TCEQ Executive Director's Response to Comments, and remand the matter back to the TCEQ for further proceedings. The TCEQ has filed the administrative record with the District Court. No further activity has occurred in the appeal. In addition to this administrative appeal, two other petitions were filed in Travis County District Court by non-parties to the administrative hearing before the TCEQ and the State Office of Administrative Hearings (SOAH) seeking to challenge the TCEQ's issuance of the Oak Grove air permit and asking the District Court to remand the matter to the SOAH for further proceedings. Finally, the plaintiffs in these two additional lawsuits filed a third, joint petition claiming insufficiencies in the Oak Grove application, permit, and process and seeking party status and remand to the SOAH for further proceedings. EFH Corp. and TCEH believe the Oak Grove air permit granted by the TCEQ is protective of the environment and that the application for and the processing of the air permit by the TCEQ was in accordance with law. There can be no assurance that the outcome of these matters would not result in an adverse impact on the Oak Grove project.

In December 2006, a lawsuit was filed in the US District Court for the Western District of Texas against Luminant Generation Company LLC (then known as TXU Generation Company LP), Oak Grove Management Company LLC (both wholly-owned subsidiaries of TCEH) and EFH Corp. (then known as TXU Corp.). The complaint sought 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 facility in Robertson County, Texas. The plaintiffs alleged violations of the Federal Clean Air Act, Texas Health and Safety Code and Texas Administrative Code and sought to temporarily and permanently enjoin the construction and operation of the Oak Grove generation plant. The complaint also asserted that the permit application was deficient in failing to comply with various modeling and analyses requirements relative to the impact of emissions from the Oak Grove plant. Plaintiffs further requested 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. EFH Corp. and TCEH believe the Oak Grove air permit granted by the TCEQ in June 2007 is 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 applicable law. EFH Corp. and the other defendants filed a Motion to Dismiss the litigation, which was granted by the District Court in May 2007. The plaintiffs appealed the District Court's dismissal of the case to the US Fifth Circuit Court of Appeals, and in July 2008, the US Fifth Circuit Court of Appeals upheld the District Court's dismissal of the case. The plaintiffs have appealed that decision by the US Fifth Circuit Court of Appeals to the US Supreme Court. EFH Corp. and TCEH believe that the US Fifth Circuit Court of Appeals properly upheld the District Court's decision, and will continue to defend that decision because EFH Corp. and TCEH believe that the claims made by the plaintiffs are without merit. EFH Corp. and TCEH are unable to estimate any possible loss or predict the outcome of this litigation. There can be no assurance that the outcome of this matter would not result in an adverse impact on the Oak Grove project.

In May 2008, the Sierra Club announced that it may sue Oak Grove Management Company LLC for violating federal Clean Air Act provisions regarding hazardous air pollutants. Similarly, in July 2008, the Sierra Club announced that it may sue Luminant, after the expiration of a 60-day waiting period, for violating federal Clean Air Act provisions in connection with its Martin Lake generation facility. TCEH believes that, contrary to Sierra Club's allegations, it obtained lawful permits for constructing the Oak Grove generation facility and that it is in compliance with emissions requirements applicable to the Martin Lake generation facility. TCEH cannot predict whether the Sierra Club will actually file suit or the outcome of any such proceedings.

In September 2007, a subsidiary of TCEH acquired from Alcoa Inc. the air permit related to the Sandow 5 facility that had been previously issued by the TCEQ. Although a federal district court approved a settlement pursuant to which TCEH acquired the permit, environmental groups opposed to the settlement appealed the district court's decision to the US Fifth Circuit Court of Appeals. In June 2008, the US Fifth Circuit Court of Appeals upheld the district court's decision. TCEH believes the claims are without merit and will vigorously defend any further appeal. There can be no assurance that the outcome of this matter would not result in an adverse impact on the Sandow 5 project or TCEH.

Other Litigation

In July 2008, Alcoa Inc. filed a lawsuit in Milam County, Texas district court against Luminant Generation Company LLC, Luminant Mining Company LLC, Sandow Power Company LLC, Luminant Energy Company LLC (each of which is a wholly-owned subsidiary of TCEH) and EFH Corp. The lawsuit makes various claims concerning operation of the Sandow Unit 4 generation facility and the Three Oaks lignite mine and construction of the Sandow 5 unit, including claims for breach of contract, breach of fiduciary duty, fraud and conversion, and requests money damages in an unspecified amount, declaratory judgment, an accounting and rescission. A federal district court in Austin, Texas has ordered Alcoa Inc. to amend its Milam County complaint to remove any references to a federal consent decree relating to Sandow Units 4 and 5. Alcoa Inc. has not yet filed its amended complaint. While EFH Corp. and TCEH are unable to estimate any possible loss or predict the outcome of this litigation, EFH Corp. and TCEH believe the claims made in this litigation are without merit and, accordingly, intend to vigorously defend this litigation.

Regulatory Investigations and Reviews

In March 2007, the PUCT issued a Notice of Violation (NOV) stating that the PUCT Staff was recommending an enforcement action, including the assessment of administrative penalties, against EFH Corp. and certain affiliates for alleged market power abuse by its power generation affiliates and Luminant Energy in ERCOT-administered balancing energy auctions during certain periods of the summer of 2005. In September 2007, the PUCT issued a revised NOV in which the proposed administrative penalty amount was reduced from \$210 million to \$171 million. The revised NOV was necessary, according to the PUCT Staff, to correct calculation errors in the initial NOV. As revised, the NOV is premised upon the PUCT Staff's allegation that Luminant Energy's bidding behavior was not competitive and increased market participants' costs of balancing energy by approximately \$57 million, including approximately \$19 million in incremental revenues to EFH Corp. A hearing requested by Luminant Energy to contest the alleged occurrence of a violation and the amount of the penalty in the NOV was scheduled to start in April 2008 but was stayed pending resolution of discovery disputes and Luminant Energy's motion to dismiss, which was filed in November 2007. That motion was denied by the state administrative law judges, and in February 2008 the PUCT declined to hear Luminant Energy's appeal of that denial. In March 2008, Luminant Energy submitted to the administrative law judges its motion for summary decision on the discrete legal issue of what the maximum lawful penalty calculation could be in this proceeding. In April 2008, PUCT Staff submitted its cross-motion on the same issue. In July 2008, the administrative law judges issued their order on the cross-motions for summary decision. The order held that the PUCT Staff's proposed penalty calculation is unlawful and ruled partially in Luminant Energy's favor holding that the proper maximum penalty calculation should be based on the number of allegedly improper bid curves submitted to ERCOT during the relevant time period. The order also holds that a fact issue exists with respect to the number of bid curves submitted during the relevant period. Based upon this order and the PUCT Staff's alleged number of bid curves, TCEH believes the maximum penalty would have been less than \$16 million. The PUCT Staff appealed the administrative law judges' ruling on this maximum penalty issue to the PUCT, and at the August 14, 2008 PUCT open meeting, the PUCT Commissioners determined that it was inappropriate to decide the issue of how to calculate the potential maximum penalty at this point in the case. Instead, the PUCT indicated that the maximum penalty issue should be determined as part of the final resolution of the entire proceeding, after a full hearing on the merits. EFH Corp. and TCEH believe Luminant Energy's conduct during the period in question was consistent with the PUCT's rules and policies, and no market power abuse was committed. However, in the interest of potentially resolving this matter in an expeditious manner, the NOV proceeding is currently abated while the PUCT Staff and Luminant Energy engage in settlement discussions. If the proceeding is not resolved through settlement, EFH Corp. and TCEH will continue to vigorously contest the NOV. EFH Corp. and TCEH are unable to predict the outcome of this matter.

In June 2008, the EPA issued a request for information to Luminant Energy under EPA's authority under Section 114 of the Clean Air Act. The stated purpose of the request is to obtain information necessary to determine compliance with the Clean Air Act, including New Source Review Standards and air permits issued by the TCEQ for the Big Brown, Monticello and Martin Lake generation facilities. TCEH is cooperating with the EPA and is responding in good faith to the EPA's request. TCEH is unable to predict the outcome of this matter.

Other Proceedings

In addition to the above, TCEH and its subsidiaries are 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.

Guarantees

As discussed below, TCEH and its subsidiaries have entered into contracts that contain guarantees to outside parties that could require performance or payment under certain conditions.

Residual value guarantees in operating leases — TCEH is the lessee under various operating leases that guarantee the residual values of the leased assets. At September 30, 2008, the aggregate maximum amount of residual values guaranteed totaled approximately \$53 million with an estimated residual recovery of approximately \$59 million. These leased assets consist primarily of mining equipment and rail cars. The average life of the lease portfolio is approximately four years.

See Note 7 for discussion of guarantees and security for certain TCEH indebtedness.

Letters of Credit

At September 30, 2008, TCEH had outstanding letters of credit under its credit facilities totaling \$1.233 billion as follows:

- \$829 million to support risk management and trading margin requirements in the normal course of business, including over-the-counter hedging transactions;
- \$208 million to support (and available to fund payment of) floating rate pollution control revenue bond debt of \$204 million principal amount. The letters of credit are available to fund the payment of such debt obligations and expire in 2014;
- \$121 million to support obligations under the lease agreement for an EFH Corp. office building, and
- \$75 million for miscellaneous credit support requirements.

Nuclear Insurance

As a result of the US Terrorism Risk Insurance Program Reauthorization Act of 2007 that was effective January 1, 2008, under the American Nuclear Insurers liability policy, the liability arising out of terrorist acts that was previously subject to one industry aggregate limit of \$300 million is no longer subject to an aggregate limit.

9. MEMBERSHIP INTERESTS

Dividend Restrictions

The TCEH Senior Secured Facilities and Indenture include covenants that, among other things and subject to certain exceptions, restrict TCEH's ability to pay dividends or make other distributions in respect of its membership interests. Thus, all of TCEH's net income is restricted from being used to make distributions or loans to its parent companies, EFC Holdings or EFH Corp., unless such distributions or loans are expressly permitted under the TCEH Senior Secured Facilities and Indenture. Those agreements generally permit TCEH to make unlimited distributions or loans to its parent companies for corporate overhead costs, SG&A expenses, taxes and principal and interest payments and contain certain investment and dividend baskets that would allow TCEH to make additional distributions and/or loans to its parent companies up to the amount of such baskets. The TCEH Senior Secured Facilities generally restrict TCEH from making any distribution to any of its parent companies for the ultimate purpose of making a distribution to Texas Holdings unless at the time, and after giving effect to such distribution, TCEH's consolidated total debt (as defined in the TCEH Senior Secured Facilities) to TCEH's Adjusted EBITDA would be equal to or less than 6.5 to 1.0.

Membership Interests

The following table presents the changes in membership interests for the nine months ended September 30, 2008:

	<u>Capital Accounts</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Membership Interests</u>
Balance at December 31, 2007.....	\$6,393	\$ (177)	\$6,216
Net loss	(811)	—	(811)
Net effects of cash flow hedges (net of tax).....	—	(99)	(99)
Effects of employee stock-related activities.....	(1)	—	(1)
Purchase accounting adjustments.....	26	—	26
Other	<u>1</u>	<u>—</u>	<u>1</u>
Balance at September 30, 2008	<u>\$5,608</u>	<u>\$ (276)</u>	<u>\$5,332</u>

10. COMMODITY AND OTHER DERIVATIVE CONTRACTUAL ASSETS AND LIABILITIES

The following table provides detail of commodity and other derivative contractual assets and liabilities as presented in the balance sheet:

	Successor September 30, 2008			Total – Balance Sheet amount
	Commodity contracts	Other derivatives	Reclassification (a)	
Assets:				
Current assets	\$ 1,531	\$ 17	\$ (10)	\$ 1,538
Noncurrent assets	<u>325</u>	<u>15</u>	<u>—</u>	<u>340</u>
Total	<u>\$ 1,856</u>	<u>\$ 32</u>	<u>\$ (10)</u>	<u>\$ 1,878</u>
Liabilities:				
Current liabilities	\$ 1,784	\$ 182	\$ (10)	\$ 1,956
Noncurrent liabilities	<u>2,213</u>	<u>243</u>	<u>—</u>	<u>2,456</u>
Total	<u>\$ 3,997</u>	<u>\$ 425</u>	<u>\$ (10)</u>	<u>\$ 4,412</u>
Net assets (liabilities)	<u>\$ (2,141)</u>	<u>\$ (393)</u>	<u>\$ —</u>	<u>\$ (2,534)</u>

- (a) Represents the effects of reclassification of the assets and liabilities to conform to the balance sheet presentation of current and long-term assets and liabilities.

	Successor December 31, 2007		
	Commodity contracts	Other derivatives	Total – Balance Sheet amount
Assets:			
Current assets	\$ 1,118	\$ 8	\$ 1,126
Noncurrent assets	<u>239</u>	<u>5</u>	<u>244</u>
Total	<u>\$ 1,357</u>	<u>\$ 13</u>	<u>\$ 1,370</u>
Liabilities:			
Current liabilities	\$ 1,042	\$ 66	\$ 1,108
Noncurrent liabilities	<u>2,232</u>	<u>220</u>	<u>2,452</u>
Total	<u>\$ 3,274</u>	<u>\$ 286</u>	<u>\$ 3,560</u>
Net assets (liabilities)	<u>\$ (1,917)</u>	<u>\$ (273)</u>	<u>\$ (2,190)</u>

Margin deposits net assets of \$618 million and \$445 million under master netting arrangements at September 30, 2008 and December 31, 2007, respectively, were not netted with derivative assets and liabilities since TCEH has elected to present the amounts of derivative assets and liabilities on a gross basis in the balance sheet as provided in FIN 39-1. See discussion in Note 1 under “Changes in Accounting Standards.”

This presentation can result in significant volatility in commodity contract assets and liabilities because TCEH enters into positions with the same counterparties that result in both assets and liabilities, and the underlying commodity prices can change significantly from period to period.

Commodity Contract Assets and Liabilities

Commodity contract assets and liabilities primarily represent fair values of natural gas and electricity derivative instruments that have not been designated as cash flow hedges or “normal” purchases or sales under SFAS 133. These instruments are marked-to-market in net income and reported in the income statement in net losses from commodity hedging and trading activities.

Results for the three months ended September 30, 2008 and 2007 include net "day one" losses of \$10 million and \$58 million, respectively. Results for the nine months ended September 30, 2008 and 2007 include net "day one" losses of \$68 million and \$192 million, respectively, primarily associated with commodity contracts entered into at below market prices. Substantially all of these amounts represent losses associated with related series of transactions involving natural gas financial instruments intended to hedge exposure to future changes in electricity prices. The losses are reported in the income statement in net losses from commodity hedging and trading activities, consistent with other mark-to-market hedging and trading gains and losses.

Other Derivative Assets and Liabilities

Other derivative assets and liabilities primarily represent fair values of interest rate swaps and also include fair values of commodity contracts that have been designated as cash flow hedges.

A significant portion of natural gas derivatives entered into to hedge future changes in electricity prices had previously been designated and accounted for as cash flow hedges. In March 2007, these instruments were dedesignated as cash flow hedges as allowed under SFAS 133, thus becoming subject to mark-to-market accounting in net income as the fair values change. See Note 7 for details of interest rate swaps previously designated as cash flow hedges.

A summary of transactions comprising other derivative assets and liabilities follows:

	<u>Successor</u>	
	<u>September 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>
Current and noncurrent assets:		
Interest rate swaps (a)	\$ 18	\$ 5
Commodity-related cash flow hedges	<u>14</u>	<u>8</u>
Total	<u>\$ 32</u>	<u>\$ 13</u>
Current and noncurrent liabilities:		
Interest rate swaps (a)	\$ 414	\$ 285
Commodity-related cash flow hedges	<u>11</u>	<u>1</u>
Total	<u>\$ 425</u>	<u>\$ 286</u>

(a) September 30, 2008 amount includes \$404 million in net liabilities related to interest rate hedges on \$16.55 billion principal amount of debt and \$8 million in net assets related to interest rate basis swaps on \$10.045 billion principal amount of debt, both entered into after the Merger. As of August 29, 2008 changes in fair value of these swaps are marked-to-market in net income.

Other Cash Flow Hedge Information — TCEH experienced cash flow hedge ineffectiveness of zero and \$4 million in net losses for the three and nine month periods ended September 30, 2008, respectively. For the corresponding periods of 2007, the amounts were \$1 million in net losses and \$111 million in net gains, respectively. These amounts are pretax and are reported in the income statement in net gain (loss) from commodity hedging and trading activities.

