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**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC**

**AN ENERGY FUTURE HOLDINGS CORP. ENTERPRISE**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2008**

**AND**

**INDEPENDENT AUDITORS' REPORT**

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## GLOSSARY

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

<b>1999 Restructuring Legislation</b>	Texas Electric Choice Plan, the legislation that restructured the electric utility industry in Texas to provide for retail competition
<b>2007 Annual Report</b>	TCEH's Second Amended and Restated Annual Report for the year ended December 31, 2007
<b>Adjusted EBITDA</b>	Adjusted EBITDA means EBITDA adjusted to exclude non-cash items, unusual items and other adjustments allowable under certain debt arrangements of TCEH. Adjusted EBITDA and EBITDA are not recognized terms under GAAP and, thus, are non-GAAP financial measures. 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.
<b>CAIR</b>	Clean Air Interstate Rule
<b>Capgemini</b>	Capgemini Energy LP, a subsidiary of Cap Gemini North America Inc. that provides business support services to TCEH and its subsidiaries
<b>CO<sub>2</sub></b>	carbon dioxide
<b>EBITDA</b>	Refers to earnings (net income) before interest expense, income taxes, depreciation and amortization. See the definition of Adjusted EBITDA above.
<b>EFC Holdings</b>	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.
<b>EFH Corp.</b>	Refers to Energy Future Holdings Corp., a holding company, and/or its subsidiaries, depending on context. Its major subsidiaries include TCEH and Oncor.
<b>EPA</b>	US Environmental Protection Agency
<b>EPC</b>	engineering, procurement and construction

<b>ERCOT</b>	Electric Reliability Council of Texas, the independent system operator and the regional coordinator of various electricity systems within Texas
<b>ERISA</b>	Employee Retirement Income Security Act of 1974, as amended
<b>FASB</b>	Financial Accounting Standards Board, the designated organization in the private sector for establishing standards for financial accounting and reporting
<b>FIN</b>	Financial Accounting Standards Board Interpretation
<b>FIN 39-1</b>	FIN No. 39, "Offsetting of Amounts Related to Certain Contracts — an Interpretation of APB Opinion No. 10 and FASB Statement No. 105"
<b>FIN 46R</b>	FIN No. 46R (Revised 2003), "Consolidation of Variable Interest Entities"
<b>FIN 48</b>	FASB Interpretation No. 48 (As Amended), "Accounting for Uncertainty in Income Taxes"
<b>FSP</b>	FASB Staff Position
<b>FSP FIN 39-1</b>	FSP FIN No. 39-1, "Amendment of FASB Interpretation No. 39"
<b>FSP FIN 48-1</b>	FSP FIN No. 48-1, "Definition of Settlement in FASB Interpretation No. 48"
<b>FSP SFAS 132(R)-1</b>	FSP SFAS No. 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets"
<b>FSP SFAS 140-4 and FIN 46(R)-8</b>	FSP SFAS No. 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interest in Variable Interest Entities"
<b>FSP SFAS 157-3</b>	FSP SFAS No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active"
<b>GAAP</b>	generally accepted accounting principles
<b>Intermediate Holding</b>	Refers to Energy Future Intermediate Holding Company LLC, a direct, wholly-owned subsidiary of EFH Corp. and the direct parent of Oncor Holdings.
<b>IRS</b>	US Internal Revenue Service
<b>kWh</b>	kilowatt-hours
<b>LIBOR</b>	London Interbank Offered Rate. An interest rate at which banks can borrow funds, in marketable size, from other banks in the London interbank market.
<b>Luminant</b>	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.

<b>Luminant Energy</b>	Luminant Energy Company LLC, an indirect, wholly-owned subsidiary of TCEH that engages in certain wholesale markets activities
<b>market heat rate</b>	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.
<b>Merger</b>	The transaction referred to in "Merger Agreement" (defined immediately below) that was completed on October 10, 2007.
<b>Merger Agreement</b>	Agreement and Plan of Merger, dated February 25, 2007, under which Texas Holdings agreed to acquire EFH Corp.
<b>Merger Sub</b>	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
<b>NO<sub>x</sub></b>	nitrogen oxide
<b>NRC</b>	US Nuclear Regulatory Commission
<b>Oncor</b>	Refers to Oncor Electric Delivery Company LLC, a direct majority-owned subsidiary of Oncor Holdings and an 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.
<b>Oncor Holdings</b>	Refers to Oncor Electric Delivery Holdings Company LLC, a direct wholly-owned subsidiary of Intermediate Holding and the direct majority owner of Oncor.
<b>OPEB</b>	other postretirement employee benefits
<b>PUCT</b>	Public Utility Commission of Texas
<b>PURA</b>	Texas Public Utility Regulatory Act
<b>Purchase accounting</b>	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.
<b>REP</b>	retail electric provider
<b>SEC</b>	US Securities and Exchange Commission
<b>SFAS</b>	Statement of Financial Accounting Standards issued by the FASB
<b>SFAS 5</b>	SFAS No. 5, "Accounting for Contingencies"
<b>SFAS 34</b>	SFAS No. 34, "Capitalization of Interest Cost"

<b>SFAS 87</b>	SFAS No. 87, “Employers’ Accounting for Pensions”
<b>SFAS 106</b>	SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions”
<b>SFAS 109</b>	SFAS No. 109, “Accounting for Income Taxes”
<b>SFAS 123(R)</b>	SFAS No. 123 (revised 2004), “Share-Based Payment”
<b>SFAS 132(R)</b>	SFAS No. 132 (revised 2003), "Employers' Disclosures About Pensions and Other Postretirement Benefits"
<b>SFAS 133</b>	SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” as amended and interpreted
<b>SFAS 140</b>	SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125”
<b>SFAS 141</b>	SFAS No. 141, "Business Combinations"
<b>SFAS 142</b>	SFAS No. 142, “Goodwill and Other Intangible Assets”
<b>SFAS 144</b>	SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"
<b>SFAS 157</b>	SFAS No. 157, “Fair Value Measurements”
<b>SFAS 158</b>	SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans”
<b>SFAS 161</b>	SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133"
<b>SG&amp;A</b>	selling, general and administrative
<b>SO<sub>2</sub></b>	sulfur dioxide
<b>Sponsor Group</b>	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.)
<b>TCEH</b>	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 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.
<b>TCEH Finance</b>	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.
<b>TCEH Senior Secured Facilities</b>	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 12 to Financial Statements for details of these facilities.