The net effect of recording unrealized mark-to-market gains and losses arising from hedge ineffectiveness (versus recording gains and losses upon settlement) includes the above amounts as well as the effect of reversing unrealized ineffectiveness gains and losses recorded in previous periods to offset realized gains and losses in the current period. Such net unrealized effect totaled zero and \$4 million in net losses for the three and nine month periods ended September 30, 2008, respectively, and \$2 million in net losses and \$92 million in net gains for the three and nine month periods ended September 30, 2007, respectively.

Accumulated other comprehensive income related to cash flow hedges at September 30, 2008 totaled \$276 million in net losses (after-tax), substantially all of which relates to interest rate swaps. TCEH expects that \$119 million of net losses related to cash flow hedges included in accumulated other comprehensive income as of September 30, 2008 will be reclassified into net income during the next twelve months as the related hedged transactions affect net income.

11. PENSION AND OTHER POSTRETIREMENT EMPLOYEE BENEFITS

TCEH is a participating employer in the EFH Retirement Plan, a defined benefit pension plan sponsored by EFH Corp. TCEH also participates with EFH Corp. and certain other affiliated subsidiaries of EFH Corp. to offer certain health care and life insurance benefits to eligible employees and their eligible dependents upon the retirement of such employees. The net allocated pension and OPEB costs applicable to TCEH totaled \$4 million and \$11 million for the three and nine month periods ended September 30, 2008, respectively, and \$3 million and \$13 million for the three and nine month periods ended September 30, 2007, respectively.

The discount rate reflected in net pension and OPEB costs in 2008 is 6.55%. The expected rate of return on plan assets reflected in the 2008 cost amounts is 8.25% for the pension plan and 7.90% for the OPEB plan.

For the full year 2008, TCEH expects to make no required contributions to EFH Corp.'s pension plan and to provide an estimated \$687 thousand in funding for EFH Corp.'s OPEB plan. TCEH provided contributions of \$163 thousand and \$455 thousand to the OPEB plans in the three and nine month periods ended September 30, 2008, respectively.

12. FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued SFAS 157, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies in situations where other accounting pronouncements either permit or require fair value measurements, including purchase accounting. SFAS 157 does not require any new fair value measurements. However, SFAS 157 supersedes a previous accounting rule that prohibited the recognition of day one gains or losses on derivative instruments unless the fair value of those instruments were derived from an observable market price. Additionally, SFAS 157 requires an entity to take its own credit risk (nonperformance risk) into consideration when measuring the fair value of liabilities. TCEH adopted SFAS 157 effective with the closing of the Merger. The adoption of SFAS 157 reflects the application of FSP 157-2, "Effective Date of FASB Statement No. 157," which was issued by the FASB in February 2008 and delays until financial statements issued after December 15, 2008 the effective date of SFAS 157 for all nonfinancial assets and liabilities, except for those recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. With the adoption of SFAS 157, TCEH uses a "mid-market" valuation convention (the mid-point price between bid and ask prices) as a practical expedient to measure fair value for the majority of its assets and liabilities subject to fair value measurement under SFAS 133 and other accounting rules that require such measurement on a recurring basis. TCEH primarily uses the market approach for recurring fair value measurements and uses valuation techniques to maximize the use of observable inputs and minimize the use of unobservable inputs.

TCEH categorizes its assets and liabilities recorded at fair value based upon the following fair value hierarchy established by SFAS 157:

- Level 1 valuations use quoted prices in active markets for identical assets or liabilities that are accessible at the measurement date. An active market is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. TCEH's Level 1 assets and liabilities normally include exchange traded commodity contracts. For example, TCEH has a significant number of derivatives that are NYMEX futures and swaps transacted through clearing brokers for which the pricing is actively quoted.
- Level 2 valuations use inputs other than actively quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include: (a) quoted prices for similar assets or liabilities in active markets, (b) quoted prices for identical or similar assets or liabilities in markets that are not active, (c) inputs other than quoted prices that are observable for the asset or liability such as interest rates and yield curves observable at commonly quoted intervals and (d) inputs that are derived principally from or corroborated by observable market data by correlation or other means. TCEH's Level 2 assets and liabilities utilize over the counter broker quotes, quoted prices for similar assets or liabilities that are corroborated by correlations or other mathematical means and other valuation inputs. For example, TCEH's Level 2 assets and liabilities include forward commodity positions at locations for which over-the-counter broker quotes are available.
- Level 3 valuations use unobservable inputs for the asset or liability. Unobservable inputs are used to the extent observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. TCEH uses the most meaningful information available from the market combined with its own internally developed valuation methodologies to develop its best estimate of fair value. For example, certain derivative assets or liabilities are derived from pricing models that utilize multiple inputs to the valuations, including inputs that are not observable or easily corroborated through other means.

TCEH utilizes several different valuation techniques to measure the fair value of assets and liabilities, relying primarily on the market approach of using prices and other market information for identical and/or comparable assets and liabilities for those items that are measured on a recurring basis. These methods include, among others, the use of broker quotes and statistical relationships between different price curves.

In utilizing broker quotes, TCEH attempts to obtain multiple quotes from brokers that are active in the commodity markets in which it participates (and requires at least two quotes to determine a pricing input as observable); however, not all pricing inputs are quoted by brokers. The number of broker quotes that TCEH receives for certain pricing inputs varies depending on the depth of the trading market, each individual broker's publication policy, recent trading volume shifts and various other factors. Broker quotes received are generally binding where markets are actively traded. In addition, for valuation of interest rate hedges, TCEH uses a combination of dealer provided market valuations (generally non-binding) and Bloomberg valuations based on month-end interest rate curves and standard rate swap valuation models.

Certain derivatives and financial instruments are valued utilizing option pricing models that take into consideration multiple inputs including commodity prices, volatility factors, discount rates and other inputs. Additionally, when there is not a sufficient amount of observable market data, valuation models are developed that incorporate proprietary views of market factors. Those valuation models are generally used in developing long-term forward price curves for certain commodities. TCEH believes that development of such curves is consistent with industry practice; however, the fair value measurements resulting from such curves are classified as Level 3.

With respect to amounts presented in the following fair value hierarchy table, the fair value measurement of an asset or liability (e.g. a contract) is required under SFAS 157 to fall in its entirety in one level, based on the lowest level input that is significant to the fair value measurement. Certain assets and liabilities would be classified in Level 2 instead of Level 3 of the hierarchy except for the effects of credit reserves and non-performance risk adjustments, respectively. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability being measured.

At September 30, 2008, assets and liabilities measured at fair value on a recurring basis consisted of the following:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Reclassify (a)</u>	<u>Total</u>
Assets:					
Commodity-related contracts.....	\$ 587	\$ 1,005	\$ 177	\$ 91	\$ 1,860
Interest rate swaps.....	—	18	—	—	18
Nuclear decommissioning trust (b).....	135	299	—	—	434
Salary deferral plan investments (b).....	<u>2</u>	<u>20</u>	<u>—</u>	<u>—</u>	<u>22</u>
Total assets	<u>\$ 724</u>	<u>\$ 1,342</u>	<u>\$ 177</u>	<u>\$ 91</u>	<u>\$ 2,334</u>
Liabilities:					
Commodity-related contracts.....	\$ 865	\$ 2,673	\$ 369	\$ 91	\$ 3,998
Interest rate swaps.....	—	414	—	—	414
Total liabilities.....	<u>\$ 865</u>	<u>\$ 3,087</u>	<u>\$ 369</u>	<u>\$ 91</u>	<u>\$ 4,412</u>

(a) Represents the effects of reclassification of the assets and liabilities to conform to the balance sheet presentation of current and long-term assets and liabilities.

(b) TCEH's nuclear decommissioning trust and salary deferral plan investments are included in the Investments line on the balance sheet.

Commodity-related contracts consist primarily of natural gas and electricity derivative instruments entered into for hedging purposes and include physical contracts that have not been designated "normal" purchases or sales under SFAS 133.

Interest rate swaps consist largely of variable-to-fixed rate swap instruments that are economic hedges of interest on long-term debt.

Nuclear decommissioning trust assets represent securities held for the purpose of funding the future retirement and decommissioning of TCEH's nuclear generation units. These investments include equity, debt and other fixed-income securities consistent with investment rules established by the NRC and the PUCT.

Salary deferral plan assets represent securities held for the purpose of funding the liabilities of EFH Corp.'s Salary Deferral Program. These investments include life insurance contracts, equity, debt and other fixed-income securities.

The following table presents the changes in fair value of TCEH's Level 3 assets and liabilities (all related to commodity contracts) for the three and nine months ended September 30, 2008:

	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
Balance at beginning of period (net liability)	\$ (539)	\$ (173)
Total realized and unrealized gains (losses) (a):		
Included in net income (loss)	395	(82)
Included in other comprehensive income	(8)	7
Purchases, sales, issuances and settlements (net) (b)	(31)	49
Net transfers in and/or out of Level 3 (c)	(9)	7
Balance at September 30, 2008 (net liability)	<u>\$ (192)</u>	<u>\$ (192)</u>
Net change in unrealized gains (losses) included in net income relating to instruments held at September 30, 2008 (a)	\$ 435	\$ 10

- (a) Substantially all changes in values of commodity-related contracts are reported in the income statement in net gain (loss) from commodity hedging and trading activities.
- (b) Purchases, sales and issuances represent amounts for new transactions entered into during the period and any unrealized gains (losses) that occurred during the period for those transactions. Settlements represent amounts included in the beginning balance for the period. Amount also includes fair values of transactions with Lehman Brothers Holdings Inc. that were terminated and therefore were reclassified from commodity and other derivative contractual assets to accounts receivable, which was reserved for as a charge reported in other deductions (see Notes 5 and 6).
- (c) Includes transfers due to changes in the observability of significant inputs. Amounts transferred in and/or out represent September 30, 2008 values.

13. RELATED-PARTY TRANSACTIONS

The following represent the significant related-party transactions of TCEH:

- TCEH incurs electricity delivery fees charged by Oncor. These fees totaled \$292 million and \$778 million for the three and nine month periods ended September 30, 2008, respectively, and \$302 million and \$799 million for the three and nine month periods ended September 30, 2007, respectively.
- Oncor's bankruptcy-remote financing subsidiary has issued securitization (transition) bonds to recover generation-related regulatory assets through a transition surcharge to its customers. Oncor's incremental income taxes related to the transition surcharges it collects are being reimbursed by TCEH. Therefore, TCEH's financial statements reflect a noninterest bearing note payable to Oncor of \$298 million (\$35 million reported as trade accounts and other payables to affiliates) at September 30, 2008 and \$323 million (\$34 million reported as trade accounts and other payables to affiliates) at December 31, 2007.
- TCEH reimburses Oncor for interest expense on Oncor's bankruptcy-remote financing subsidiary's transition bonds. This interest expense totaled \$11 million and \$35 million for the three and nine month periods ended September 30, 2008, respectively, and \$12 million and \$37 million for the three and nine month periods ended September 30, 2007, respectively.
- In December 2005, TCEH received a \$1.5 billion note from EFH Corp. in partial settlement of outstanding advances. EFH Corp. settled the note in connection with the Merger. The note carried interest at a rate based on the weighted average cost of TCEH's short-term borrowings. Interest income related to this note totaled \$25 million and \$71 million for the three and nine month periods ended September 30, 2007. In addition, interest income on outstanding advances to EFH Corp., which were also settled in connection with the Merger, totaled \$74 million and \$197 million for the three and nine month periods ended September 30, 2007.
- Subsequent to the Merger, TCEH receives notes payable on demand from EFH Corp. in exchange for cash to be used for working capital and general corporate purposes of EFH Corp. The notes totaled \$407 million at September 30, 2008 and \$25 million at December, 31, 2007, and the average daily balance of the notes for the three and nine month periods ended September 30, 2008 were \$480 million and \$365 million, respectively. The notes carry interest at a rate based on the one-month LIBOR rate plus 5.00%, and interest income totaled \$9 million and \$22 million for the three and nine month periods ended September 30, 2008. TCEH also receives notes from EFC Holdings in exchange for cash to be used for working capital and general corporate purposes of EFC Holdings. The notes totaled \$6 million at September 30, 2008, and the average daily balance of the notes from the issuance date until September 30, 2008 was \$3 million. The notes carry interest at a rate based on the one-month LIBOR rate plus 5.00%, and interest income totaled \$91 thousand and \$155 thousand for the three and nine month periods ended September 30, 2008.
- An EFH Corp. subsidiary charges TCEH for financial, accounting, environmental and other administrative services at cost. These costs, which are primarily reported in SG&A expenses, totaled \$15 million and \$46 million for the three and nine month periods ended September 30, 2008, respectively, and \$14 million and \$43 million for the three and nine month periods ended September 30, 2007, respectively.

- Under Texas regulatory provisions, the trust fund for decommissioning TCEH's Comanche Peak nuclear generation facility, reported in investments on TCEH's balance sheet, is funded by a delivery fee surcharge billed to REPs by Oncor and remitted to TCEH, with the intent that the trust fund assets will be sufficient to fund the decommissioning liability, reported in noncurrent liabilities on TCEH's balance sheet. Income and expenses associated with the trust fund and the decommissioning liability incurred by TCEH are offset by a net change in the intercompany receivable/payable with Oncor, which in turn results in a change in the net regulatory asset/liability. At September 30, 2008, the excess of the decommissioning liability over the trust fund balance resulted in a regulatory asset of \$67 million, which is reported on Oncor's balance sheet. At December 31, 2007, the excess of the trust fund balance over the estimated decommissioning liability resulted in a regulatory liability of \$13 million, which is reported on Oncor's balance sheet.
- TCEH has a 53.1% limited partnership interest, with a carrying value of \$21 million and \$28 million at September 30, 2008 and December 31, 2007, respectively, in an EFH Corp. subsidiary holding Capgemini-related assets. Equity losses related to this interest totaled \$2 million and \$7 million for the three and nine month periods ended September 30, 2008, respectively, and \$2 million and \$5 million for the three and nine month periods ended September 30, 2007, respectively. These losses primarily represent amortization of software assets held by the subsidiary. The equity losses are reported as other deductions.
- EFH Corp. files a consolidated federal income tax return; however, TCEH's federal income tax and Texas margin tax expense and related balance sheet amounts, including income taxes payable to or receivable from EFH Corp., are recorded as if the entity is a stand-alone corporation. As a result, TCEH had an income tax receivable from EFH Corp. of \$259 million and \$190 million at September 30, 2008 and December 31, 2007, respectively.
- As of September 30, 2008, TCEH had cash collateral of \$15 million posted with Oncor related to interconnection agreements for three generation units being developed by Luminant.
- Certain transmission and distribution utilities in Texas have tariffs in place to assure adequate credit worthiness of any REP to support the REP's obligation to collect securitization bond-related (transition) charges on behalf of the utility. Under these tariffs, as a result of TCEH's credit rating being below investment grade, TCEH is required to post collateral support in an amount equal to estimated transition charges over specified time periods. TCEH has posted a letter of credit in the amount of \$14 million for the benefit of Oncor.
- Oncor and Texas Holdings agreed to the terms of a stipulation with major interested parties to resolve all outstanding issues in the PUCT review related to the Merger. As part of this stipulation, TCEH will post a letter of credit in an amount equal to \$170 million to secure TXU Energy's payment obligations to Oncor if two or more of Oncor's credit ratings are below investment grade. As of September 30, 2008, Oncor maintains an investment grade rating with each of the credit rating agencies.
- At the closing of the Merger, TCEH entered into the TCEH Senior Secured Facilities with a syndicate of financial institutions and other lenders. This syndicate included affiliates of GS Capital Partners. Affiliates of GS Capital Partners have from time to time engaged in commercial banking and financial advisory transactions with TCEH in the normal course of business.
- Affiliates of Goldman Sachs & Co. are party to certain commodity and interest rate hedging transactions with TCEH in the normal course of business.
- From time to time affiliates of the Sponsor Group may acquire debt or debt securities issued by TCEH in open market transactions or through loan syndications.
- See Note 4 for contributions of entities and net assets to TCEH, Note 6 for information regarding the accounts receivable securitization program and related subordinated notes receivable from TXU Receivables Company, Note 7 for guarantees and Note 11 for information regarding pension and other postretirement employee benefits.

14. SUPPLEMENTARY FINANCIAL INFORMATION

Stock-Based Compensation

Under the terms of the EFH Corp. 2007 Stock Incentive Plan, options to purchase 2 million and 13 million shares of EFH Corp. common stock were issued to certain TCEH management employees in the three and nine months ended September 30, 2008. Vested awards must be exercised within 10 years of the grant date. The terms of the options were fixed at grant date. Options to purchase 1 million and 2 million shares were forfeited during the three and nine months ended September 30, 2008, respectively.

Expenses recognized for options granted totaled \$4 million and \$7 million for the three and nine month periods ended September 30, 2008, respectively.

Interest Expense and Related Charges

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Interest.....	\$ 646	\$ 128	\$ 1,910	\$ 337
Amortization of fair value debt discounts resulting from purchase accounting.....	4	—	11	—
Amortization of debt issuance cost, premiums and discounts	41	3	91	10
Unrealized mark-to-market net (gain) loss on interest rate swaps.....	(36)	—	(36)	—
Interest capitalized in accordance with SFAS 34	(74)	(14)	(220)	(37)
Total interest expense and related charges .	<u>\$ 581</u>	<u>\$ 117</u>	<u>\$ 1,756</u>	<u>\$ 310</u>

Restricted Cash

	<u>Successor</u>			
	<u>At September 30, 2008</u>		<u>At December 31, 2007</u>	
	<u>Current</u> <u>Assets</u>	<u>Noncurrent</u> <u>Assets</u>	<u>Current</u> <u>Assets</u>	<u>Noncurrent</u> <u>Assets</u>
Amounts related to Letter of Credit Facility (See Note 7)	\$ —	\$ 1,250	\$ —	\$ 1,250
Amounts related to margin deposits held.....	20	—	—	—
Pollution control revenue bond funds held by trustee (See Note 7).....	—	—	—	29
Total restricted cash	<u>\$ 20</u>	<u>\$ 1,250</u>	<u>\$ —</u>	<u>\$ 1,279</u>

Inventories by Major Category

	<u>Successor</u>	
	<u>September 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>
Materials and supplies	\$ 132	\$ 121
Fuel stock	144	138
Natural gas in storage.....	65	93
Total inventories.....	<u>\$ 341</u>	<u>\$ 352</u>

Investments Held in Money Market Fund

As of September 30, 2008, TCEH held a \$242 million interest in The Reserve's US Government Fund, which began liquidation proceedings in September 2008 due to the credit crisis and withdrawal demands. In September 2008, TCEH attempted to redeem its interest in the US Government Fund, but due to the liquidation process, the funds were not immediately made available. TCEH expects to receive its funds by the end of the fourth quarter.

Investments

	Successor	
	September 30, 2008	December 31, 2007
Nuclear decommissioning trust	\$ 434	\$ 484
Assets related to employee benefit plans, including employee savings programs	38	54
Land.....	42	42
Investment in affiliate holding Capgemini-related assets	21	28
Wind investment project.....	3	3
Miscellaneous other	—	1
Total investments	<u>\$ 538</u>	<u>\$ 612</u>

Property, Plant and Equipment

As of September 30, 2008 and December 31, 2007, property, plant and equipment of \$21.1 billion and \$20.5 billion, respectively, is stated net of accumulated depreciation and amortization of \$1.1 billion and \$288 million, respectively. Property, plant and equipment was fair-valued in connection with purchase accounting for the Merger.

Asset Retirement Obligations

Asset retirement obligations primarily relate to nuclear generation plant decommissioning, land reclamation related to lignite mining, removal of lignite/coal-fueled plant ash treatment facilities and generation plant asbestos removal and disposal costs. There is no earnings impact with respect to the recognition of the asset retirement costs for nuclear decommissioning, as all costs are recoverable through the regulatory process as part of Oncor's rates.

The following table summarizes the changes to the asset retirement liability, reported in other noncurrent liabilities and deferred credits in the balance sheet, during the nine months ended September 30, 2008:

	Successor
Asset retirement liability at January 1, 2008	\$ 773
Additions:	
Accretion and incremental reclamation costs	38
Reductions:	
Mining reclamation payments.....	<u>(15)</u>
Asset retirement liability at September 30, 2008	<u>\$ 796</u>

Other Noncurrent Liabilities and Deferred Credits

The balance of other noncurrent liabilities and deferred credits consists of the following:

	Successor	
	September 30,	December 31,
	2008	2007
Unfavorable purchase and sales contracts	\$ 735	\$ 751
Uncertain tax positions (including accrued interest)	803	798
Asset retirement obligations	796	773
Retirement plan and other employee benefits	63	50
Other	<u>35</u>	<u>52</u>
Total other noncurrent liabilities and deferred credits	<u>\$ 2,432</u>	<u>\$ 2,424</u>

Unfavorable Purchase and Sales Contracts — Unfavorable purchase and sales contracts primarily represent the extent to which contracts on a net basis were unfavorable to market prices as of the date of the Merger. These are contracts for which: 1) TCEH has made the “normal” purchase or sale election allowed or 2) the contract did not meet the definition of a derivative under SFAS 133. Under purchase accounting, TCEH recorded the value as of October 10, 2007 as a deferred credit. Amortization of the deferred credit related to unfavorable contracts is primarily on a straight-line basis, which approximates the economic realization, and is recorded as revenues or a reduction of purchased power costs as appropriate. The amortization amount totaled \$6 million and \$23 million in the three and nine months ended September 30, 2008, respectively. Favorable purchase and sales contracts are recorded as intangible assets (see Note 3).

The estimated amortization of unfavorable purchase and sales contracts for each of the five succeeding fiscal years from December 31, 2007 is as follows:

Year	Successor Amount
2008.....	\$ 30
2009.....	28
2010.....	27
2011.....	27
2012.....	27

Supplemental Cash Flow Information

	Successor Nine Months Ended September 30, 2008	Predecessor Nine Months Ended September 30, 2007
Cash payments related to:		
Interest paid	\$ 1,731	\$ 337
Capitalized interest	<u>(220)</u>	<u>(37)</u>
Interest paid (net of capitalized interest)	1,511	300
Income taxes	34	916
Noncash investing and financing activities:		
Noncash construction expenditures (a)	155	128
Promissory note issued in conjunction with acquisition of mining-related assets	—	65
Capital leases	13	59
Purchase accounting adjustments	26	—

(a) Represents end-of-period accruals.

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To the Board of Managers of Texas Competitive Electric Holdings Company LLC:

We have reviewed the accompanying condensed consolidated balance sheet of Texas Competitive Electric Holdings Company LLC and subsidiaries (a wholly-owned subsidiary of Energy Future Competitive Holdings Company, which is a wholly-owned subsidiary of Energy Future Holdings Corp.) ("TCEH") as of September 30, 2008, and the related condensed statements of consolidated income (loss) and comprehensive income (loss) for the three-month and nine-month periods ended September 30, 2008 and 2007, and of cash flows for the nine-month periods ended September 30, 2008 and 2007. These interim financial statements are the responsibility of TCEH's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants and the auditing standards of the Public Company Accounting Oversight Board (United States) for reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and of making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and with the auditing standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the condensed consolidated financial statements, TCEH reclassified the results of its commodity hedging and trading activities. Also, as discussed in Note 1 to the condensed consolidated financial statements, TCEH accounted for the contribution of certain subsidiaries, assets, and liabilities from Energy Future Holdings Corp. in a manner similar to a pooling of interests.

We have previously audited, in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Accounting Oversight Board (United States), the consolidated balance sheet of Texas Competitive Electric Holdings Company LLC and subsidiaries as of December 31, 2007, and the related statements of consolidated income (loss), comprehensive income (loss), cash flows, and membership interests for the period from October 11, 2007 through December 31, 2007 (successor) and the period from January 1, 2007 through October 10, 2007 (predecessor) (not presented herein); and in our report dated April 14, 2008 (June 2, 2008 as to the effects of the adoption of FASB Staff Position No. FIN 39-1) (which report includes an explanatory paragraph related to TCEH's change in basis of accounting beginning October 11, 2007, and the contribution of certain subsidiaries, assets, and liabilities from Energy Future Holdings Corp. in a manner similar to a pooling of interests), we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the condensed consolidated balance sheet as of December 31, 2007 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Deloitte & Touche LLP

Dallas, Texas
November 5, 2008

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

BUSINESS

TCEH is a Dallas-based holding company for subsidiaries engaged in competitive electricity market activities largely in Texas, including Luminant, which is engaged in electricity generation, development and construction of new generation facilities, wholesale energy sales and purchases and commodity risk management and trading activities and TXU Energy, which is engaged in retail electricity sales. Commodity risk management and allocation of financial resources are performed at the TCEH level; therefore, there are no reportable business segments. TCEH is a wholly-owned subsidiary of EFC Holdings, which is a wholly-owned subsidiary of EFH Corp. While TCEH is a wholly-owned subsidiary of EFH Corp. and EFC Holdings, TCEH is a separate legal entity from EFH Corp. and EFC Holdings and all of their other affiliates with its own assets and liabilities.

In connection with the Merger, which closed on October 10, 2007, certain wholly-owned subsidiaries of EFH Corp. established for the purpose of developing and constructing new generation facilities became subsidiaries of TCEH, and certain assets and liabilities of other such subsidiaries were transferred to TCEH and its subsidiaries. Those subsidiaries holding impaired construction work-in-process assets related to eight canceled coal-fueled generation units did not become subsidiaries of TCEH. (In addition, a wholly-owned subsidiary of EFC Holdings representing a lease trust holding certain combustion turbines became a subsidiary of TCEH.) Because these transactions were between entities under the common control of EFH Corp., TCEH accounted for the transactions in a manner similar to a pooling of interests. As a result, historical operations, financial position and cash flows of TCEH and the entities and other net assets contributed are presented on a combined basis for all periods presented.

Significant Activities and Events

Uncertain Financial Markets — While TCEH believes its cash on hand and cash from operations combined with availability under its existing credit facilities provides sufficient liquidity to fund current obligations, projected working capital requirements and capital spending, there can be no assurance, considering the current uncertainty in financial markets, that counterparties to its credit facilities will perform as expected through the maturity dates and counterparties in the natural gas hedging program will meet their obligations, or that material unexpected changes in financial markets or the economy will not result in liquidity constraints or require increased funding, including related to pension and OPEB obligations. In light of current market conditions, TCEH reviewed the quality of its investments in money market funds and determined there are no indications that these investments should be valued at less than carrying value at September 30, 2008.

Also see Note 3 to Financial Statements regarding potential impairment of goodwill and Note 5 to Financial Statements regarding a charge related to the filing by Lehman Brothers Holdings Inc. for bankruptcy under Chapter 11 of the US Bankruptcy Code, Note 14 to Financial Statements for discussion of an investment in a money market fund that is being liquidated, and "Liquidity and Capital Resources" (below) for discussion of actions taken in response to the uncertain financial markets.

Long-Term Hedging Program — TCEH has a long-term hedging program designed to reduce exposure to changes in future electricity prices due to changes in the price of natural gas. Under the program, subsidiaries of TCEH have entered into market transactions involving natural gas-related financial instruments. As of October 24, 2008, these subsidiaries have effectively sold forward approximately 2.1 billion MMBtu of natural gas (equivalent to the natural gas exposure of approximately 280,000 GWh at an assumed 7.5 MMBtu/MWh market heat rate) over the period from 2008 to 2014 at average annual sales prices ranging from \$7.20 per MMBtu to \$8.35 per MMBtu. TCEH currently expects to hedge approximately 80% of the equivalent natural gas price exposure of its expected baseload generation output on a rolling five-year basis. For the period from 2008 to 2014, and taking into consideration the estimated portfolio impacts of TXU Energy's retail electricity business, the hedging transactions described in the previous sentence result in TCEH having effectively hedged approximately 77% of its expected baseload generation natural gas price exposure for such period (on an average basis for such period). The hedges were entered into with the continuing expectation that wholesale electricity prices in ERCOT will be highly correlated with natural gas prices. If market heat rates decline in the future, which would indicate a lessening of such correlation, TCEH expects that the cash flows targeted under the long-term hedging program may not be achieved.

Beginning in the second quarter of 2008, TCEH entered into related put and call transactions (referred to as collars), primarily for outer years of the program, that effectively hedge natural gas prices within a range. These transactions represented approximately 5% of the positions in the program at October 24, 2008, with the approximate weighted average strike prices under the collars being a floor of \$7.80 per MMBtu and a ceiling of \$11.75 per MMBtu. TCEH expects to employ both collars and, as has been the case, swap transactions for future hedging activity under its long-term hedging program. Under the terms of the collars, if forward natural gas prices are lower than the floor price, unrealized mark-to-market gains related to the hedges would be recognized in net income, and if forward prices are higher than the ceiling price, unrealized mark-to-market losses related to the hedges would be recognized in net income.

Prior to March 2007, a significant portion of the instruments under the long-term hedging program were designated and accounted for as cash flow hedges. In March 2007, these instruments were dedesignated as allowed under SFAS 133. Subsequent changes in the fair value of these instruments are being recorded as unrealized gains and losses in net income, which has and could continue to result in significantly increased volatility in reported net income. Based on the size of the long-term hedging program as of October 24, 2008, a \$1.00/MMBtu change in natural gas prices across the period from 2008 through 2014 would result in the recognition by TCEH of up to approximately \$2.1 billion in pretax unrealized mark-to-market gains or losses.

Reported unrealized mark-to-market net gains associated with the long-term hedging program were significant in the three months ended September 30, 2008 (\$6.2 billion) due to net decreases in forward natural gas prices. Reported unrealized mark-to-market net gains in the nine months ended September 30, 2008 totaled \$133 million. Given the volatility of natural gas prices, it is not possible to predict future reported unrealized mark-to-market gains or losses and the actual gains or losses that will ultimately be realized upon settlement of the hedge positions in future years. If natural gas prices at settlement are lower than the prices of the hedge positions, the hedges are expected to mitigate the otherwise negative effect on earnings of lower wholesale electricity prices. However, if natural gas prices at settlement are higher than the prices of the hedge positions, the hedges are expected to dampen the otherwise positive effect on earnings of higher wholesale electricity prices and will in this context be viewed as having resulted in an opportunity cost. The cumulative unrealized mark-to-market net losses related to positions in the long-term hedging program totaled \$1.8 billion at December 31, 2007, \$1.7 billion at September 30, 2008 and \$44 million at October 24, 2008. These values can change materially as market conditions change.

As of September 30, 2008, more than 95% of the long-term hedging transactions were secured by a first-lien interest in TCEH's assets (including the transactions supported by the TCEH Commodity Collateral Posting Facility – see discussion below under "Liquidity And Capital Resources") thereby reducing the cash and letter of credit collateral requirements for the hedging program.

Interest Rate Swap Transactions — See discussion in Note 7 to Financial Statements regarding various interest rate swap transactions entered into since the Merger. As of September 30, 2008, TCEH had entered into a series of interest rate swaps that effectively fix the interest rates at between 7.3% and 8.3% on \$16.55 billion principal amount of its senior secured debt maturing from 2009 to 2014. Taking into consideration these swap transactions, approximately 16% of TCEH's total long-term debt portfolio at September 30, 2008 was exposed to variable interest rate risk. On August 29, 2008, swaps in effect at that time were dedesignated as cash flow hedges in accordance with SFAS 133, and subsequent changes in their fair value are being marked-to market in net income (reported in interest expense and related charges.) These swaps were dedesignated as a result of the intent to change the variable interest rate terms of the hedged debt (from three-month LIBOR to one-month LIBOR) in connection with the planned execution of interest rate basis swaps to further reduce the fixed borrowing costs. In October 2008, TCEH entered into interest rate swaps that effectively fix the interest rates at between 7.5% and 7.6% on an additional \$1 billion principal amount of the TCEH Senior Secured Facilities; these swaps will also be marked-to-market in net income. TCEH may enter into additional interest rate hedges from time to time. The cumulative unrealized mark-to-market net losses related to all interest rate swaps totaled \$280 million at December 31, 2007 (all reported in accumulated other comprehensive income) and \$404 million at September 30, 2008 (\$432 million of which was reported in accumulated other comprehensive income) due to changes in market interest rates. These fair values can change materially as market conditions change.

Environmental Regulatory Matters — See discussion in Note 3 to Financial Statements regarding the invalidation of the EPA's Clean Air Interstate Rule and the related impairment of intangible assets representing NO_x and SO₂ emission allowances in the third quarter of 2008.

Texas Generation Facilities Development — Luminant is developing three lignite-fueled generation units (2 units at Oak Grove and 1 unit at Sandow) in the state of Texas with a total estimated capacity of approximately 2,200 MW. Agreements have been executed with EPC contractors to engineer and construct the units; design and procurement activities for the three units are essentially complete, and construction is well underway. Air permits for construction of all three units have been obtained. Aggregate cash capital expenditures for these three units are expected to total approximately \$3.25 billion including all construction, site preparation and mining development costs, of which approximately \$2.6 billion was incurred as of September 30, 2008. Total recorded costs, including purchase accounting fair value adjustments and capitalized interest, are expected to total approximately \$5.0 billion upon completion of the units. The expected commercial operation dates of the units remain as follows: Sandow in 2009 and Oak Grove's two units in 2009 and 2010. See discussion in Note 8 to Financial Statements under "Litigation Related to Generation Development" regarding pending litigation related to the new units.