<b>TCEQ</b>	Texas Commission on Environmental Quality
<b>Texas Holdings</b>	Refers to Texas Energy Future Holdings Limited Partnership, a Delaware limited partnership controlled by the Sponsor Group that owns substantially all of the common stock of EFH Corp.
<b>TXU Energy</b>	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.
<b>US</b>	United States of America

## **INDEPENDENT AUDITORS' REPORT**

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

We have audited the accompanying consolidated balance sheets of Texas Competitive Electric Holdings Company LLC and subsidiaries ( "TCEH") as of December 31, 2008 and 2007 (successor), and the related statements of consolidated income (loss), comprehensive income (loss), cash flows and membership interests for the year ended December 31, 2008 (successor), the period from October 11, 2007 through December 31, 2007 (successor), the period from January 1, 2007 through October 10, 2007 (predecessor) and the year ended December 31, 2006 (predecessor). These financial statements are the responsibility of TCEH's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. TCEH is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of TCEH's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Texas Competitive Electric Holdings Company LLC and subsidiaries at December 31, 2008 and 2007 (successor), and the results of their operations and their cash flows for the year ended December 31, 2008 (successor), for the period from October 11, 2007 through December 31, 2007 (successor), the period from January 1, 2007 through October 10, 2007 (predecessor) and for the year ended December 31, 2006 (predecessor), in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, TCEH is an indirect wholly owned subsidiary of Energy Future Holdings Corp. ("EFH Corp."), which was merged with Texas Energy Future Merger Sub Corp on October 10, 2007. As also discussed in Note 1 to the consolidated financial statements, TCEH reclassified the results of its commodity hedging and trading activities on a retrospective basis.

/s/ Deloitte & Touche LLP

Dallas, Texas  
March 2, 2009

**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC**  
**STATEMENTS OF CONSOLIDATED INCOME (LOSS)**  
(Millions of Dollars)

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period From January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Operating revenues .....	\$ 9,787	\$ 1,671	\$ 6,884	\$ 9,396
Fuel, purchased power costs and delivery fees .....	(5,600)	(852)	(3,209)	(3,928)
Net gain (loss) from commodity hedging and trading activities .....	2,184	(1,492)	(554)	153
Operating costs .....	(676)	(123)	(473)	(605)
Depreciation and amortization .....	(1,092)	(315)	(253)	(334)
Selling, general and administrative expenses .....	(679)	(153)	(451)	(531)
Franchise and revenue-based taxes .....	(110)	(30)	(81)	(126)
Impairment of goodwill .....	(8,000)	—	—	—
Other income (Note 10) .....	34	2	22	23
Other deductions (Note 10) .....	(1,263)	(5)	20	(210)
Interest income .....	60	10	271	203
Interest expense and related charges (Note 23) .....	<u>(3,918)</u>	<u>(587)</u>	<u>(323)</u>	<u>(392)</u>
Income (loss) before income taxes .....	(9,273)	(1,874)	1,853	3,649
Income tax (expense) benefit .....	<u>411</u>	<u>651</u>	<u>(595)</u>	<u>(1,255)</u>
Net income (loss) .....	<u>\$ (8,862)</u>	<u>\$ (1,223)</u>	<u>\$ 1,258</u>	<u>\$ 2,394</u>

See Notes to Financial Statements.

**STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME (LOSS)**  
(Millions of Dollars)

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Net income (loss) .....	\$ (8,862)	\$ (1,223)	\$ 1,258	\$ 2,394
Other comprehensive income (loss), net of tax effects:				
Cash flow hedges:				
Net increase (decrease) in fair value of derivatives (net of tax (expense) benefit of \$98, \$97, \$154 and \$(321) .....	(181)	(177)	(288)	598
Derivative value net (gains) losses related to hedged transactions recognized during the period and reported in net income (net of tax (expense) benefit of \$66, \$—, \$(48) and \$(26)) .....	<u>122</u>	<u>—</u>	<u>(89)</u>	<u>(47)</u>
Total adjustments to net income (loss) .....	<u>(59)</u>	<u>(177)</u>	<u>(377)</u>	<u>551</u>
Comprehensive income (loss) .....	<u>\$ (8,921)</u>	<u>\$ (1,400)</u>	<u>\$ 881</u>	<u>\$ 2,945</u>

See Notes to Financial Statements.

**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC**  
**STATEMENTS OF CONSOLIDATED CASH FLOWS**  
(Millions of Dollars)

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Cash flows — operating activities				
Net income (loss) .....	\$ (8,862)	\$ (1,223)	\$ 1,258	\$ 2,394
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:				
Depreciation and amortization .....	1,536	442	306	400
Deferred income tax expense (benefit) – net .....	(378)	(451)	(81)	162
Impairment of goodwill (Note 3) .....	8,000	—	—	—
Impairment of trade name intangible asset (Note 3) .....	481	—	—	—
Impairment of emission allowances intangible assets (Note 3) .....	501	—	—	—
Impairment of natural gas-fueled generation plants (Note 5) .....	229	—	—	201
Charge related to Lehman bankruptcy (Note 10) .....	26	—	—	—
Net effect of unrealized mark-to-market valuations of commodity positions – losses (gains) .....	(2,329)	1,556	722	(272)
Unrealized net loss on mark-to-market valuations of interest rate swaps .....	1,477	—	—	—
Bad debt expense .....	81	13	44	67
Stock-based incentive compensation expense .....	10	—	6	9
Recognition of losses on dedesignated cash flow hedges .....	66	1	8	10
Customer appreciation bonus charge (net of amounts credited to customers in 2006) .....	—	—	—	122
Credit related to impaired leases (Note 10) .....	—	—	(48)	(2)
Net (gains) losses on sale of assets .....	—	—	(1)	(12)
Net equity loss from unconsolidated affiliate .....	10	2	5	10
Other, net .....	(22)	2	6	3
Changes in operating assets and liabilities:				
Affiliate accounts receivable/payable – net .....	42	(79)	87	(60)
Accounts receivable – trade .....	(491)	(211)	308	348
Impact of accounts receivable sales program .....	53	(223)	45	(41)
Inventories .....	(12)	(14)	(33)	1
Accounts payable – trade .....	366	260	(444)	(209)
Commodity and other derivative contractual assets and liabilities .....	(28)	(10)	(167)	—
Margin deposits – net .....	595	(614)	(569)	564
Other – net assets .....	355	(276)	2	(281)
Other – net liabilities .....	(46)	433	(189)	1,271
Cash provided by (used in) operating activities .....	<u>1,660</u>	<u>(392)</u>	<u>1,265</u>	<u>4,685</u>
Cash flows — financing activities				
Issuances of securities/long-term borrowings (Note 12)				
Merger-related debt financing .....	—	33,732	—	—
Pollution control revenue bonds .....	242	—	—	243
Other long-term debt .....	1,443	—	1,000	—
Retirements/repurchases of securities/long-term borrowings (Note 12):				
Merger-related debt repurchases .....	—	(8,992)	—	—
Pollution control revenue bonds .....	(242)	—	(143)	(259)
Other long-term debt .....	(612)	(45)	(15)	(411)
Increase (decrease) in short-term borrowings (Note 12):				
Bank .....	462	(1,617)	1,860	(245)
Commercial paper .....	—	—	(623)	317
Decrease in income tax-related note payable to Oncor .....	(34)	(9)	(24)	(40)
Distribution paid to parent .....	—	(21,000)	(1,135)	(1,144)
Excess tax benefit on stock-based incentive compensation .....	—	—	—	11
Debt discount, financing and reacquisition expenses – net .....	(1)	(576)	(12)	(19)
Advances from affiliates .....	5	—	—	—
Other .....	37	—	—	—
Cash provided by (used in) financing activities .....	<u>\$ 1,300</u>	<u>\$ 1,493</u>	<u>\$ 908</u>	<u>\$(1,547)</u>

**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC**  
**STATEMENTS OF CONSOLIDATED CASH FLOWS (CONT.)**  
(Millions of Dollars)

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Cash flows — investing activities				
Net loans (to) from affiliates .....	\$ (572)	\$ 9	\$ 67	\$(1,996)
Capital expenditures .....	(1,908)	(496)	(1,409)	(791)
Nuclear fuel purchases .....	(166)	(23)	(54)	(117)
Investment held in money market fund (Note 1) .....	(142)	—	—	—
Purchase of mining-related assets .....	—	—	(122)	—
Proceeds from sale of assets .....	29	14	2	17
Proceeds from letter of credit facility posted with trustee (Note 23) .....	—	(1,250)	—	—
Proceeds from pollution control revenue bonds (deposited with) withdrawn from trustee — restricted cash .....	29	13	202	(240)
Other changes in restricted cash .....	(4)	1	(1)	—
Cash settlements related to outsourcing contract termination .....	41	—	—	—
Proceeds from sale of environmental allowances and credits .....	39	—	—	—
Purchases of environmental allowances and credits .....	(34)	—	—	—
Proceeds from sales of nuclear decommissioning trust fund securities ...	1,623	831	602	207
Investments in nuclear decommissioning trust fund securities .....	(1,639)	(835)	(614)	(223)
Other .....	<u>8</u>	<u>(6)</u>	<u>3</u>	<u>—</u>
Cash used in investing activities .....	<u>(2,696)</u>	<u>(1,742)</u>	<u>(1,324)</u>	<u>(3,143)</u>
Net change in cash and cash equivalents .....	264	(641)	849	(5)
Cash and cash equivalents — beginning balance .....	<u>215</u>	<u>856</u>	<u>7</u>	<u>12</u>
Cash and cash equivalents — ending balance .....	<u>\$ 479</u>	<u>\$ 215</u>	<u>\$ 856</u>	<u>\$ 7</u>

See Notes to Financial Statements.

**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY**  
**CONSOLIDATED BALANCE SHEETS**  
(Millions of Dollars)

	Successor	
	December 31, 2008	December 31, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 479	\$ 215
Investments held in money market fund (Note 1) .....	142	—
Restricted cash (Note 23) .....	4	—
Trade accounts receivable — net (Note 11) .....	994	827
Notes receivable from parents (Note 22) .....	598	25
Income taxes receivable from parent (Note 22) .....	—	190
Inventories (Note 23) .....	361	352
Commodity and other derivative contractual assets (Note 15) .....	2,391	1,126
Accumulated deferred income taxes (Note 9) .....	21	17
Margin deposits related to commodity positions .....	439	513
Other current assets .....	<u>85</u>	<u>70</u>
Total current assets .....	<u>5,514</u>	<u>3,335</u>
Restricted cash (Note 23) .....	1,250	1,279
Investments (Note 16) .....	483	612
Property, plant and equipment — net (Note 23) .....	20,902	20,545
Goodwill (Note 3) .....	10,322	18,060
Intangible assets (Note 3) .....	2,774	4,137
Commodity and other derivative contractual assets (Note 15) .....	962	244
Other noncurrent assets, principally unamortized debt issuance costs .....	<u>750</u>	<u>848</u>
Total assets .....	<u>\$ 42,957</u>	<u>\$ 49,060</u>
<b>LIABILITIES AND MEMBERSHIP INTERESTS</b>		
Current liabilities:		
Short-term borrowings (Note 12) .....	\$ 900	\$ 438
Advances from parent .....	4	—
Long-term debt due currently (Note 12) .....	261	195
Trade accounts payable – nonaffiliates .....	1,000	754
Trade accounts and other payables to affiliates .....	168	207
Commodity and other derivative contractual liabilities (Note 15) .....	2,730	1,108
Margin deposits related to commodity positions .....	525	5
Accrued income taxes payable to parent (Notes 9 and 22) .....	33	—
Accrued taxes other than income .....	70	56
Accrued interest .....	310	349
Other current liabilities .....	<u>276</u>	<u>239</u>
Total current liabilities .....	<u>6,277</u>	<u>3,351</u>
Accumulated deferred income taxes (Note 9) .....	5,249	5,919
Commodity and other derivative contractual liabilities (Note 15) .....	2,095	2,452
Notes or other liabilities due affiliates (Note 22) .....	254	289
Long-term debt, less amounts due currently (Note 12) .....	29,209	28,409
Other noncurrent liabilities and deferred credits (Note 23) .....	<u>2,527</u>	<u>2,424</u>
Total liabilities .....	<u>45,611</u>	<u>42,844</u>
Commitments and Contingencies (Note 13)		
Membership interests (Note 14) .....	<u>(2,654)</u>	<u>6,216</u>
Total liabilities and membership interests .....	<u>\$ 42,957</u>	<u>\$ 49,060</u>

See Notes to Financial Statements.