The development program includes up to \$500 million for investments in state-of-the-art emissions controls for the three new units. The development program also includes an environmental retrofit program under which Luminant will install additional environmental control systems at its existing lignite/coal-fueled generation facilities. Estimated capital expenditures associated with these additional environmental control systems total approximately \$1.0 billion to \$1.3 billion. Luminant has not yet completed all detailed cost and engineering studies for the additional environmental systems, and the cost estimates could materially change as Luminant determines the details of and further evaluates the engineering and construction costs related to these investments.

Nuclear Generation Development — In September 2008, Luminant filed a combined operating license application with the NRC for two new nuclear generation facilities, each with approximately 1,700 MW (gross capacity), at its existing Comanche Peak nuclear generation site. In connection with the filing of the application, Luminant and Mitsubishi Heavy Industries Ltd. entered into an agreement to form a joint venture to further the development of the two new nuclear generation units using Mitsubishi Heavy Industry Ltd.'s US-Advanced Pressurized Water Reactor technology. TCEH anticipates that closing of the joint venture will occur prior to the end of 2008.

In September 2008, Luminant filed Part I of its loan guarantee application with the US Department of Energy (DOE) for financing related to the proposed units. Luminant is currently preparing Part II of the application and expects to submit it to the DOE by mid-December 2008.

Cities Aggregation Power Project — In September 2008, Luminant and certain of its affiliates entered into a 24-year agreement to sell electricity to Cities Aggregation Power Project (CAPP), a non-profit organization that makes bulk electricity purchases on behalf of its member cities and local subdivisions. Under the terms of the contract, CAPP will prepay Luminant approximately \$465 million for the fixed cost portion of the electricity. The agreement is contingent upon (i) CAPP successfully issuing bonds to finance a prepayment to Luminant on behalf of participating cities, (ii) adoption of an ordinance by each of the participating cities that, among other things, authorizes the payment of each such participating city's share of the electricity cost under the agreement and (iii) CAPP entering into back-to-back contracts with the participating cities for 150 MW of electricity. Given the conditions to closing that are outside of Luminant's control, there can be no assurance that CAPP will purchase electricity (or make the prepayment) under the agreement.

PRESENTATION AND ANALYSIS OF RESULTS

The accompanying condensed statements of consolidated income (loss) and comprehensive income (loss) are presented for four periods: three and nine months ended September 30, 2008 (Successor) and three and nine months ended September 30, 2007 (Predecessor), which relate to periods after and before the Merger, respectively, and the accompanying condensed statements of consolidated cash flows are presented for the same nine month periods. While the results of operations of the Predecessor and Successor are not comparable due to the change in basis resulting from the application of purchase accounting for the Merger, the effects of purchase accounting on the results of the Successor are discussed in the comparison of results for the 2008 and 2007 periods.

See Note 1 to Financial Statements under "Basis of Presentation" for discussion of a change in classification of results from commodity hedging and trading activities.

All dollar amounts in Management's Discussion and Analysis of Financial Condition and Results of Operations (including the tables) are stated in millions of US dollars unless otherwise indicated.

RESULTS OF OPERATIONS

Sales Volume and Customer Count Data

	Successor	Predecessor		Successor	Predecessor	
	Three	Three		Nine	Nine	
	Months	Months		Months	Months	
	Ended	Ended		Ended	Ended	
	September	September		September	September	
	30, 2008	30, 2007	Change %	30, 2008	30, 2007	Change %
Sales volumes:						
Retail electricity sales volumes - gigawatt hours (GWh):						
Residential	9,098	8,789	3.5	22,153	21,256	4.2
Small business (a).....	2,241	2,313	(3.1)	5,802	5,861	(1.0)
Large business and other customers.....	<u>4,038</u>	<u>3,902</u>	<u>3.5</u>	<u>10,951</u>	<u>10,946</u>	<u>—</u>
Total retail electricity.....	15,377	15,004	2.5	38,906	38,063	2.2
Wholesale electricity sales volumes.....	12,472	9,938	25.5	35,529	27,914	27.3
Net sales (purchases) of balancing electricity						
to/from ERCOT.....	<u>145</u>	<u>(4)</u>	<u>—</u>	<u>(1,335)</u>	<u>622</u>	<u>—</u>
Total sales volumes.....	<u>27,994</u>	<u>24,938</u>	<u>12.3</u>	<u>73,100</u>	<u>66,599</u>	<u>9.8</u>
Average volume (kWh) per retail customer (b):						
Residential	4,757	4,764	(0.1)	11,654	11,399	2.2
Small business	8,732	8,969	(2.6)	22,578	22,421	0.7
Large business and other customers.....	145,802	109,115	33.6	361,554	276,764	30.6
Weather (service territory average) – percent of normal (c):						
Percent of normal:						
Cooling degree days.....	100.7%	97.2%		109.0%	94.2%	
Heating degree days.....				93.7%	106.2%	
Customer counts:						
Retail electricity customers (end of period and in thousands) (d):						
Residential.....				1,927	1,858	3.7
Small business (a)				258	256	0.8
Large business and other customers				<u>27</u>	<u>35</u>	<u>(22.9)</u>
Total retail electricity customers				<u>2,212</u>	<u>2,149</u>	<u>2.9</u>

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

(b) Calculated using average number of customers for period.

(c) Weather data is obtained from Weatherbank, Inc., an independent company that collects and archives weather data from reporting stations of the National Oceanic and Atmospheric Administration (a federal agency under the US Department of Commerce).

(d) Based on number of meters.

Revenue and Market Share Data

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Operating revenues:				
Retail electricity revenues:				
Residential	\$ 1,258	\$ 1,221	\$ 2,966	\$ 2,954
Small business (a).....	335	335	852	849
Large business and other customers.....	<u>447</u>	<u>368</u>	<u>1,143</u>	<u>1,025</u>
Total retail electricity revenues.....	2,040	1,924	4,961	4,828
Wholesale electricity revenues.....	1,134	589	2,797	1,571
Net sales (purchases) of balancing electricity				
to/from ERCOT	(44)	(19)	(227)	(11)
Amortization of intangibles (b).....	26	—	(15)	—
Other operating revenues.....	<u>102</u>	<u>78</u>	<u>293</u>	<u>236</u>
Total operating revenues	<u>\$ 3,258</u>	<u>\$ 2,572</u>	<u>\$ 7,809</u>	<u>\$ 6,624</u>
Commodity hedging and trading activities:				
Unrealized net gains (losses), including cash flow				
hedge ineffectiveness.....	\$ 6,068	\$ 479	\$ (237)	\$ (695)
Unrealized net gains (losses) representing reversals				
of previously recognized fair values of positions				
settled in the current period	20	—	(68)	(8)
Realized net gains (losses) on settled positions (c).....	<u>(43)</u>	<u>(17)</u>	<u>57</u>	<u>96</u>
Net gain (loss).....	<u>\$ 6,045</u>	<u>\$ 462</u>	<u>\$ (248)</u>	<u>\$ (607)</u>
Average revenues per MWh:				
Residential	\$ 138.32	\$138.96	\$ 133.90	\$ 138.99
Estimated share of ERCOT retail markets (d) (e) (f):				
Residential.....			37%	36%
Business markets.....			26%	27%

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

(b) Represents amortization of the intangible net asset value of retail and wholesale power sales agreements resulting from purchase accounting.

(c) Includes physical commodity trading activity not subject to mark-to-market accounting of \$11 million and \$7 million in net losses in the three months ended September 30, 2008 and 2007, respectively, and \$29 and \$13 million in net losses in the nine months ended September 30, 2008 and 2007, respectively.

(d) Based on number of meters at end of period.

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

(f) Calculations based on TXU Energy customer segmentation and ERCOT total customer counts.

Production, Purchased Power and Delivery Cost Data

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Fuel, purchased power costs and delivery fees (\$ millions):				
Nuclear	\$ 25	\$ 24	\$ 69	\$ 63
Lignite/coal	<u>172</u>	<u>161</u>	<u>485</u>	<u>451</u>
Total baseload fuel	197	185	554	514
Natural gas fuel and purchased power	1,161	559	2,532	1,377
Amortization of intangibles (a)	87	—	246	—
Other costs	<u>94</u>	<u>57</u>	<u>304</u>	<u>203</u>
Fuel and purchased power costs	1,539	801	3,636	2,094
Delivery fees	<u>384</u>	<u>383</u>	<u>1,010</u>	<u>992</u>
Total	<u>\$ 1,923</u>	<u>\$ 1,184</u>	<u>\$ 4,646</u>	<u>\$ 3,086</u>
Fuel and purchased power costs (which excludes generation plant operating costs) per MWh:				
Nuclear fuel	\$ 4.88	\$ 4.68	\$ 4.75	\$ 4.59
Lignite/coal (b)	\$ 15.39	\$ 14.18	\$ 15.83	\$ 14.31
Natural gas fuel and purchased power	\$ 104.02	\$ 63.71	\$ 91.55	\$ 62.29
Delivery fees per MWh	\$ 24.77	\$ 25.09	\$ 25.69	\$ 25.60

- (a) Represents amortization of the intangible net asset values of environmental credits, coal purchase contracts and power purchase agreements and the stepped up value of nuclear fuel resulting from purchase accounting.
- (b) Includes depreciation and amortization of lignite mining assets, which is reported in the depreciation and amortization expense line item, but is part of overall fuel costs.

	<u>Successor</u> <u>Three</u> <u>Months</u> <u>Ended</u> <u>September</u> <u>30, 2008</u>	<u>Predecessor</u> <u>Three</u> <u>Months</u> <u>Ended</u> <u>September</u> <u>30, 2007</u>	<u>Change %</u>	<u>Successor</u> <u>Nine</u> <u>Months</u> <u>Ended</u> <u>September</u> <u>30, 2008</u>	<u>Predecessor</u> <u>Nine</u> <u>Months</u> <u>Ended</u> <u>September</u> <u>30, 2007</u>	<u>Change %</u>
Production and purchased power volumes (GWh):						
Nuclear	4,996	5,110	(2.2)	14,448	13,664	5.7
Lignite/coal	<u>12,240</u>	<u>12,353</u>	<u>(0.9)</u>	<u>33,697</u>	<u>34,297</u>	<u>(1.7)</u>
Total baseload generation	17,236	17,463	(1.3)	48,145	47,961	0.4
Natural gas-fueled generation	2,124	2,108	0.8	3,843	3,491	10.1
Purchased power	<u>9,042</u>	<u>6,662</u>	<u>35.7</u>	<u>23,816</u>	<u>18,619</u>	<u>27.9</u>
Total energy supply	28,402	26,233	8.3	75,804	70,071	8.2
Less line loss and power imbalances	408	1,295	(68.5)	2,704	3,472	(22.1)
Net energy supply volumes	<u>27,994</u>	<u>24,938</u>	<u>12.3</u>	<u>73,100</u>	<u>66,599</u>	<u>9.8</u>
Baseload capacity factors (%):						
Nuclear	98.4%	100.6%	(2.2)	95.6%	90.8%	5.3
Lignite/coal	95.0%	95.8%	(0.8)	87.7%	89.7%	(2.2)
Total baseload generation	95.5%	97.2%	(1.7)	89.8%	90.0%	(0.2)

Financial Results

Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007

	<u>Successor</u>	<u>Predecessor</u>
	<u>Three Months Ended September 30, 2008</u>	<u>Three Months Ended September 30, 2007</u>
Total retail electricity revenues	\$ 2,040	\$ 1,924
Wholesale electricity revenues	1,134	589
Wholesale balancing activities	(44)	(19)
Amortization of intangibles (a).....	26	—
Other operating revenues	102	78
Total operating revenues	<u>\$ 3,258</u>	<u>\$ 2,572</u>

(a) Represents amortization of the intangible values of retail and wholesale power sales agreements resulting from purchase accounting.

Operating revenues increased \$686 million, or 27%, to \$3.258 billion in 2008, as shown in the table above.

The \$116 million, or 6%, increase in retail electricity revenues reflected the following:

- Higher average pricing contributed \$68 million to the revenue increase. Higher average retail pricing reflected higher prices in the business markets driven by higher natural gas prices, partially offset by an approximate \$5 million effect of lower pricing in the residential customer market. Lower residential pricing reflected the effect of a five percent price discount in October 2007 to those residential customers in EFH Corp.’s historical service territory with month-to-month service plans and a rate equivalent to the former price-to-beat.
- A two percent increase in retail sales volumes contributed \$48 million to the revenue increase. Residential volumes increased four percent, primarily due to an increase in residential customer counts and the effects of slightly warmer weather in 2008 compared to 2007. Business and other customer volumes increased 1%.
- Total retail electricity customer counts at September 30, 2008 increased three percent from September 30, 2007. Competitive activity resulted in a four percent increase in residential customers and a one percent increase in small business customers.

Wholesale electricity revenues increased \$545 million, or 93%. A 53% increase in average wholesale electricity prices, driven by higher natural gas prices, contributed \$395 million to revenue growth, and a 25% increase in sales volumes contributed \$150 million. Higher wholesale sales and purchase volumes reflected several factors, including increased demand (due to warmer weather) and congestion, as well as increased near-term bilateral power contracting activity due in part to increased demand and market volatility in 2008. The higher natural gas prices also contributed to the increase in fuel and purchased power costs.

Wholesale sales and purchases of electricity are reported gross in the income statement only if the transactions are scheduled for physical delivery with ERCOT. In ERCOT’s grid management activities, all scheduled transactions may not result in physical delivery, but TCEH has no visibility into those activities.

Wholesale balancing activity comparisons are generally not meaningful because the activity represents intraday purchases and sales transactions with ERCOT for real-time balancing purposes, as measured in 15-minute intervals, which are highly variable.

Other operating revenues increased \$24 million, or 31%, to \$102 million primarily due to higher retail natural gas revenues reflecting increased prices.

Fuel, purchased power costs and delivery fees increased \$739 million, or 62%, to \$1.923 billion. The increase was driven by higher purchased power costs, reflecting 36% growth in purchased power volumes as well as the effect of higher natural gas prices on wholesale power prices. The increase also reflected a 53% increase in fuel costs per MWh in natural gas-fueled generation facilities due to the higher natural gas prices. Higher fuel costs also reflected higher usage and prices (including transportation costs) of purchased coal. The increase reflects \$87 million of net expense recorded in the 2008 period representing amortization of the intangible net asset values of environmental credits, coal purchase contracts and power purchase agreements and the stepped-up value of nuclear fuel resulting from purchase accounting. Other cost increases included \$37 million related primarily to congestion-related charges and \$14 million in higher cost of natural gas for resale.

Results from commodity hedging and trading activities include realized and unrealized gains and losses associated with financial instruments used for commodity hedging and trading purposes, as well as gains and losses on physical sales and purchases of commodities for trading and certain commodity hedging purposes. A substantial majority of the commodity hedging activities are intended to mitigate the risk of commodity price movements on future revenues and involve natural gas positions entered into as part of the long-term hedging program. The results of these activities have been volatile because of the effects of movements in forward natural gas prices on unrealized mark-to-market valuations. Following is an analysis of activities for the three months ended September 30, 2008 and 2007:

Three Months Ended September 30, 2008 — Unrealized mark-to-market net gains totaling \$6.088 billion include:

- \$6.091 billion in net gains related to hedge positions, which includes \$6.074 billion in net gains from changes in fair value and \$17 million in net gains that represent reversals of previously recorded fair values of positions settled in the period. These net gains are driven by the effect of decreases in natural gas prices in forward periods on positions in the long-term hedging program;
- \$10 million in "day one" losses related to large hedge positions (see Note 10 to Financial Statements), and
- \$7 million in net gains related to trading positions, which includes \$4 million in net gains from changes in fair value and \$3 million in net gains that represent reversals of previously recorded fair values of positions settled in the period.

Realized net losses totaling \$43 million include:

- \$105 million in net losses related to hedge positions that primarily offset hedged electricity revenues recognized in the period, and
- \$62 million in net gains related to trading positions.

Three Months Ended September 30, 2007 — Unrealized mark-to-market net gains totaling \$479 million include:

- \$539 million in net gains related to hedge positions, which includes \$542 million in net gains from changes in fair value and \$3 million in net losses that represent reversals of previously recorded fair values of positions settled in the period, and
- a \$58 million "day one" loss on a related series of commodity price hedges (see Note 10 to Financial Statements).

Realized net losses totaling \$17 million include:

- \$4 million in net losses related to hedge positions that offset hedged electricity revenues recognized in the period, and
- \$13 million in net losses related to trading positions.