**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC**  
**STATEMENTS OF CONSOLIDATED MEMBERSHIP INTERESTS**  
(Millions of Dollars)

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Membership interests:				
Capital account:				
Balance at beginning of period (a) .....	\$ 6,393	\$28,315	\$ 6,359	\$ 4,501
Net income (loss).....	(8,862)	(1,223)	1,258	2,394
Effects of purchase accounting push-down.....	48	—	—	—
Effect of adoption of FIN 48 .....	—	—	(36)	—
Distributions paid to parent .....	—	—	(1,135)	(1,144)
Intercompany payable/receivable settlements and contributions related to the Merger.....	—	—	(4,057)	—
Dividend to parent to fund Merger.....	—	(21,000)	—	—
Merger-related transactions .....	—	301	—	—
Transfer of TXU Enterprise Holdings Company LLC ownership to parent.....	—	—	—	6
Effects of stock-based incentive compensation plans.....	3	—	31	22
Acquired subsidiaries and net assets .....	—	—	—	(6)
Allocated pension assets.....	—	—	8	—
Effects of allocation of SFAS 158 transition adjustment.....	—	—	—	65
Recapitalization of exchangeable preferred membership interests .....	—	—	—	521
Balance at end of period.....	<u>(2,418)</u>	<u>6,393</u>	<u>2,428</u>	<u>6,359</u>
Accumulated other comprehensive income (loss), net of tax effects (b):				
Balance at beginning of period.....	(177)	—	430	(121)
Change during the period.....	<u>(59)</u>	<u>(177)</u>	<u>(377)</u>	<u>551</u>
Balance at end of period .....	<u>(236)</u>	<u>(177)</u>	<u>53</u>	<u>430</u>
Total membership interests at end of period .....	<u>\$ (2,654)</u>	<u>\$ 6,216</u>	<u>\$ 2,481</u>	<u>\$ 6,789</u>

(a) The beginning equity balance for the Successor period reflects the application of push-down accounting as a result of the Merger.

(b) All amounts relate to cash flow hedges.

See Notes to Financial Statements.

**TEXAS COMPETITIVE ELECTRIC HOLDINGS COMPANY LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. 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 electricity generation, development and construction of new generation facilities, wholesale energy sales and purchases, commodity risk management and trading activities, and 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 have become 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 have not become subsidiaries of TCEH. In addition, a wholly-owned subsidiary of EFC Holdings representing a lease trust holding certain combustion turbines has become 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 further information.

***Basis of Presentation***

The consolidated financial statements of TCEH have been prepared in accordance with US GAAP. The accompanying consolidated statements of income (loss), comprehensive income (loss) and cash flows present results of operations and cash flows of TCEH for periods preceding the Merger (Predecessor) and for periods subsequent to the Merger (Successor). The consolidated financial statements have been prepared on the same basis as the audited financial statements included in TCEH's 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 immediately below and certain reclassifications in the statements of consolidated comprehensive income (loss) to conform to current period presentation. The consolidated financial statements of the Successor reflect the application of purchase accounting in accordance with the provisions of SFAS 141 and reflect the adoption of SFAS 157. All intercompany items and transactions have been eliminated in consolidation. All dollar amounts in the financial statements and tables in the notes are stated in millions of US dollars unless otherwise indicated.

***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 reported in the 2007 Annual Report 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.

	Successor		Predecessor			
	As Originally Reported	As Reclassified	As Originally Reported	As Reclassified	As Originally Reported	As Reclassified
	Period from October 11, 2007 through December 31, 2007	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006	Year Ended December 31, 2006
Operating revenues .....	\$ 179	\$ 1,671	\$ 6,330	\$ 6,884	\$ 9,549	\$ 9,396
Net gain (loss) from commodity hedging and trading activities .....	n/a	(1,492)	n/a	(554)	n/a	153
Net income (loss) .....	(1,223)	(1,223)	1,258	1,258	2,394	2,394

### *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 and the recording of \$18.3 billion of goodwill by TCEH. 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.

### *Derivative Instruments and Mark-to-Market Accounting*

TCEH enters into contracts for the purchase and sale of electricity, natural gas and other commodities and also enters into other derivative instruments such as options, swaps, futures and forwards primarily to manage commodity price and interest rate risks. If the instrument meets the definition of a derivative under SFAS 133, changes in the fair value of the derivative are recognized in net income as unrealized gains and losses, unless the criteria for certain exceptions are met, and an offsetting derivative asset or liability is recorded in the balance sheet. This recognition is referred to as "mark-to-market" accounting. The fair values of TCEH's unsettled derivative instruments under mark-to-market accounting are reported in the balance sheet as commodity and other derivative contractual assets or liabilities. When derivative instruments are settled and realized gains and losses are recorded, the previously recorded unrealized gains and losses and derivative assets and liabilities are reversed. See Note 15 and 20 for additional information regarding commodity and other derivative contractual assets and liabilities and fair value measurement. Under the election criteria of SFAS 133, TCEH may elect the "normal" purchase and sale exemption. A commodity-related derivative contract may be designated as a "normal" purchase or sale if the commodity is to be physically received or delivered for use or sale in the normal course of business. If designated as normal, the derivative contract is accounted for under the accrual method of accounting (not marked-to-market) with no balance sheet or income statement recognition of the contract until settlement.

Because derivative instruments are frequently used as economic hedges, SFAS 133 allows the designation of such instruments as cash flow or fair value hedges provided certain conditions are met. A cash flow hedge mitigates the risk associated with the variability of the future cash flows related to an asset or liability (e.g., a forecasted sale of electricity in the future at market prices or the payment of interest related to variable rate debt), while a fair value hedge mitigates risk associated with fixed future cash flows (e.g., debt with fixed interest rate payments). In accounting for changes in the fair value of cash flow hedges, derivative assets and liabilities are recorded on the balance sheet with an offset to other comprehensive income or loss to the extent the hedges are effective and the hedged transaction remains probable of occurring. If the hedged transaction becomes probable of not occurring, hedge accounting is discontinued and the amount recorded in other comprehensive income is immediately reclassified into net income. If the relationship between the hedge and the hedged transaction ceases to exist or is dedesignated, hedge accounting is discontinued, and the amounts recorded in other comprehensive income are recognized as the previously hedged transaction impacts earnings. Changes in value of fair value hedges are recorded as derivative assets or liabilities with an offset to net income, and the carrying value of the related asset or liability (hedged item) is adjusted for changes in fair value with an offset to net income. If the fair value hedge is settled prior to the maturity of the hedged item, the cumulative fair value gain or loss associated with the hedge is amortized into income over the remaining life of the hedged item. In the statement of cash flow, the effects of settlements of derivative instruments are classified consistent with the related hedged transactions.

To qualify for hedge accounting, a hedge must be considered highly effective in offsetting changes in fair value of the hedged item. Assessment of the hedge's effectiveness is tested at least quarterly throughout its term to continue to qualify for hedge accounting. Changes in fair value that represent hedge ineffectiveness, even if the hedge continues to be assessed as effective, are immediately recognized in net income. Ineffectiveness is generally measured as the cumulative excess, if any, of the change in value of the hedging instrument over the change in value of the hedged item. See Notes 12 and 15 for additional information concerning hedging activity.