Operating costs increased \$19 million, or 14%, to \$157 million in 2008. The increase reflects \$16 million in higher maintenance costs related to the timing and scope of planned and unplanned outages in baseload generation facilities, \$4 million in costs related to combustion turbines now being operated for TCEH's own benefit, \$4 million in higher property taxes and \$4 million of expenses associated with operational readiness at the generation units under construction, partially offset by \$7 million in costs in 2007 for utilization of SO₂ credits for the coal/lignite-fueled generation plants.

Depreciation and amortization increased \$212 million to \$296 million. The increase includes \$170 million of incremental depreciation expense from stepped-up property, plant and equipment values and \$13 million in incremental amortization expense related to the intangible value of customer relationships, each resulting from the effects of purchase accounting. The remaining increase primarily reflects normal additions and replacements of equipment in generation operations.

SG&A expenses increased \$22 million, or 15%, to \$172 million in 2008. The increase reflects:

- \$11 million in higher expenses in the retail operations, primarily increased employees and labor costs to support customer growth initiatives and computer system enhancement costs, net of a \$1 million decrease in fees associated with the sale of accounts receivable program;
- \$7 million in higher retail customer bad debt expense, and
- \$4 million in higher salaries in generation operations driven by construction development and reflecting the transfer of employees to Luminant who were previously assigned to generation plants being developed by other EFH Corp. subsidiaries.

Other income totaled \$2 million in 2008 and \$8 million in 2007. Other deductions totaled \$531 million in 2008 and a net credit of \$34 million in 2007. The 2008 amount includes \$499 million in impairment charges related to NO_x and SO₂ environmental allowances intangible assets discussed in Note 3 to Financial Statements and \$26 million in charges to reserve for net receivables (excluding termination related costs) from terminated hedging transactions with subsidiaries of Lehman Brothers Holdings Inc., which has filed for bankruptcy under Chapter 11 of the US Bankruptcy Code. The 2007 amount includes a \$48 million reduction in the liability previously recorded for leases related to gas-fueled combustion turbines that TCEH had ceased operating for its own benefit and a \$10 million charge related to the termination of a railcar operating lease. See Note 5 to the Financial Statements for details of other income and deductions.

Interest income decreased \$77 million to \$20 million in 2008 reflecting lower average balances of notes/advances to parent.

Interest expense and related charges increased \$464 million to \$581 million in 2008. The increase reflects \$494 million due to higher average borrowings driven by the Merger-related financings, and \$30 million due to higher average interest rates, including a \$36 million unrealized mark-to-market gain related to interest rate swaps and \$4 million of amortization of debt fair value discount resulting from purchase accounting, partially offset by \$60 million in increased capitalized interest.

Income tax expense on pretax income totaled \$2.010 billion in 2008 and \$501 million in 2007. The effective income tax rates increased to 35.6% in 2008 from 34.0% in 2007. The effective rates reflect the application of EFH Corp.'s statutory tax rate to the unrealized mark-to-market net losses in 2007 and 2008 and impairment of SO₂ and NO_x environmental allowance in 2008. The increase in the effective tax rate is driven by the effect of a higher lignite depletion benefit in 2007 on a smaller income base and the absence in 2008 of the production deduction due to forecasted net operating losses.

Net income increased \$2.655 billion to \$3.629 billion in 2008 driven by unrealized mark-to-market gains on positions in the long-term hedging program, partially offset by higher net interest expense, the impairment of environmental allowances intangible assets and the effects of purchase accounting.

Financial Results

Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007

	<u>Successor</u>	<u>Predecessor</u>
	<u>Nine Months Ended September 30, 2008</u>	<u>Nine Months Ended September 30, 2007</u>
Total retail electricity revenues	\$ 4,961	\$ 4,828
Wholesale electricity revenues	2,797	1,571
Wholesale balancing activities	(227)	(11)
Amortization of intangibles (a).....	(15)	—
Other operating revenues	293	236
Total operating revenues	<u>\$ 7,809</u>	<u>\$ 6,624</u>

(a) Represents amortization of the intangible values of retail and wholesale power sales agreements resulting from purchase accounting.

Operating revenues increased \$1.185 billion, or 18%, to \$7.809 billion in 2008, as shown in the table above.

The \$133 million, or 3%, increase in retail electricity revenues reflected the following:

- A two percent increase in retail sales volumes contributed \$107 million to the revenue increase. Residential volumes increased four percent reflecting the effects of warmer than normal weather in 2008 combined with the cooler than normal weather experienced in 2007 and an increase in residential customer counts as discussed in the analysis of third quarter results. Business and other customer volumes were comparable with 2007.
- Higher average pricing increased revenues by \$26 million. Higher average retail pricing reflected higher prices in the business markets driven by higher natural gas prices, partially offset by an approximate \$108 million effect of lower pricing in the residential customer market. Lower residential pricing reflected the effect of a six percent price discount in March 2007, an additional four percent price discount in June 2007 and another five percent price discount in October 2007 to those residential customers in TCEH’s historical service territory with month-to-month service plans and a rate equivalent to the former price-to-beat.

Wholesale electricity revenues increased \$1.226 billion, or 78%. A 40% increase in average wholesale electricity prices driven by higher natural gas prices contributed \$797 million to revenue growth and a 27% increase in sales volumes contributed \$429 million. The rise in natural gas prices through July 2008 reflected the overall trend of higher energy prices and increased demand in natural gas-fueled generation due to warmer weather in 2008. Higher wholesale sales and purchase volumes reflected several factors, including increased demand (due to warmer weather), baseload plant outages and congestion, as well as increased near-term bilateral power contracting activity due in part to increased demand and market volatility in 2008. The higher natural gas prices also contributed to the increase in fuel and purchased power costs.

Wholesale balancing activity comparisons are not generally meaningful because the activity represents intraday purchases and sales transactions with ERCOT for real-time balancing purposes, as measured in 15-minute intervals, which are highly variable. The relatively large amount in 2008 reflects weather-driven volatility, generation facility outages and congestion effects.

Other operating revenues increased \$57 million, or 24%, to \$293 million primarily due to higher retail natural gas revenues reflecting increased prices.

Fuel, purchased power costs and delivery fees increased \$1.560 billion, or 51%, to \$4.646 billion. The increase was driven by higher purchased power costs, reflecting 28% growth in purchased power volumes as well as the effect of higher natural gas prices on wholesale power prices. The increase also reflected greater utilization of natural gas-fueled generation facilities to meet peak demand and a 56% increase in fuel costs per MWh in those facilities due to higher natural gas prices. Higher fuel costs also reflected higher usage and prices (including transportation costs) of purchased coal. The increase reflects \$246 million of net expense recorded in the 2008 period representing amortization of the intangible net asset values of environmental credits, coal purchase contracts and power purchase agreements and the stepped-up value of nuclear fuel resulting from purchase accounting. Other cost increases included \$101 million related primarily to congestion-related charges and \$41 million in higher costs of natural gas for resale.

Following is an analysis of results from commodity hedging and trading activities for the nine months ended September 30, 2008 and 2007:

Nine Months Ended September 30, 2008 — Unrealized mark-to-market net losses totaling \$305 million include:

- \$250 million in net losses related to hedge positions, which includes \$248 million in net losses from changes in fair value and \$2 million in net losses that represent reversals of previously recorded fair values of positions settled in the period;
- \$69 million in "day one" net losses related to large hedge positions (see Note 10 to Financial Statements), and
- \$13 million in net gains related to trading positions, which includes \$79 million in net gains from changes in fair value and \$66 million in net losses that represent reversals of previously recorded fair values of positions settled in the period.

Realized net gains totaling \$57 million include:

- \$76 million in net losses related to hedge positions that primarily offset hedged electricity revenues recognized in the period, and
- \$133 million in net gains related to trading positions.

Nine Months Ended September 30, 2007 — Unrealized mark-to-market net losses totaling \$703 million include:

- \$557 million in net losses related to hedge positions, which includes \$585 million in net losses from changes in fair value and \$28 million in net gains that represent reversals of previously recorded fair values of positions settled in the period;
- \$218 million in "day one" losses related to large hedge positions and a \$30 million "day one" gain on a long-term power purchase agreement (see Note 10 to Financial Statements);
- \$92 million in hedge ineffectiveness net gains, which includes \$111 million in net gains from changes in fair value and \$19 million in net losses that represent reversals of previously recorded unrealized net gains related to positions settled in the period. These amounts relate to positions accounted for as cash flow hedges, and
- \$46 million in net losses related to trading positions, which includes \$29 million in net losses from changes in fair value and \$17 million in net losses that represent reversals of previously recorded fair values of positions settled in the period.

Realized net gains totaling \$96 million include:

- \$70 million in net gains related to hedge positions that offset hedged electricity revenues recognized in the period, and
- \$26 million in net gains related to trading positions.

Operating costs increased \$49 million, or 11%, to \$501 million in 2008. The increase reflects \$36 million in higher maintenance costs related to the timing and scope of planned and unplanned outages in baseload generation facilities, \$11 million in costs related to combustion turbines now being operated for TCEH's own benefit, \$10 million in higher property taxes and \$5 million of expenses associated with operational readiness at the generation units under construction, partially offset by \$7 million in costs in 2007 for utilization of SO₂ credits for the lignite/coal-fueled generation plants and \$3 million in individually insignificant items.

Depreciation and amortization increased \$582 million to \$827 million. The increase includes \$502 million of incremental depreciation expense from stepped-up property, plant and equipment values and \$38 million in incremental amortization expense related to the intangible value of customer relationships, each resulting from the effects of purchase accounting. The remaining increase primarily reflects normal additions and replacements of equipment in generation operations.

SG&A expenses increased \$60 million, or 14%, to \$496 million in 2008. The increase reflects:

- \$26 million in higher expenses in the retail operations, primarily increased employees and labor costs to support customer growth initiatives and increased marketing and computer systems enhancement costs, net of a \$6 million decrease in fees associated with the sale of accounts receivable program;
- \$14 million in higher salaries in generation operations driven by construction development and reflecting the transfer of employees to Luminant who were previously assigned to generation plants being developed by other EFH Corp. subsidiaries, and
- \$16 million in higher retail customer bad debt expense.

Other income totaled \$8 million in 2008 and \$19 million in 2007. Other deductions totaled \$550 million in 2008 and a net credit of \$20 million in 2007. The 2008 amount includes \$501 million in impairment charges related to NO_x and SO₂ environmental allowances intangible assets discussed in Note 3 to Financial Statements and \$26 million in charges to reserve for net receivables (excluding termination related costs) from terminated hedging transactions with subsidiaries of Lehman Brothers Holdings Inc., which has filed for bankruptcy under the US Bankruptcy Code. The 2007 amount includes a \$48 million reduction in the liability previously recorded for leases related to gas-fueled combustion turbines that TCEH had ceased operating for its own benefit and a \$10 million charge related to the termination of a railcar operating lease. See Note 5 to Financial Statements for details of other income and deductions.

Interest income decreased \$215 million to \$45 million in 2008 reflecting lower average notes receivable/advances.

Interest expense and related charges increased by \$1.446 billion to \$1.756 billion in 2008. The increase reflects \$1.363 billion due to higher average borrowings driven by the Merger-related financings, and \$266 million due to higher average interest rates, including a \$36 million mark-to-market gain related to interest rate swaps and \$11 million of amortization of debt fair value discount resulting from purchase accounting, partially offset by \$183 million in increased capitalized interest.

Income tax benefits on pretax losses totaled \$425 million in 2008 and income tax expense on pretax income totaled \$529 million in 2007. The 2007 amount includes a deferred tax benefit of \$30 million related to an amendment of the Texas margin tax by the Texas legislature. Excluding the effect of this 2007 item, the effective income tax rates were 34.4% on a loss in 2008 compared to 32.7% on income in 2007. (The unusual deferred tax benefit in 2007 distorts the comparison; therefore it has been excluded for purposes of a more meaningful discussion). The effective rates reflect the application of EFH Corp.'s statutory tax rate to the unrealized mark-to-market net losses in 2007 and 2008 as well as the 2007 impairment charge related to the cancellation of certain generation facility development activities and the impairment of SO₂ and NO_x environmental allowances intangible assets in 2008. The increase in the effective tax rate is driven by the effect of a lower lignite depletion benefit in 2008 on a smaller income base and the absence in 2008 of the production deduction due to forecasted net operating losses. The impact on the rate is also due to the effect of the Texas margin tax on pretax losses in 2008, under which interest expense is not deductible.

Net income (loss) decreased \$1.991 billion to a net loss of \$811 million in 2008 driven by higher net interest expense, the impairment of environmental allowances intangible assets and the effects of purchase accounting, partially offset by the decrease in unrealized mark-to-market losses on positions in the long-term hedging program.

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

The table below summarizes the changes in commodity contract assets and liabilities for the nine months ended September 30, 2008. The net changes in these assets and liabilities, excluding “other activity” as described below, represent the pretax effect of mark-to-market accounting on net income for positions in the commodity contract portfolio that are not subject to cash flow hedge accounting (see discussion below and in Note 10 to Financial Statements). For the nine months ended September 30, 2008, this effect totaled \$217 million in unrealized net losses, which represented \$233 million in net losses from changes in fair value and \$16 million in net gains representing reversals of previously recognized fair values of positions settled in the current period. These positions represent both economic hedging and trading activities.

	<u>Successor</u> <u>Nine Months Ended</u> <u>September 30, 2008</u>
Commodity contract net asset (liability) at beginning of period.....	\$ (1,917)
Settlements of positions (a).....	16
Unrealized mark-to-market valuations of positions (b)	(233)
Other activity (c)	<u>(7)</u>
Commodity contract net asset (liability) at end of period.....	<u>\$ (2,141)</u>

(a) Represents reversals of fair values previously recognized to offset gains and losses realized upon settlement of the positions in the current period. Includes settlements of positions entered into in the current period and the expiration of option premiums during the current period.

(b) Primarily represents mark-to-market effects of positions in the long-term hedging program (see discussion above under "Long-Term Hedging Program"). Of this amount, \$82 million in net losses relates to positions not settled as of the end of the period. Includes \$68 million in net losses recorded at contract inception dates (see Note 10 to Financial Statements).

(c) These amounts do not represent unrealized gains or losses. Includes initial values of positions involving the receipt or payment of cash or other consideration.

Note: Of the \$217 million in unrealized net losses for the period, \$301 million in net losses are reported in the income statement as net loss from commodity hedging and trading activities. The difference of \$84 million in net gains relate to physically settled sales and purchase transactions, with \$155 million in net gains reported in revenues and \$71 million in net losses reported in fuel, purchased power costs and delivery fees, as required by accounting rules.

In addition to the effect on net income of recording unrealized mark-to-market gains and losses that are reflected in the table above, similar effects arise in the recording of unrealized ineffectiveness gains and losses associated with commodity-related positions accounted for as cash flow hedges. These effects on net income, which include reversals of previously recorded unrealized ineffectiveness gains and losses to offset realized gains and losses upon settlement, are included in net gain (loss) from commodity hedging and trading activities and reflected in the balance sheet as changes in commodity and other derivative contractual assets and liabilities (see Note 10 to Financial Statements). The total pretax effect of recording unrealized gains and losses in net income related to commodity contracts under SFAS 133 is summarized as follows:

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Unrealized gains (losses) related to contracts				
marked-to-market	\$ 6,142	\$ 481	\$ (217)	\$ (795)
Ineffectiveness gains (losses) related to contracts				
accounted for as cash flow hedges (a)	—	(2)	(4)	92
Total unrealized gains (losses) related to commodity contracts.....	<u>\$ 6,142</u>	<u>\$ 479</u>	<u>\$ (221)</u>	<u>\$ (703)</u>

(a) See Note 10 to Financial Statements.

Maturity Table — Following are the components of the net commodity contract liability at September 30, 2008:

Net commodity contract liability	\$(2,141)
Net receipts of natural gas under physical swap transactions	<u>33</u>
Amount of net liability arising from recognition of fair values	<u><u>\$(2,108)</u></u>

The following table presents the net commodity contract liability arising from recognition of fair values as of September 30, 2008, scheduled by the source of fair value and contractual settlement dates of the underlying positions. See Note 12 to Financial Statements for fair value disclosures required under SFAS 157.

<u>Source of fair value (a)</u>	Maturity dates of unrealized commodity contract liabilities at September 30, 2008				Total
	Less than 1 year	1-3 years	4-5 years	Excess of 5 years	
Prices actively quoted.....	\$ (158)	\$ (89)	\$ (20)	\$ —	\$ (267)
Prices provided by other external sources	50	(808)	(806)	(75)	(1,639)
Prices based on models.....	<u>(7)</u>	<u>(53)</u>	<u>(40)</u>	<u>(102)</u>	<u>(202)</u>
Total.....	<u>\$ (115)</u>	<u>\$ (950)</u>	<u>\$ (866)</u>	<u>\$ (177)</u>	<u>\$(2,108)</u>
Percentage of total fair value.....	6%	45%	41%	8%	100%

(a) Under this analysis, a contract can have more than one source of fair value. In such cases, the value of the contract is segregated by source of value.