Realized and unrealized gains and losses from transacting in energy-related derivative instruments are primarily reported in the income statement in net gain (loss) from commodity hedging and trading activities. In accordance with accounting rules, realized gains and losses associated with physically settled sales and purchase derivative instruments are reported in revenues and fuel, purchased power costs and delivery fees.

### ***Revenue Recognition***

TCEH records revenue from electricity sales under the accrual method of accounting. Revenues are recognized when electricity is provided to customers on the basis of periodic cycle meter readings and include an estimated accrual for the revenues earned from the meter reading date to the end of the period (unbilled revenue).

TCEH's reported revenues include, on a net basis, ERCOT electricity balancing transactions, which represent wholesale purchases and sales of electricity for real-time balancing purposes as measured in 15-minute intervals. As is industry practice, these purchases and sales with ERCOT, as the balancing energy clearinghouse agent, are reported net in the income statement. Although difficult to predict, it is expected that the balancing activity will frequently result in net revenues due in part to generation volumes exceeding retail load. TCEH believes that presentation of this activity as a component of revenues more appropriately reflects TCEH's market position.

### ***Impairment of Long-Lived Assets***

TCEH evaluates long-lived assets (including intangible assets with finite lives) for impairment whenever indications of impairment exist in accordance with the requirements of SFAS 144. The carrying value of such assets is deemed to be impaired if the projected undiscounted cash flows are less than the carrying value. If there is such impairment, a loss would be recognized based on the amount by which the carrying value exceeds the fair value. Fair value is determined primarily by discounted cash flows, supported by available market valuations, if applicable. See Note 5 for details of the impairment of the natural gas-fueled generation fleet recorded in 2008 and 2006.

Finite-lived intangibles identified as a result of purchase accounting are amortized over their estimated useful lives based on the expected realization of economic effects. See Note 3 to Financial Statements for additional information.

#### ***Goodwill and Intangible Assets with Indefinite Lives***

TCEH evaluates goodwill and intangible assets with indefinite lives for impairment at least annually (as of October 1) in accordance with SFAS 142, "Goodwill and Other Intangible Assets". The impairment tests performed are based on discounted cash flow analyses. See Note 3 for details of goodwill and intangible assets with indefinite lives, including discussion of goodwill and trade name intangible asset impairments recorded in 2008.

#### ***Amortization of Nuclear Fuel***

Amortization of nuclear fuel is calculated on the units-of-production method and is reported as fuel costs.

#### ***Major Maintenance***

Major maintenance costs incurred during generation plant outages and the costs of other maintenance activities are charged to expense as incurred. This accounting is consistent with FASB Staff Position AUG AIR-1, "Accounting for Planned Major Maintenance Activities."

#### ***Defined Benefit Pension Plans and Other Postretirement Employee Benefit Plans***

TCEH bears a portion of the costs of the EFH Corp. sponsored pension plan offering pension benefits based on either a traditional defined benefit formula or a cash balance formula to eligible employees and also offers certain health care and life insurance benefits to eligible employees and their eligible dependents upon the retirement of such employees from TCEH. Costs of pension and OPEB plans are determined in accordance with SFAS 87 and SFAS 106 and are dependent upon numerous factors, assumptions and estimates. Effective December 31, 2006, TCEH adopted SFAS 158. See Note 18 for additional information regarding pension and OPEB plans.

#### ***Stock-Based Incentive Compensation***

Prior to the Merger, EFH Corp. provided discretionary awards payable in its common stock to qualified managerial employees under its shareholder-approved long-term incentive plans. These awards were accounted for based on the provisions of SFAS 123(R), which provides for the recognition of stock-based compensation expense over the vesting period based on the grant-date fair value of those awards. In December 2007, EFH Corp.'s board of directors established its 2007 Stock Incentive Plan, which authorizes discretionary grants to directors, officers and qualified managerial employees of EFH Corp. and its affiliates (including TCEH) of non-qualified stock options, stock appreciation rights, restricted shares, shares of common stock, the opportunity to purchase shares of common stock and other EFH Corp. stock-based awards. Stock options have been granted to employees of TCEH under the plan and are being accounted for based upon the provisions of SFAS 123(R). See Note 19 for information regarding stock-based incentive compensation.

#### ***Sales and Excise Taxes***

Sales and excise taxes are accounted for as a "pass through" item on the balance sheet; i.e., the tax is billed to customers and recorded as trade accounts receivable with an offsetting amount recorded as a liability to the taxing jurisdiction.

### ***Franchise and Revenue-Based Taxes***

Unlike sales and excise taxes, franchise and gross receipt taxes are not a “pass through” item. These taxes are assessed to TCEH by state and local government bodies, based on revenues or kWh delivered, as a cost of doing business and are recorded as an expense. Rates charged to customers by TCEH are intended to recover the taxes, but TCEH is not acting as an agent to collect the taxes from customers.

### ***Income Taxes***

EFH Corp. files a consolidated federal income tax return; however, TCEH's income tax expense and related balance sheet amounts are recorded as if the entity was a stand-alone corporation. Deferred income taxes are provided for temporary differences between the book and tax basis of assets and liabilities. Previously earned investment tax credits were deferred and amortized as a reduction of income tax expense over the estimated lives of the related properties. In connection with purchase accounting, the remaining unamortized investment tax credit amount of \$300 million was eliminated.

Prior to 2007, TCEH generally accounted for uncertainty related to positions taken on tax returns based on the probable liability approach consistent with SFAS 5. Effective January 1, 2007, the company adopted FIN 48 as discussed in Note 7.

### ***Accounting for Contingencies***

The financial results of TCEH may be affected by judgments and estimates related to loss contingencies. Accruals for loss contingencies are recorded when management determines that it is probable that an asset has been impaired or a liability has been incurred and that such economic loss can be reasonably estimated. Such determinations are subject to interpretations of current facts and circumstances, forecasts of future events and estimates of the financial impacts of such events. See Note 13 for a discussion of contingencies.

### ***Cash and Cash Equivalents***

For purposes of reporting cash and cash equivalents, temporary cash investments purchased with a remaining maturity of three months or less are considered to be cash equivalents.

TCEH held an 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, totaling \$242 million, in the US Government Fund, but due to the liquidation process, the funds were not immediately made available; accordingly, such amount was reclassified from cash and cash equivalents to investment held in money market fund. TCEH received \$100 million of the funds in November 2008 and the remaining \$142 million in January 2009.

### ***Restricted Cash***

The terms of certain agreements require the restriction of cash for specific purposes. At December 31, 2008, \$1.250 billion of cash is restricted to support letters of credit. See Notes 12 and 23 for more details regarding this and other restricted cash.