The “prices actively quoted” category reflects only exchange traded contracts for which active quotes are readily available. The “prices provided by other external sources” category represents forward commodity positions valued using prices for which over-the-counter broker quotes are available. Over-the-counter quotes for power in ERCOT generally extend through 2012 and over-the-counter quotes for natural gas generally extend through 2015, depending upon delivery point. The “prices based on models” category contains the value of all over-the-counter traded options, valued using option pricing models. In addition, this category contains other contractual arrangements that may have forward and option components, as well as other contracts that are valued using proprietary long-term pricing models that utilize certain market based inputs. In many instances, these contracts can be broken down into their component parts and each component valued separately. Components valued as forward commodity positions are included in the “prices provided by other external sources” category. Components valued as options are included in the “prices based on models” category.

COMPREHENSIVE INCOME

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

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>	<u>Successor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2008</u>	<u>Predecessor</u> <u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2007</u>
Net increase (decrease) in fair value of cash flow hedges:				
Commodities.....	\$ (8)	\$ 7	\$ (7)	\$ (290)
Financing - interest rate swaps.....	<u>(131)</u>	<u>—</u>	<u>(175)</u>	<u>—</u>
	<u>(139)</u>	<u>7</u>	<u>(182)</u>	<u>(290)</u>
Derivative value net losses (gains) reported in net income that relate to hedged transactions recognized in the period:				
Commodities.....	5	(11)	7	(90)
Financing - interest rate swaps.....	<u>36</u>	<u>2</u>	<u>76</u>	<u>6</u>
	<u>41</u>	<u>(9)</u>	<u>83</u>	<u>(84)</u>
Total loss effect of cash flow hedges reported in other comprehensive income.....	<u>\$ (98)</u>	<u>\$ (2)</u>	<u>\$ (99)</u>	<u>\$ (374)</u>

EFH Corp. has historically used, and expects to continue to use, derivative instruments that are effective in offsetting future cash flow variability in interest rates and energy commodity prices. Amounts in accumulated other comprehensive income include (i) the value of unsettled transactions accounted for as cash flow hedges (for the effective portion), based on current market conditions, and (ii) the value of dedesignated and terminated cash flow hedges at the time of such dedesignation, less amounts reclassified to earnings as the original hedged transactions are recognized, unless the hedged transactions become probable of not occurring. The effects of the hedge will be recorded in the statement of income as the hedged transactions are actually settled and affect earnings. Also see Note 10 to Financial Statements.

FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows — Cash provided by operating activities for the nine months ended September 30, 2008 totaled \$863 million compared to cash provided of \$731 million in 2007. The increase in cash provided of \$132 million reflects:

- a \$532 million favorable change in margin deposits primarily due to the effect of lower forward natural gas prices on positions in the long-term hedging program. The majority of the margin deposits are funded by borrowings from the TCEH Commodity Collateral Posting Facility as discussed in Note 10 to Financial Statements;
- a \$882 million decrease in cash income taxes paid to EFH Corp. reflecting payment in 2007 of 2006 taxes, and
- a \$102 million premium paid in 2007 related to a structured natural gas-related option transaction entered into as part of TCEH's long-term hedging program,

partially offset by a \$1.394 billion increase in cash interest payments.

Cash provided by financing activities increased \$1.957 billion as summarized below:

	Successor	Predecessor
	Nine Months	Nine Months
	Ended	Ended
	September 30,	September 30,
	2008	2007
Net issuances, repayments and repurchases of borrowings.....	\$ 2,912	\$ 1,849
Decrease in income tax-related note payable to Oncor (see Note 13 to Financial Statements)	(25)	(24)
Distributions paid to parent.....	—	(851)
Debt discount, financing and reacquisition expenses.....	(4)	(8)
Other.....	40	—
Total provided by financing activities	<u>\$ 2,923</u>	<u>\$ 966</u>

Cash used in investing activities increased \$1.053 billion as summarized below:

	Successor	Predecessor
	Nine Months	Nine Months
	Ended	Ended
	September 30,	September 30,
	2008	2007
Net (advances to) repayments from affiliates.....	\$ (388)	\$ 322
Capital expenditures, including nuclear fuel	(1,514)	(1,584)
Investment held in money market fund	(242)	—
Net reduction of restricted cash	9	197
Other.....	6	(11)
Total used in investing activities.....	<u>\$ (2,129)</u>	<u>\$ (1,076)</u>

Depreciation and amortization expense reported in the statement of cash flows exceeds the amount reported in the statement of income by \$326 million and \$49 million for the nine months ended September 30, 2008 and 2007, respectively. The 2008 difference represents amortization of intangible net assets and debt fair value discounts arising from purchase accounting that is reported in various other income statement line items including operating revenues, fuel, purchased power costs and delivery fees and interest expense and related charges. The 2008 and 2007 differences also reflect the amortization of nuclear fuel, which is reported as fuel cost in the statement of income consistent with industry practice.

Debt Financing Activity — Long-term borrowings for the nine months ended September 30, 2008 totaled \$1.277 billion and included \$1.004 billion of borrowings under the TCEH Delayed Draw Term Loan Facility to fund expenditures, principally related to the construction of the new generation facilities and the remarketing of \$242 million principal amount of pollution control revenue bonds. Retirements for the nine months ended September 30, 2008 totaled \$397 million and included the remarketing of \$242 million principal amount of pollution control revenue bonds and \$123 million repaid under the TCEH Initial Term Loan Facility. Short-term borrowings increased \$2.032 billion in the nine months ended September 30, 2008 driven by \$1.910 billion of cash borrowings from the TCEH Revolving Credit Facility, the vast majority of which is being held in highly liquid short-term investments as discussed below, and an increase of \$122 million in borrowings under the Commodity Collateral Posting Facility.

See Note 7 to Financial Statements for further detail of long-term debt and other financing arrangements.

TCEH may from time to time purchase its outstanding debt securities for cash in open market purchases, privately negotiated transactions or other transactions. TCEH will evaluate any such transactions in light of market prices of the securities, taking into account its liquidity requirements and prospects for future access to capital, contractual restrictions and other factors. The amounts involved in any such transactions, individually or in the aggregate, may be material.

Credit Facilities — The following table summarizes changes in liquidity available under TCEH's committed credit facilities for the year-to-date period ended October 31, 2008:

	Availability		
	December 31, 2007	October 31, 2008 (a)	Change
TCEH Delayed Draw Term Loan Facility.....	\$ 1,950	\$ 842	\$ (1,108)
TCEH Revolving Credit Facility	<u>\$ 2,636</u>	<u>\$ 1,166</u>	<u>\$ (1,470)</u>
Total	<u>\$ 4,586</u>	<u>\$ 2,008</u>	<u>\$ (2,578)</u>

- (a) The TCEH Delayed Draw Term Loan Facility includes \$14 million of undrawn commitments from a subsidiary of Lehman Brothers Holdings Inc. and excludes \$2 million of requested draws by TCEH that have not been funded by the Lehman subsidiary as of October 31, 2008. The TCEH Revolving Credit Facility includes \$134 million of undrawn commitments from the Lehman subsidiary and excludes \$35 million of requested draws by TCEH that have not been funded by the Lehman subsidiary as of October 31, 2008.

The TCEH Delayed Draw Term Loan Facility is used to fund certain specified expenditures, principally related to the construction of the new generation facilities, and related expenses. The TCEH Revolving Credit Facility is used for working capital and other general corporate purposes. The TCEH Letter of Credit Facility is used for issuing letters of credit for general corporate purposes and had availability of \$347 million of letters of credit as of October 31, 2008. During September and October 2008, TCEH borrowed approximately \$2.3 billion under its Revolving Credit Facility, of which approximately \$1 billion was repaid from October 28 through October 31, 2008. As of October 31, 2008, TCEH held cash and cash equivalents totaling \$1.320 billion and a \$242 million investment in a money market fund being liquidated (as described in Note 14 to Financial Statements). TCEH has unlimited availability under the committed TCEH Commodity Collateral Posting Facility to fund the collateral posting requirements for specified natural gas hedging transaction volumes. (See discussion below under "Liquidity Effects of Commodity Hedging and Trading Activities.")

Although TCEH did not have any immediate needs for the additional liquidity from the cash borrowings from the TCEH Revolving Credit Facility, the borrowings were made as a precautionary measure due to significant dislocation in the financial markets as evidenced by, among other matters, the bankruptcy filing by Lehman as well as a substantial widening of credit default swap spreads of other institutional banks, a significant increase in the LIBOR rate, a significant halt in commercial paper markets and a significant widening of TED (the price difference between 3-month T-Bill futures and 3-month Eurodollar futures) spreads (collectively, “Key Market Metrics”). TCEH anticipated repaying some or all of these borrowings upon seeing an improvement in financial market conditions. Given the enactment of federal legislation that is intended to support the solvency of institutional banks, significant improvement in each of the Key Market Metrics and the increased interest cost associated with having these borrowings remain outstanding, TCEH has repaid a portion of these borrowings. TCEH will continue to monitor financial market conditions, and TCEH anticipates repaying the remaining borrowings to the extent financial market conditions continue to improve. If, however, financial market conditions worsen, TCEH may continue to retain these borrowings and may borrow repaid funds. TCEH expects to maintain the cash proceeds from the borrowings in highly liquid short-term investments pending use for liquidity needs or repayment.

Bankruptcy Filing of Lehman Brothers Holdings Inc. - In September 2008, Lehman Brothers Holdings Inc. (Lehman) filed for bankruptcy under the US Bankruptcy Code. TCEH and its subsidiaries have business relationships with Lehman and its subsidiaries.

Subsidiaries of TCEH were counterparties with subsidiaries of Lehman with respect to wholesale energy marketing transactions, including natural gas hedging transactions that were part of TCEH's corporate hedging program. The obligations of these Lehman subsidiaries are guaranteed by Lehman, and the Lehman bankruptcy filing gave TCEH's subsidiaries the right to terminate the transactions. TCEH's subsidiaries provided notice to the Lehman subsidiaries terminating these transactions effective on September 15, 2008 (the “Termination Date”) pursuant to its rights under the master agreement for the transactions. As of the Termination Date, its subsidiaries' direct net financial position with respect to these transactions was \$26 million (excluding termination related costs), which was reserved for as a charge reported in other deductions in the three months ended September 30, 2008. TCEH's overall corporate hedging program was not materially impacted by this termination.

A subsidiary of Lehman that filed for bankruptcy under the US Bankruptcy Code in October 2008 is a lender under the TCEH Senior Secured Facilities. The aggregate amount of unfunded commitments under the TCEH Delayed Draw Term Loan Facility as of October 31, 2008 was approximately \$842 million, which amount includes approximately \$14 million of availability attributable to the Lehman subsidiary's aggregate funding commitment but excludes approximately \$2 million of draw requests by TCEH that have not been funded by the Lehman subsidiary as of October 31, 2008. In addition, as of October 31, 2008, TCEH had outstanding cash borrowings under its Revolving Credit Facility of approximately \$1.481 billion in the aggregate, including approximately \$139 million funded by the Lehman subsidiary, and outstanding letters of credit under its Revolving Credit Facility of approximately \$18 million in the aggregate, of which approximately \$2 million was for the account of the Lehman subsidiary. The aggregate amount of unfunded commitments under the TCEH Revolving Credit Facility as of October 31, 2008, was approximately \$1.166 billion, which amount includes approximately \$134 million of availability attributable to the Lehman subsidiary's aggregate funding commitment but excludes approximately \$35 million of draw requests by TCEH that have not been funded by the Lehman subsidiary as of October 31, 2008. TCEH does not believe the potential reduction in available capacity under these credit facilities will have a significant impact on its liquidity or the liquidity of its subsidiaries.

Commodity Hedging and Trading Activities — With the tightening of credit markets, there has been some decline in the number of market participants in the energy commodities markets, resulting in less liquidity particularly in the ERCOT wholesale electricity market. Participation by financial institutions and other intermediaries (including investment banks) has declined. However, traditional counterparties with physical assets to hedge continue to participate in the markets. TCEH continues to monitor liquidity and credit risk in the markets to assess any impacts on its overall hedging strategy.

PIK Interest Election — TCEH has the option every six months until November 1, 2012, at its election, to use the payment-in-kind (PIK) feature of its Toggle Notes in lieu of making cash interest payments. While TCEH has sufficient liquidity to meet its anticipated ongoing needs without use of this PIK feature, the company has elected to do so for the May 1, 2009 interest payment date as an efficient and cost-effective method to further enhance liquidity, in light of the substantial dislocation in the financial markets. Moreover, the incremental liquidity obtained by using the PIK feature of the Toggle Notes for this specific payment period partially offsets the liquidity that was effectively lost as a result of the default by affiliates of Lehman under TCEH's Senior Secured Facilities. In the future, TCEH will evaluate this option at each election period, taking into account market conditions and other relevant factors at such time.

As a result, on October 31, 2008, TCEH delivered notice to The Bank of New York, in its capacity as trustee under the indenture for the TCEH Toggle Notes, that, with respect to the interest that will be due on such notes on the May 1, 2009 interest payment date in the amount of approximately \$92 million, TCEH will make such interest payment by using the PIK feature of the TCEH Toggle Notes instead of paying cash.

Liquidity Needs, Including Capital Expenditures — Capital expenditures, including capitalized interest, for 2008 are expected to total approximately \$2.2 billion and include investments in TCEH generation facilities, including:

- approximately \$1.3 billion for construction of one generation unit at Sandow and two generation units and mine development at Oak Grove;
- approximately \$700 million for major maintenance, primarily in existing generation operations, and
- approximately \$200 million for environmental expenditures related to existing generation units.

Because its businesses are capital intensive, TCEH expects to rely over the long-term upon access to financial markets as a significant source of liquidity for capital requirements not satisfied by cash-on-hand or operating cash flows. The inability to raise capital on favorable terms or failure of counterparties to perform under credit, hedging or other financial agreements, particularly considering the current uncertainty in the financial markets, could impact TCEH's ability to sustain and grow its businesses and would likely increase capital costs. TCEH expects cash flows from operations combined with availability under its credit facilities discussed in Note 7 to Financial Statements to provide sufficient liquidity to fund its current obligations, projected working capital requirements, any restructuring obligations and capital spending for a period that includes the next twelve months.

Notes Receivable from Parent — On November 5, 2008, Oncor issued and sold a 19.75% minority stake to an investor group to further enhance Oncor's separation from Texas Holdings, EFH Corp., and EFH Corp.'s other subsidiaries. The proceeds received by Oncor from this sale were ultimately distributed to EFH Corp. Under the terms of certain financing arrangements of EFH Corp. and TCEH, upon such distribution, under certain circumstances, EFH Corp. is required to repay certain outstanding intercompany loans from TCEH. As of November 5, 2008, \$837 million of such intercompany loans were outstanding.

Liquidity Effects of Commodity Hedging and Trading Activities — Commodity hedging and trading transactions typically require a counterparty to post collateral if the forward price of the underlying commodity moves such that the hedging or trading instrument held by such counterparty has declined in value. TCEH and its subsidiaries use cash and letters of credit and other collateral structures to satisfy such collateral obligations. In addition, TCEH's Commodity Collateral Posting Facility, an uncapped senior secured revolving credit facility funds the cash collateral posting requirements for a significant portion of the positions in the long-term hedging program not otherwise secured by a first-lien in the assets of TCEH. The aggregate principal amount of this facility is determined by the exposure arising from higher forward market prices, regardless of the amount of such exposure, on a portfolio of certain natural gas hedging transaction volumes. Including those hedging transactions where margin deposits are covered by unlimited borrowings under the TCEH Commodity Collateral Posting Facility, at October 24, 2008, more than 95% of EFC Holdings' long-term natural gas hedging program transactions were secured by a first-lien interest in the assets of TCEH that is pari passu with the TCEH Senior Secured Facilities, the effect of which is a significant reduction in TCEH's liquidity exposure associated with collateral requirements for those hedging transactions. See Note 7 to Financial Statements for more information about this facility.

As of September 30, 2008, TCEH has received or posted cash and letters of credit for commodity hedging and trading activities as follows:

- \$302 million in cash has been posted with counterparties for exchange cleared transactions (including initial margin), as compared to \$79 million posted as of December 31, 2007,
- \$464 million in cash has been posted with counterparties for over-the-counter and other non-exchanged cleared transactions, as compared to \$429 million posted as of December 31, 2007, and
- \$829 million in letters of credit have been posted with counterparties, as compared to \$592 million posted as of December 31, 2007.