### ***Property, Plant and Equipment***

As a result of purchase accounting, carrying amounts of property, plant and equipment at October 10, 2007 were adjusted to estimated fair values. Subsequent additions are recorded at cost. The cost of self-constructed property additions includes materials and both direct and indirect labor and applicable overhead, including payroll-related costs.

Depreciation of TCEH's property, plant and equipment is calculated on a straight-line basis over the estimated service lives of the properties. As is common in the industry, the Predecessor historically recorded depreciation expense using composite depreciation rates that reflect blended estimates of the lives of major asset components as compared to depreciation expense calculated on an asset-by-asset basis. Effective with the Merger, depreciation expense for TCEH's properties is calculated on an asset-by-asset basis. Estimated depreciable lives are based on management's estimates of the assets' economic useful lives.

### ***Capitalized Interest***

Interest related to qualifying construction projects and qualifying software projects is capitalized in accordance with SFAS 34. See Note 23 for details of amounts.

### ***Inventories***

All inventories are reported at the lower of cost (on a weighted average basis) or market unless expected to be used in the generation of electricity. In connection with purchase accounting, inventory amounts at October 10, 2007 were recorded at fair value. Also see discussion immediately below regarding environmental allowances and credits.

### ***Environmental Allowances and Credits***

Effective with the Merger, TCEH began accounting for all environmental allowances and credits as identifiable intangible assets with finite lives that are subject to amortization. The recorded values of these intangible assets were originally established reflecting fair value determinations as of the date of the Merger under purchase accounting. Amortization expense associated with these intangible assets is recognized on a unit of production basis as the allowances or credits are consumed in generation operations. In accordance with SFAS 144, the environmental allowances and credits are assessed for impairment when conditions or events occur that could affect the carrying value of the assets. See Note 3 for details of impairment amounts recorded in 2008. TCEH previously accounted for environmental allowances and credits as inventory. Both accounting methods are acceptable under GAAP.

### ***Investments***

Investments in a nuclear decommissioning trust fund are carried at market value in the balance sheet. Investments in unconsolidated business entities over which TCEH has significant influence but does not maintain effective control, generally representing ownership of at least 20% and not more than 50% of common equity, are accounted for under the equity method. Assets related to employee benefit plans represent investments held to satisfy deferred compensation liabilities and are recorded at market value. See Note 16 for details of investments.

### ***Changes in Accounting Standards***

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. As SFAS 161 provides only disclosure requirements, the adoption of this standard will not have any effect on TCEH's reported results of operations or financial condition. TCEH will provide the enhanced disclosures in its Form 10-Q for the three months ended March 31, 2009.

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 was effective upon issuance, including prior periods for which financial statements had not been issued. TCEH has determined this FSP does not change its approach for measuring fair value of financial assets.

Effective December 31, 2008, TCEH adopted FSP SFAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities." This FSP amends SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" to require additional disclosures about transfers of financial assets. It also amends FIN 46R, "Consolidation of Variable Interest Entities," to require additional disclosures about an entity's involvement with variable interest entities. The disclosures required by this FSP are intended to provide greater transparency about a transferor's continuing involvement with transferred financial assets and an entity's involvement with variable interest entities and qualifying special purpose entities (SPEs). As the FSP provides only disclosure requirements, the adoption of this FSP did not have any effect on TCEH's reported results of operations, financial condition or cash flows. See Note 11 for related disclosures.

In December 2008, the FASB issued FSP SFAS 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets." This FSP amends SFAS 132(R) to provide enhanced disclosures regarding how investment allocation decisions are made and certain aspects of fair value measurements on plan assets. The disclosures required by this FSP are intended to provide transparency related to the types of assets and associated risks in an employer's defined benefit pension or other postretirement employee benefits plan and events in the economy and markets that could have a significant effect on the value of plan assets. This FSP is effective for fiscal years ending after December 15, 2009. As the FSP provides only disclosure requirements, the adoption of this FSP will not have any effect on TCEH's reported results of operations, financial condition or cash flows. TCEH is evaluating the impact of this FSP on its financial statement disclosures.

## **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 upon finalization of purchase accounting in 2008 totaled \$23.2 billion. See Note 3 for disclosures related to goodwill, including an impairment recorded in the fourth quarter of 2008.

Purchase accounting impacts, including goodwill recognition, have been "pushed down", resulting in 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 \$18.3 billion of goodwill.

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 following table summarizes the components of the final purchase price allocation (billions of dollars):

Purchase price assigned to TCEH .....		\$ 28.4
Property, plant and equipment .....	20.0	
Intangible assets.....	4.4	
Other assets.....	<u>3.7</u>	
Total assets acquired.....	28.1	
Short-term borrowings and long-term debt.....	5.9	
Deferred tax liabilities .....	6.7	
Other liabilities .....	<u>5.4</u>	
Total liabilities assumed.....	18.0	
Net identifiable assets acquired.....		<u>10.1</u>
Goodwill.....		<u>\$ 18.3</u>

The following table summarizes the change in the total amount of goodwill during 2008 as a result of purchase accounting (billions of dollars):

Goodwill at December 31, 2007 .....		\$ 18.1
Purchase price allocation adjustments .....		0.1
Property, plant and equipment .....	0.3	
Intangible assets.....	<u>—</u>	
Other assets.....	<u>—</u>	
Total assets acquired.....	0.3	
Deferred income tax liabilities .....	(0.2)	
Other liabilities .....	<u>—</u>	
Total liabilities assumed.....	(0.2)	
Net identifiable assets acquired.....		<u>0.1</u>
Goodwill at completion of purchase accounting.....		<u>\$ 18.3</u>

The above changes largely relate to finalization of fair values of natural gas-fueled generation plants and amounts related to the Capgemini outsourcing agreement, as well as the effects on related deferred income taxes.

During 2008, additional exit liabilities totaling \$28 million were recorded largely in connection with the termination of outsourcing arrangements with Capgemini under change of control provisions of such arrangements (also see Note 17). This amount is expected to be settled no later than June 30, 2011, the targeted date of completion of transition of outsourced activities back to EFH Corp. or to service providers.

### 3. GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

#### *Goodwill*

Reported goodwill as of December 31, 2008 and 2007 totaled \$10.3 billion and \$18.1 billion, respectively. None of this goodwill is being deducted for tax purposes.

As discussed in Note 2, TCEH accounted for the Merger under purchase accounting. The total goodwill amount recorded as a result of purchase accounting totaled \$18.3 billion representing the excess of the purchase price over the fair value of the tangible and identifiable intangible net assets acquired in the Merger; subsequently, an impairment charge was recorded in the fourth quarter of 2008 (discussed immediately below).

#### *Goodwill and Trade Name Intangible Asset Impairments*

In the fourth quarter of 2008, TCEH recorded a goodwill impairment charge totaling \$8.0 billion, which is not deductible for income tax purposes. This amount represents TCEH's best estimate of impairment pending finalization of the fair value calculations, which is expected in the first quarter of 2009. The impairment primarily arises from the dislocation in the capital markets that has increased interest rate spreads and the resulting discount rates used in estimating fair values and the effect of recent declines in market values of debt and equity securities of comparable companies.

Also in the fourth quarter of 2008, TCEH recorded a trade name intangible asset impairment charge totaling \$481 million (\$310 million after-tax). The estimated fair value of this intangible asset is based on an assumed royalty methodology. The impairment primarily arises from the increase in the discount rate used in estimating fair value.

Although the annual goodwill and intangible assets with indefinite lives impairment test date set by management is October 1, management determined that in consideration of the continuing deterioration of securities values during the fourth quarter of 2008, an impairment testing trigger occurred subsequent to that test date; consequently, the impairment charges were based on estimated fair values at December 31, 2008.

The impairment determination involves significant assumptions and judgments in estimating the enterprise value of TCEH and the fair values of its assets and liabilities.

#### *Identifiable Intangible Assets*

Identifiable intangible assets reported in the balance sheet are comprised of the following:

	Successor					
	As of December 31, 2008			As of December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Retail customer relationship .....	\$ 463	\$ 130	\$ 333	\$ 463	\$ 79	\$ 384
Favorable purchase and sales contracts .....	700	249	451	702	68	634
Capitalized in-service software.....	48	13	35	41	3	38
Environmental allowances and credits .....	994	121	873	1,525	19	1,506
Mining development costs .....	19	2	17	—	—	—
Total intangible assets subject to amortization ..	<u>\$2,224</u>	<u>\$ 515</u>	1,709	<u>\$2,731</u>	<u>\$ 169</u>	2,562
Trade name (not subject to amortization).....			955			1,436
Mineral interests (not currently subject to amortization) .....			110			139
Total intangible assets .....			<u>\$2,774</u>			<u>\$4,137</u>

Amortization expense related to intangible assets consisted of:

	Successor			Predecessor	
	Useful lives at December 31, 2008 (weighted average in years)	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Retail customer relationship .....	4	\$ 51	\$ 79	\$ —	\$ —
Favorable purchase and sales contracts .....	10	168	72	—	—
Capitalized in-service software .....	7	10	2	4	2
Environmental allowances and credits .....	29	102	20	—	—
Mining development costs .....	7	1	—	—	—
Total amortization expense .....		<u>\$ 332</u>	<u>\$ 173</u>	<u>\$ 4</u>	<u>\$ 2</u>

As discussed in Note 2, purchase accounting impacts were “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 estimated fair value of the 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 intangibles 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, based on observable prices or estimates, of commodity contracts for which: 1) TCEH has made the “normal” purchase or sale election allowed by SFAS 133 or 2) the contracts that 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 23).
- *Trade Name* — The trade name intangible asset represents the estimated fair value of the TXU Energy trade name, and was determined to be an indefinite-lived asset not subject to amortization. This intangible asset will be evaluated for impairment at least annually (as of October 1) in accordance with SFAS 142, “Goodwill and Other Intangible Assets”. See above for discussion of an impairment charge recorded in 2008.
- *Environmental Allowances and Credits* — This intangible asset represents the fair value, based on observable prices or estimates, of environmental credits held by TCEH, substantially all of which are expected to be used in its power generation activity. These credits will be amortized to fuel and purchase power costs utilizing a units-of-production method.

#### ***Impairment of Environmental Allowances and Credits 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 requires reductions of SO<sub>2</sub> and NO<sub>x</sub> emissions from power generation facilities in such states. The SO<sub>2</sub> 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 NO<sub>x</sub> 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 SO<sub>2</sub> reductions under the Acid Rain Program.

In the second quarter of 2008, TCEH determined that certain of its SO<sub>2</sub> 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 SO<sub>2</sub> 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 July 2008 decision, 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 SO<sub>2</sub> 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 SO<sub>2</sub> allowances than it would need to comply with the Acid Rain Program. While there continued to be a market for SO<sub>2</sub> allowances, the D.C. Circuit Court's decision resulted in a material decrease in the market price of SO<sub>2</sub> allowances.

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

In December 2008, in response to an EPA petition, the D.C. Circuit Court reversed, in part, its previous ruling. Such reversal confirmed CAIR is not valid, but allowed it to remain in place while the EPA revises CAIR to correct the previously identified shortcomings. Since the D.C. Circuit Court did not prescribe a deadline for this revision, at this time, TCEH cannot predict how or when the EPA may revise CAIR.

***Estimated Amortization of Intangible Assets*** — The estimated aggregate amortization expense of intangible assets for each of the five succeeding fiscal years from December 31, 2008 is as follows:

<u>Year</u>	<u>Successor</u>
2009.....	\$ 327
2010.....	199
2011.....	158
2012.....	124
2013.....	109

#### 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. In addition, EFH Corp. subsidiaries contributed certain assets and liabilities to TCEH. These contributions included assets and liabilities associated with the three new lignite/coal-fueled generation units currently under development and certain natural gas hedge positions. 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 gain (loss) 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.

	<u>Predecessor</u>	
	<u>Period from January 1, 2007 through October 10, 2007</u>	<u>Year Ended December 31, 2006</u>
Revenues:		
TCEH.....	\$ 6,878	\$9,384
Contributed subsidiaries.....	<u>6</u>	<u>12</u>
Combined.....	<u>\$ 6,884</u>	<u>\$9,396</u>
Net gain (loss) from commodity hedging and trading activities (a):		
TCEH.....	\$ (264)	\$ 211
Contributed subsidiaries.....	<u>(290)</u>	<u>(58)</u>
Combined.....	<u>\$ (554)</u>	<u>\$ 153</u>
Net income (loss):		
TCEH.....	\$ 1,448	\$2,435
Contributed subsidiaries.....	<u>(190)</u>	<u>(41)</u>
Combined.....	<u>\$ 1,258</u>	<u>\$2,394</u>

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

## **5. IMPAIRMENT OF NATURAL GAS-FUELED GENERATION FLEET**

In the fourth quarter of 2008, TCEH performed an evaluation of its natural gas-fueled generation fleet for impairment in accordance with the requirements of SFAS 144, which provides that long-lived assets should be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The impairment test was triggered by a determination that it was more likely than not that certain generation units would be retired or mothballed (idled) earlier than previously expected. The natural gas-fueled generation units are generally operated to meet peak demands for electricity and the fleet is tested for impairment as an asset group. As a result of the evaluation, it was determined that an impairment existed, and a charge of \$229 million (\$147 million after-tax) was recorded to write down the assets to fair value of approximately \$28 million, which was determined based on discounted estimated future cash flows.