Borrowings under the TCEH Commodity Collateral Posting Facility funded the substantial majority of the above cash postings. The posted letters of credit were largely supported by restricted cash borrowed under the TCEH Letter of Credit Facility. See Notes 7 and 8 to Financial Statements.

With respect to exchange cleared transactions, these transactions typically require initial margin (i.e. the upfront cash and/or letter of credit posted to take into account the size and maturity of the positions and credit quality) in addition to variance margin (i.e. the daily cash margin posted to take into account changes in the value of the underlying commodity). The amount of initial margin required is generally defined by exchange rules. Clearing agents, however, typically have the right to request additional initial margin based on various factors including market depth, volatility and credit quality, which may be in the form of cash, letters of credit, a guaranty or other forms as negotiated with the clearing agent. With respect to cash collateral that is received, such cash collateral is either used by TCEH for working capital and other corporate purposes, including reducing short-term borrowings under credit facilities, or it is required to be deposited in a separate account and restricted from being used for working capital and other corporate purposes. On over-the-counter transactions, such counterparties generally have the right to substitute letters of credit for such cash collateral. In such event, the cash collateral previously posted would be returned to such counterparties thereby reducing TCEH liquidity in the event that it was not restricted. As of September 30, 2008, cash collateral received totaled \$20 million. See Note 14 to Financial Statements regarding restricted cash.

As a result of the long-term hedging program, increases in natural gas prices result in increased cash collateral and letter of credit margin requirements. As a representative example, as of October 24, 2008, for each \$1.00 per MMBtu increase in forward natural gas prices across the period from 2008 through 2014, TCEH's cash collateral posting requirements associated with the long-term hedging program would increase by approximately \$820 million, essentially all of which would be funded by the TCEH Commodity Collateral Posting Facility.

Sale of Accounts Receivable — TCEH participates in an accounts receivable securitization program established by EFH Corp., the activity under which is accounted for as a sale of accounts receivable in accordance with SFAS 140. Under the program, subsidiaries of TCEH (originators) sell trade accounts receivable to TXU Receivables Company, a consolidated wholly-owned bankruptcy-remote direct subsidiary of EFH Corp., which sells undivided interests in the purchased accounts receivable for cash to special purpose entities established by financial institutions. All new trade receivables under the program generated by the originators are continuously purchased by TXU Receivables Company with the proceeds from collections of receivables previously purchased. Funding to TCEH under the program totaled \$700 million and \$363 million at September 30, 2008 and December 31, 2007, respectively. See Note 6 to Financial Statements for a more complete description of the program including the impact of the program on the financial statements for the periods presented and the contingencies that could result in a reduction of funding available under the program.

Covenants and Restrictions under Financing Arrangements — Each of the TCEH Senior Secured Facilities and the TCEH Indenture contains covenants that could have a material impact on the liquidity and operations of TCEH and its subsidiaries. A brief description of certain of these covenants is provided below. See also Note 7 to Financial Statements for additional discussion of the covenants contained in these financing arrangements. Certain series of TCEH's pollution control revenue bonds, which were remarketed in June 2008, include covenants discussed below regarding the TCEH indenture.

When the term “Adjusted EBITDA” (see Glossary) is referenced in the covenant description below, it is a reference to, and generally synonymous with, the term “Consolidated EBITDA” that is used in the TCEH Senior Secured Facilities and a reference to, and generally synonymous with, the term “EBITDA” that is used in the TCEH Indenture. Adjusted EBITDA (as used in the restricted payments covenants for the TCEH Indenture), for the twelve months ended September 30, 2008 totaled \$3.5 billion for TCEH. See Appendix B for a reconciliation of net income to Adjusted EBITDA for TCEH for the nine and twelve months ended September 30, 2008 and 2007.

Maintenance Covenant — Under the TCEH Senior Secured Facilities, TCEH and its restricted subsidiaries are required to maintain a consolidated secured debt to Adjusted EBITDA ratio (as defined in the TCEH Senior Secured Facilities) measured over a rolling four-quarter measurement period, which cannot exceed 7.25 to 1.00 for the first measurement period ending September 30, 2008, declining over time to 5.75 to 1.00 for the measurement periods ending March 31, 2014 and thereafter. In the event that TCEH fails to comply with this ratio, it has the right to cure its non-compliance by soliciting a cash investment in an amount necessary to become compliant. The ratio for the period ending September 30, 2008 was 4.59 to 1.0.

Debt Incurrence Covenants — Under the indenture governing the EFH Corp. Notes, TCEH and its restricted subsidiaries are not permitted to incur indebtedness or issue certain classes of preferred stock unless, on a pro forma basis, after giving effect to such incurrence or issuance, the fixed charge coverage ratio (as defined in the indenture) on a consolidated basis for TCEH and its restricted subsidiaries is at least 2.0 to 1.0 or such incurrence or issuance is otherwise permitted by specified exceptions in the indenture. The fixed charge coverage ratio for that purpose is generally defined as the ratio of Adjusted EBITDA of TCEH to fixed charges of TCEH, in each case, on a consolidated basis. The fixed charge coverage ratio for TCEH as of September 30, 2008 was 1.4 to 1.0.

Under the TCEH Senior Secured Facilities, TCEH and its restricted subsidiaries are generally not permitted to incur indebtedness unless, on a pro forma basis, after giving effect to such incurrence, the Adjusted EBITDA to consolidated interest expense ratio (as defined in the TCEH Senior Secured Facilities) is at least 2.0 to 1.0 or such incurrence is otherwise permitted by specified exceptions in the TCEH Senior Secured Facilities. This ratio was 1.4 to 1.0 for the twelve months ended September 30, 2008.

Under the TCEH Indenture, TCEH and substantially all of its subsidiaries are not permitted to incur indebtedness or issue certain classes of preferred stock unless, on a pro forma basis, after giving effect to such incurrence or issuance, the fixed charge coverage ratio (as defined in the Indenture) on a consolidated basis for TCEH and its restricted subsidiaries is at least 2.0 to 1.0 or such incurrence or issuance is otherwise permitted by specific exceptions in the Indenture. The fixed charge coverage ratio is generally defined as the ratio of Adjusted EBITDA of TCEH to fixed charges (as defined in the Indenture) of TCEH, in each case, on a consolidated basis. The ratio was 1.4 to 1.0 for the twelve months ended September 30, 2008.

Under the TCEH Senior Secured Facilities and indenture governing the TCEH Notes, TCEH and its restricted subsidiaries have limitations (subject to certain exceptions) on making restricted payments or investments (as defined in the applicable debt agreements), including certain dividends, equity repurchases, debt repayments, extensions of credit and certain types of investments.

Financial Covenants, Credit Rating Provisions and Cross Default Provisions — The terms of certain financing arrangements of TCEH contain financial covenants that require maintenance of leverage ratios and/or contain a minimum net worth covenant. As of September 30, 2008, TCEH was in compliance with all such applicable covenants.

Credit Ratings — The rating agencies assign issuer credit ratings for TCEH and its subsidiaries. The issuer credit ratings as of November 3, 2008 for TCEH and its subsidiaries are B-, B2 and B by S&P, Moody’s and Fitch, respectively.

Additionally, the rating agencies assign credit ratings on certain debt securities issued by TCEH. The credit ratings assigned for debt securities issued by TCEH as of October 24, 2008 are presented below:

	S&P	Moody's	Fitch
TCEH (Senior Secured)	B+	Ba3	BB
TCEH (Senior Unsecured) (a)	CCC	B3	B+
TCEH (Unsecured)	CCC	Caa1	B-

(a) Cash Pay and Toggle Notes

S&P and Fitch have placed the ratings for EFH Corp. and its subsidiaries on “stable outlook.” On November 3, 2008, Moody’s announced that it changed the rating outlook for EFH Corp. and TCEH to negative from stable.

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

Material Credit Rating Covenants and Credit Worthiness Effects on Liquidity — As a result of TCEH’s non-investment grade credit rating and considering collateral thresholds of certain retail and wholesale commodity contracts, as of September 30, 2008 counterparties to those contracts could have required TCEH to post up to an aggregate of \$100 million in additional collateral. This amount largely represents the below market terms of these contracts as of September 30, 2008; thus, this amount will vary depending on the value of these contracts on any given day.

Certain transmission and distribution utilities in Texas have tariffs in place to assure adequate credit worthiness of any REP to support the REP’s obligation to collect securitization bond-related (transition) charges on behalf of the utility. Under these tariffs, as a result of the previous downgrade of TCEH's credit rating to below investment grade, TCEH is required to post collateral support in an amount equal to estimated transition charges over specified time periods. The amount of collateral support required to be posted, as well as the time period of transition charges covered, varies by utility. Based on requests to post collateral support from utilities that have been received by TCEH and its subsidiaries as of September 30, 2008, TCEH has posted collateral support in the form of letters of credit to the applicable utilities in an aggregate amount equal to \$24 million, with \$14 million of this amount posted for the benefit of Oncor.

The PUCT has rules in place to assure adequate credit worthiness of any REP. Under these rules, TCEH maintains availability under its credit facilities of an amount no less than the aggregate amount of customer deposits and any advanced payments received from customers, and maintains equity in an amount that exceeds the minimum required by PUCT rules. As of September 30, 2008, the amount of customer deposits received from customers held by TCEH's REP subsidiaries totaled approximately \$120 million.

The RRC has rules in place to assure adequate credit worthiness of parties that have mining reclamation obligations. Under these rules, should the RRC determine that the credit worthiness of Luminant Generation Company LLC is not sufficient to support Luminant's reclamation obligations, TCEH may be required to post cash or letter of credit collateral support in an amount currently estimated to be approximately \$600 million to \$800 million. This amount would vary depending upon numerous factors, including Luminant Generation Company LLC’s credit worthiness and the level of mining reclamation obligations.

ERCOT also has rules in place to assure adequate credit worthiness of parties that schedule power on the ERCOT System. Under these rules, TCEH has posted collateral support, predominantly in the form of letters of credit, totaling \$77 million as of September 30, 2008 (which is subject to periodic adjustments).

Oncor and Texas Holdings agreed to the terms of a stipulation with major interested parties to resolve all outstanding issues in the PUCT review related to the Merger. As part of this stipulation, TCEH is required to post a letter of credit in an amount equal to \$170 million to secure TXU Energy’s payment obligations to Oncor if two or more of Oncor’s credit ratings are below investment grade. As of November 3, 2008, Oncor maintains an investment grade rating with each of the rating agencies.

Other arrangements of TCEH, including the accounts receivable securitization program (see Note 6 to Financial Statements) and certain leases, contain terms pursuant to which the interest rates charged under the agreements may be adjusted depending on credit ratings of TCEH.

Material Cross Default Provisions — Certain financing arrangements contain provisions that may result in an event of default if there were a failure under other financing arrangements to meet payment terms or to observe other covenants that could or does result in an acceleration of payments due. Such provisions are referred to as “cross default” provisions.

A default by TCEH or any restricted subsidiary in respect of indebtedness, excluding indebtedness relating to the sale of receivables program, in an aggregate amount in excess of \$200 million may result in a cross default under the TCEH Senior Secured Facilities. Under these facilities such a default may cause the maturity of outstanding balances (\$22.651 billion at October 31, 2008) under such facility to be accelerated.

The TCEH Indenture contains a cross acceleration provision where a payment default at maturity or on acceleration of principal indebtedness under any instrument or instruments of TCEH and any of its restricted subsidiaries in the aggregate amount equal to or greater than \$250 million may cause the acceleration of the TCEH Notes.

The accounts receivable securitization program contains a cross default provision with a threshold of \$200 million that applies in the aggregate to the originators, any parent guarantor of an originator or TCEH acting as collection agent under the program. TXU Receivables Company and EFH Corporate Services Company, as collection agent, in the aggregate have a cross default threshold of \$50,000. If any of the aforementioned defaults on indebtedness of the applicable threshold were to occur, the program could terminate.

TCEH and its subsidiaries enter into energy-related and financial contracts, the master forms of which contain provisions whereby an event of default or acceleration of settlement would occur if TCEH or those subsidiaries were to default under an obligation in respect of borrowings in excess of thresholds, which vary, stated in the contracts. The entities whose default would trigger cross default vary depending on the contract.

Each of TCEH’s natural gas hedging agreements that are secured with a lien on its assets on a pari passu basis with the TCEH Senior Secured Facilities contains a cross default provision. In the event of a default by TCEH or any of its subsidiaries relating to indebtedness (such amounts varying by contract but ranging from \$200 million to \$250 million), then each counterparty under these hedging agreements would have the right to terminate its hedge agreement with TCEH and require all outstanding obligations under such agreement to be settled.

In the event of a default by TCEH relating to indebtedness in an amount equal to or greater than \$200 million that results in the acceleration of such debt, then each counterparty under TCEH's interest rate swap agreements with a notional value totaling \$27.595 billion at October 31, 2008 would have the right to terminate its interest rate swap agreement with TCEH and require all outstanding obligations under such agreement to be settled.

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

OFF BALANCE SHEET ARRANGEMENTS

See discussion above under “Sale of Accounts Receivable” and in Note 6 to Financial Statements.

Also see Note 8 to Financial Statements regarding guarantees.

COMMITMENTS AND CONTINGENCIES

See Note 8 to Financial Statements for discussion of commitments and contingencies.

CHANGES IN ACCOUNTING STANDARDS

See Note 1 to Financial Statements for a discussion of changes in accounting standards.

REGULATION AND RATES

Regulatory Investigations and Reviews

See Note 8 to Financial Statements.

Wholesale Market Design

In August 2003, the PUCT adopted a rule that, when implemented, will alter the wholesale market design in the ERCOT market. The rule requires ERCOT:

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

ERCOT currently has a zonal wholesale market structure consisting of four geographic zones. The proposed location-based congestion-management market is referred to as a “nodal” market because wholesale pricing would differ across the various nodes on the transmission grid. The implementation of a nodal market is being done in conjunction with transmission improvements designed to reduce current congestion. In 2006, the PUCT approved a set of Nodal Protocols, which was filed by ERCOT and describes the operation of a wholesale nodal market, and set an implementation date of no later than January 1, 2009. After having delayed the start of the nodal market beyond the January 1, 2009 implementation date, and pursuant to a request from the PUCT, ERCOT has delayed announcement of a new schedule for the implementation of the nodal market while it conducts a revised cost-benefit analysis for implementation of a nodal market design. TCEH is currently unable to predict when a new nodal market implementation schedule will be proposed by ERCOT.

In August 2006, the PUCT adopted an interim order approving ERCOT’s application for a surcharge imposed on all Qualified Scheduling Entities in the ERCOT market (including subsidiaries of TCEH) for the purpose of financing 38% of ERCOT’s expected nodal implementation costs. The surcharge took effect in October 2006. Additionally, at its January 15, 2008 meeting, the ERCOT Board of Directors agreed to request an increase in the surcharge to be effective in June 2008. ERCOT filed this request at the PUCT in March 2008 and it was approved by the PUCT in May 2008. TCEH expects that the annual impact of the surcharge will be approximately \$10 to \$11 million in additional expenses; however, TCEH is unable to predict the ultimate impact of the proposed nodal wholesale market design on its operations or financial results.

Environmental Regulations

See discussion in Note 3 to Financial Statements regarding the invalidation of the EPA’s Clean Air Interstate Rule and the related impairment of intangible assets representing NO_x and SO₂ emission allowances.

Summary

TCEH cannot predict future regulatory or legislative actions or any changes in economic and securities market conditions. Such actions or changes could significantly alter its basic financial position, results of operations or cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Risk Oversight

TCEH manages the commodity price, counterparty credit and commodity-related operational risk related to the unregulated energy business within limitations established by senior management and in accordance with TCEH's overall risk management policies. Interest rate risk is managed centrally by the corporate treasury function. Market risks are monitored by risk management groups that operate independently of the wholesale commercial operations, utilizing defined practices and analytical methodologies. These techniques measure the risk of change in value of the portfolio of contracts and the hypothetical effect on this value from changes in market conditions and include, but are not limited to, Value at Risk (VaR) methodologies. Key risk control activities include, but are not limited to, transaction review and approval (including credit review), operational and market risk measurement, validation of transaction capture, portfolio valuation and reporting, including mark-to-market valuation, VaR and other risk measurement metrics.

EFH Corp. has a corporate risk management organization that is headed by a Chief Risk Officer. The Chief Risk Officer, through his designees at TCEH, enforces applicable risk limits, including the respective policies and procedures to ensure compliance with such limits and evaluates the risks inherent in the various businesses of TCEH and their associated transactions.

Commodity Price Risk

TCEH's businesses are subject to the inherent risks of market fluctuations in the price of electricity, natural gas and other energy-related products they market or purchase. TCEH's businesses actively manage their portfolio of owned generation assets, fuel supply and retail sales load to mitigate the near-term impacts of these risks on results of operations. These businesses, similar to other participants in the market, cannot fully manage the long-term value impact of structural declines or increases in natural gas and power prices and spark spreads (differences between the market price of electricity and its cost of production).

In managing energy price risk, subsidiaries of TCEH enter into a variety of market transactions including, but not limited to, short- and long-term contracts for physical delivery, exchange traded and over-the-counter financial contracts and bilateral contracts with customers. Activities in the wholesale operations include hedging, the structuring of long-term contractual arrangements and proprietary trading. The wholesale operation continuously monitors the valuation of identified risks and adjusts positions based on current market conditions. TCEH strives to use consistent assumptions regarding forward market price curves in evaluating and recording the effects of commodity price risk.

Long-Term Hedging Program — See discussion above under "Significant Activities and Events" for an update of the program, including potential effects on reported results.

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

A Monte Carlo simulation methodology is used to calculate VaR and is considered by management to be the most effective way to estimate changes in a portfolio's value based on assumed market conditions for liquid markets. The use of this method requires a number of key assumptions, such as use of (i) an assumed confidence level; (ii) an assumed holding period (i.e. the time necessary for management action, such as to liquidate positions); and (iii) historical estimates of volatility and correlation data.

Trading VaR — This measurement estimates the potential loss in fair value, due to changes in market conditions, of all contracts entered into for trading purposes based on a 95% confidence level and an assumed holding period of five to 60 days.

	Successor	
	Nine Months Ended September 30, 2008	Year Ended December 31, 2007
Month-end average Trading VaR:	\$ 7	\$ 9
Month-end high Trading VaR:	\$ 15	\$ 14
Month-end low Trading VaR:	\$ 3	\$ 6

VaR for Energy-Related Contracts Subject to Mark-to-Market (MtM) Accounting — This measurement estimates the potential loss in fair value, due to changes in market conditions, of all contracts marked-to-market in net income (principally hedges not accounted for as cash flow hedges and trading positions), based on a 95% confidence level and an assumed holding period of five to 60 days.

	Successor	
	Nine Months Ended September 30, 2008	Year Ended December 31, 2007
Month-end average MtM VaR:	\$ 2,249	\$ 1,081
Month-end high MtM VaR:	\$ 3,549	\$ 1,576
Month-end low MtM VaR:	\$ 1,087	\$ 322

Earnings at Risk (EaR) — This measurement estimates the potential reduction of pretax earnings for the periods presented, due to changes in market conditions, of all energy-related contracts marked-to-market in net income and contracts not marked-to-market in net income that are expected to be settled within the fiscal year (physical purchases and sales of commodities). Transactions accounted for as cash flow hedges are also included for this measurement. A 95% confidence level and a five to 60 day holding period are assumed in determining EaR.

	Successor	
	Nine Months Ended September 30, 2008	Year Ended December 31, 2007
Month-end average EaR:	\$ 2,260	\$ 1,070
Month-end high EaR:	\$ 3,916	\$ 1,559
Month-end low EaR:	\$ 1,069	\$ 318

The increases in the risk measures (MtM VaR and EaR) above were driven by higher natural gas prices and significant increases in market volatility.

Interest Rate Risk

As of September 30, 2008, the potential reduction of annual pretax earnings due to a one-point increase in interest rates totaled approximately \$36 million, taking into account the interest rate swaps discussed in Note 7 to the Financial Statements. See "Significant Activities and Events"— "Interest Rate Hedges" for discussion of interest rate swaps transacted in October 2008.

Credit Risk

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

Credit Exposure — TCEH's gross exposure to credit risk associated with trade accounts receivable (retail and wholesale) and net asset positions arising from hedging and trading activities totaled \$1.170 billion at September 30, 2008. The components of this exposure are discussed in more detail below.

Assets subject to credit risk as of September 30, 2008 include \$853 million in accounts receivable from the retail sale of electricity to residential and business customers. As of September 30, 2008, TCEH had cash deposits of \$111 million as collateral for these receivables. The risk of material loss (after consideration of bad debt allowances) from nonperformance by these customers is unlikely based upon historical experience. Allowances for uncollectible accounts receivable are established for the potential loss from nonpayment by these customers based on historical experience, market or operational conditions and changes in the financial condition of large business customers.

Most of the remaining credit exposure is with wholesale counterparties. These counterparties include energy companies, financial institutions, electric utilities, independent power producers, oil and gas producers, local distribution companies and energy trading and marketing companies. As of September 30, 2008, the exposure to credit risk from the wholesale customers and counterparties totaled \$317 million taking into account standardized master netting contracts and agreements described above but before taking into account \$32 million in credit collateral (cash, letters of credit and other security interests) held by TCEH subsidiaries.

Of this \$285 million net exposure, 57% is with investment grade customers and counterparties, as determined using publicly available information including major rating agencies' published ratings and TCEH's internal credit evaluation process. Those customers and counterparties without a S&P rating of at least BBB- or similar rating from another major rating agency are rated using internal credit methodologies and credit scoring models to estimate a S&P equivalent rating. TCEH routinely monitors and manages its credit exposure to these customers and counterparties on this basis. See discussion above under "Bankruptcy Filing of Lehman Brothers Holdings Inc."

The following table presents the distribution of credit exposure as of September 30, 2008, for wholesale counterparties. This credit exposure represents wholesale trade accounts receivable and net asset positions on the balance sheet arising from hedging and trading activities by investment grade and noninvestment grade, credit quality and maturity after taking into consideration netting within each contract and any master netting contracts with counterparties. The amounts below do not include asset liens held as security for a portion of the net exposure.

	Successor						
	Exposure before Credit Collateral	Credit Collateral	Net Exposure	Net Exposure by Maturity			Total
				2 years or less	Between 2-5 years	Greater than 5 years	
Investment grade.....	\$ 169	\$ 7	\$ 162	\$164	\$ (69)	\$ 67	\$ 162
Noninvestment grade.....	<u>148</u>	<u>25</u>	<u>123</u>	<u>120</u>	<u>3</u>	<u>—</u>	<u>123</u>
Totals.....	<u>\$ 317</u>	<u>\$ 32</u>	<u>\$ 285</u>	<u>\$ 284</u>	<u>\$ (66)</u>	<u>\$ 67</u>	<u>\$ 285</u>
Investment grade.....	53%		57%				
Noninvestment grade.....	47%		43%				

In addition to the exposures in the table above, TCEH has contracts classified as “normal” purchase or sale and non-derivative contractual commitments that are not marked-to-market in the financial statements. Such contractual commitments may contain pricing that is favorable considering current market conditions and therefore represent economic risk if the counterparties do not perform. Nonperformance could have a material adverse impact on TCEH’s future results of operations, financial condition and cash flows.

TCEH has changed the presentation of this table from past disclosures by excluding large retail business customers, the credit risk of which is managed separately as discussed above, and by excluding forward values of contracts not reflected on the balance sheet. TCEH believes this presentation more accurately reflects its exposure in relation to its financial position as reflected in the balance sheet and is more consistent with industry reporting practices.

TCEH does not anticipate any material adverse effect on its financial position or results of operations due to nonperformance by any customer or counterparty.

TCEH's subsidiaries had credit exposure to three counterparties each having an exposure greater than 10% of the net \$285 million credit exposure. These three counterparties represented 17%, 13% and 11%, respectively, of the net exposure. TCEH views exposure to these three counterparties to be within an acceptable level of risk tolerance due to the applicable counterparty's credit rating, collateral postings or business relationship with TCEH. However, this concentration increases the risk that the default would have a material effect on TCEH's net income and cash flows.

With respect to credit risk related to the long-term hedging program, over 91% of the transaction volumes are with counterparties with an A credit rating or better. Additionally, TCEH has potential credit concentration risk related to the limited number of counterparties in the program. The transactions with these counterparties contain certain credit rating provisions that would require the counterparties to post collateral in the event of significant declines in natural gas prices and a material downgrade in the credit rating of the counterparties. TCEH views the potential concentration of risk with these counterparties to be within an acceptable risk tolerance due to the strong financial profile of the counterparties taken as a whole.

Under the terms of the TCEH Senior Secured Facilities, the commitments of the lenders to make loans to TCEH are several and not joint. Accordingly, if any lender fails to make loans to TCEH, TCEH’s available liquidity could be reduced by an amount up to the aggregate amount of such lender’s commitments under the TCEH Senior Secured Facilities. See discussion above under “Bankruptcy Filing of Lehman Brothers Holdings Inc.”

FORWARD-LOOKING STATEMENTS

This report and other presentations made by TCEH contain “forward-looking statements”. All statements, other than statements of historical facts, that are included in this report, or made in presentations, in response to questions or otherwise, that address activities, events or developments that TCEH expects or anticipates to occur in the future, including such matters as projections, capital allocation, future capital expenditures, business strategy, competitive strengths, goals, future acquisitions or dispositions, development or operation of power production assets, market and industry developments and the growth of TCEH's business and operations (often, but not always, through the use of words or phrases such as “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimated,” “projection,” “target,” and “outlook”), are forward-looking statements. Although TCEH believes that in making any such forward-looking statement its expectations are based on reasonable assumptions, any such forward-looking statement involves uncertainties and is qualified in its entirety by reference to the discussion of risk factors discussed under “Risk Factors” in the 2007 Annual Report and this Quarterly Report and the following important factors, among others, that could cause the actual results of TCEH to differ materially from those projected in such forward-looking statements:

- prevailing governmental policies and regulatory actions, including those of the Texas Legislature, the Governor of Texas, the US Congress, FERC, the PUCT, the RRC, the NRC, the EPA and the TCEQ, with respect to, among other things:
 - allowed prices;
 - industry, market and rate structure;
 - purchased power and recovery of investments;
 - operations of nuclear generating facilities;
 - operations of mines;
 - acquisitions and disposal of assets and facilities;
 - development, construction and operation of facilities;
 - decommissioning costs;
 - present or prospective wholesale and retail competition;
 - changes in tax laws and policies, and
 - changes in and compliance with environmental and safety laws and policies, including climate change initiatives;
- legal and administrative proceedings and settlements;
- general industry trends;
- TCEH's ability to attract and retain profitable customers;
- TCEH's ability to profitably serve its customers;
- restrictions on competitive retail pricing;
- changes in wholesale electricity prices or energy commodity prices;
- changes in prices of transportation of natural gas, coal, crude oil and refined products;
- unanticipated changes in market heat rates in the ERCOT electricity market;
- TCEH's ability to effectively hedge against changes in commodity prices, market heat rates and interest rates;
- weather conditions and other natural phenomena, and acts of sabotage, wars or terrorist activities;
- unanticipated population growth or decline, and changes in market demand and demographic patterns;
- changes in business strategy, development plans or vendor relationships;
- access to adequate transmission facilities to meet changing demands;
- unanticipated changes in interest rates, commodity prices, rates of inflation or foreign exchange rates;
- unanticipated changes in operating expenses, liquidity needs and capital expenditures;
- commercial bank market and capital market conditions;
- competition for new energy development and other business opportunities;
- inability of various counterparties to meet their obligations with respect to TCEH's financial instruments;
- changes in technology used by and services offered by TCEH;
- significant changes in TCEH's relationship with its employees, including the availability of qualified personnel, and the potential adverse effects if labor disputes or grievances were to occur;
- changes in assumptions used to estimate future executive compensation payments;

- significant changes in critical accounting policies;
- actions by credit rating agencies;
- the ability of TCEH to implement cost reduction initiatives, and
- with respect to TCEH's lignite coal-fueled generation construction and development program, more specifically, TCEH's ability to fund such investments, changes in competitive market rules, unexpected judicial rulings, changes in environmental laws or regulations, changes in electric generation and emissions control technologies, changes in projected demand for electricity, the ability of TCEH and its contractors to attract and retain, at projected rates, skilled labor for constructing the new generating units, changes in wholesale electricity prices or energy commodity prices, transmission capacity and constraints, supplier performance risk, changes in the cost and availability of materials necessary for the construction program and the ability of TCEH to manage the significant construction program to a timely conclusion with limited cost overruns.

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

Item 4T. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of TCEH's management, including the principal executive officers and principal financial officer, of the effectiveness of the design and operation of the disclosure controls and procedures in effect as of the end of the current period included in this quarterly report. Based on the evaluation performed, TCEH's management, including the principal executive officer and principal financial officer, concluded that the disclosure controls and procedures were effective. During the most recent fiscal quarter covered by this quarterly report, there has been no change in TCEH's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, TCEH's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS.

Reference is made to the discussion in Note 8 regarding legal proceedings.

Item 1A. RISK FACTORS.

There have been no material changes from the risk factors disclosed under the heading "Risk Factors" in Item 1A of the 2007 Annual Report and in Item 1A of TCEH's Quarterly Report for the six months ended June 30, 2008, except for information disclosed elsewhere in this Quarterly Report that provides factual updates to risk factors contained in the 2007 Annual Report and TCEH's Quarterly Report for the six months ended June 30, 2008.

TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC
CONDENSED STATEMENT OF CONSOLIDATED INCOME (LOSS)
(Unaudited)
(millions of dollars)

	Period from October 1, 2007 through September 30, 2008
Operating revenues	\$ 9,740
Fuel, purchased power and delivery fees.....	(5,621)
Income (loss) from commodity hedging and trading activities.....	(1,687)
Operating costs.....	(645)
Depreciation and amortization.....	(1,150)
Selling, general and administrative expenses.....	(664)
Franchise and revenue-based taxes.....	(107)
Other income.....	13
Other deductions.....	(555)
Interest income.....	66
Interest expense and related charges.....	<u>(2,356)</u>
Income (loss) before income taxes	(2,966)
Income tax (expense) benefit.....	<u>1,010</u>
Net income (loss).....	<u>\$ (1,956)</u>

Appendix B

TCEH Consolidated
Adjusted EBITDA Reconciliation

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007	Twelve Months Ended September 30, 2008	Twelve Months Ended September 30, 2007
Net income	\$ (811)	\$ 1,180	\$ (1,956)	\$ 1,679
Income tax expense (benefit)	(425)	529	(1,010)	791
Interest expense and related charges	1,756	310	2,356	386
Depreciation and amortization	827	245	1,150	326
EBITDA	<u>\$ 1,347</u>	<u>\$ 2,264</u>	<u>\$ 540</u>	<u>\$ 3,182</u>
Interest income	(45)	(260)	(66)	(326)
Amortization of nuclear fuel	55	50	74	65
Purchase accounting adjustments (a)	290	—	424	—
Unrealized net (gain) or loss resulting from hedging transactions ..	221	703	1,796	645
Impairment of assets and inventory write down (b)	502	—	502	—
One-time customer appreciation bonus	—	—	—	165
Losses on sale of receivables	22	28	33	38
Noncash compensation expense (SFAS 123R) (c)	8	7	8	11
Severance expense (d)	1	—	1	2
Transition and business optimization costs (e)	30	12	39	12
Transaction and merger expenses (f)	1	—	1	—
Restructuring and other (g)	32	(32)	34	(32)
Expenses incurred to upgrade or expand a generation station (h) ...	100	4	100	5
Adjusted EBITDA per Incurrence Covenant	<u>\$ 2,564</u>	<u>\$ 2,776</u>	<u>\$ 3,486</u>	<u>\$ 3,767</u>
Expenses related to unplanned generation station outages (h)	218	—	218	—
Adjusted EBITDA per Maintenance Covenant	<u>\$ 2,782</u>	<u>\$ 2,776</u>	<u>\$ 3,704</u>	<u>\$ 3,767</u>

- (a) Purchase accounting adjustments include amortization of the intangible net asset value of retail and wholesale power sales agreements, environmental credits, coal purchase contracts and power purchase agreements and the stepped up value of nuclear fuel. Also includes certain credits not recognized in net income due to purchase accounting.
- (b) Impairment of assets represents the impairment of emission allowances intangible assets. See Note 3 to Financial Statements.
- (c) Noncash compensation expense excludes capitalized amounts.
- (d) Severance expense includes amounts incurred related to outsourcing, restructuring and other amounts deemed to be in excess of normal recurring amounts.
- (e) Transition and business optimization costs include professional fees primarily for retail billing and customer care systems enhancements and incentive compensation.
- (f) Transaction and merger expenses include costs related to the Merger.
- (g) Restructuring and other for the 2008 periods includes the charge related to the bankruptcy of a subsidiary of Lehman Brothers Holdings, Inc. and for the 2007 periods includes credits related to impaired combustion turbine leases and other restructuring initiatives and nonrecurring activities.
- (h) Expenses incurred to upgrade or expand a generation station reflect noncapital outage costs.