In 2006, TCEH also performed an evaluation of its natural gas-fueled generation fleet for impairment in accordance with the requirements of SFAS 144. In consideration of the lignite/coal-fueled generation plant development program then underway, among other factors, TCEH determined at that time that it was more likely than not that its natural gas-fueled generation units would be sold or otherwise disposed of before the end of their previously estimated useful lives and should be tested for impairment. As a result, it was determined that an impairment existed, and a charge of \$198 million (\$129 million after-tax) was recorded in 2006 to write down the assets to fair value, which was determined based on discounted estimated future cash flows.

The impairments in both years were reported in other deductions.

## **6. CUSTOMER APPRECIATION BONUS**

In 2006, TCEH announced a special customer appreciation bonus program. Under the program, a \$100 bonus was provided to residential customers receiving service as of October 29, 2006 and living in areas where TCEH offered its then-regulated rate, which expired January 1, 2007 in accordance with applicable law. Eligible customers were not required to continue to receive service from TCEH to receive the bonus. The bonus was paid out in the form of credits on customer bills, with approximately \$40 million paid out in 2006 and the balance fully settled in 2007. The bonus program resulted in a charge of \$162 million (\$105 million after-tax) in 2006. The charge was recorded as a reduction to revenue.

## 7. ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES (FIN 48)

Effective January 1, 2007, TCEH adopted FIN 48. FIN 48 requires that each tax position be reviewed and assessed with recognition and measurement of the tax benefit based on a “more-likely-than-not” standard with respect to the ultimate outcome, regardless of whether this assessment is favorable or unfavorable. TCEH applied FSP FIN 48-1 to determine if each tax position was effectively settled for the purpose of recognizing previously uncertain tax positions. TCEH completed its review and assessment of uncertain tax positions and in the 2007 Predecessor period recorded a net charge to membership interests and an increase to noncurrent liabilities of \$36 million in accordance with the new accounting rule.

EFH Corp. and its subsidiaries file income tax returns in US federal, state and foreign jurisdictions and are subject to examinations by the IRS and other taxing authorities. Examinations of income tax returns filed by EFH Corp. and any of its subsidiaries for the years ending prior to January 1, 2003 are complete. In the fourth quarter 2008, EFH Corp. was notified of the commencement of the IRS audit of tax years 2003 to 2006. The audit is expected to require two years to complete. Texas franchise tax return periods under examination or still open for examination range from 2003 to 2007.

TCEH classifies interest and penalties related to uncertain tax positions as income tax expense. The amount of interest and penalties included in income tax expense totaled \$24 million in 2008, \$6 million for the period October 11, 2007 through December 31, 2007 and \$12 million for the period January 1, 2007 through October 10, 2007. Noncurrent liabilities included a total of \$76 million and \$51 million in accrued interest at December 31, 2008 and 2007, respectively. All interest amounts are after-tax.

The following table summarizes the changes to the uncertain tax positions, reported in other noncurrent liabilities in the consolidated balance sheet, during the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Balance at January 1 excluding interest and penalties	\$ 747	\$ 650
Additions based on tax positions related to prior years.....	45	69
Reductions based on tax positions related to prior years.....	(37)	(39)
Additions based on tax positions related to the current year.....	34	72
Settlements with taxing authorities.....	<u>—</u>	<u>(5)</u>
Balance at December 31 excluding interest and penalties.....	<u>\$ 789</u>	<u>\$ 747</u>

Of the balance at December 31, 2008, \$754 million represents tax positions for which the uncertainty relates to the timing of recognition in tax returns. The disallowance of such positions would not affect the effective tax rate, but would accelerate the payment of cash to the taxing authority to an earlier period.

With respect to tax positions for which the ultimate deductibility is uncertain (permanent items), should EFH Corp. sustain such positions on income tax returns previously filed, TCEH's liabilities recorded would be reduced by \$35 million, resulting in increased net income and a favorable impact on the effective tax rate.

TCEH does not expect that the total amount of uncertain tax positions for the positions assessed as of the date of the adoption will significantly increase or decrease within the next 12 months.

## 8. TEXAS MARGIN TAX

In May 2006, the Texas legislature enacted a new law that reformed the Texas franchise tax system and replaced it with a new tax system, referred to as the Texas margin tax. The Texas margin tax has been determined to be an income tax for accounting purposes. In accordance with the provisions of SFAS 109, which require that deferred tax assets and liabilities be adjusted for the effects of new income tax legislation in the period of enactment, TCEH estimated and recorded a deferred tax charge of \$43 million in 2006.

In June 2007, an amendment to this law was enacted that included clarifications and technical changes to the provisions of the tax calculation. In the 2007 Predecessor period, TCEH recorded a deferred tax benefit of \$32 million, essentially all of which related to changes in the rate at which a tax credit is calculated as specified in the new law. This estimated benefit is based on the Texas margin tax law in its current form and the current guidance issued by the Texas Comptroller of Public Accounts.

The Texas margin tax was effective for returns filed on or after January 1, 2008. TCEH's return filed during 2008 was based upon the taxable margin earned in 2007. Beginning January 1, 2007, margin tax has been accrued based on revenues reduced by deductions provided in the amended law.

## 9. INCOME TAXES

The components of TCEH's income tax expense are as follows:

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Current:				
US federal .....	\$ (71)	\$ (210)	\$ 666	\$ 1,090
State .....	38	10	10	1
Non-US .....	—	—	—	2
Total .....	<u>(33)</u>	<u>(200)</u>	<u>676</u>	<u>1,093</u>
Deferred:				
US federal .....	(390)	(439)	(22)	114
State .....	12	(12)	(48)	64
Non-US .....	—	—	—	(1)
Total .....	<u>(378)</u>	<u>(451)</u>	<u>(70)</u>	<u>177</u>
Amortization of investment tax credits .....	—	—	(11)	(15)
Total .....	<u>\$ (411)</u>	<u>\$ (651)</u>	<u>\$ 595</u>	<u>\$ 1,255</u>

Reconciliation of income taxes computed at the US federal statutory rate to income tax expense:

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Income (loss) before income taxes .....	<u>\$(9,273)</u>	<u>\$(1,874)</u>	<u>\$ 1,853</u>	<u>\$3,649</u>
Income taxes at the US federal statutory rate of 35%.....	(3,246)	(656)	649	\$1,277
Lignite depletion allowance.....	(29)	(5)	(30)	(51)
Production activities deduction .....	—	6	(9)	(14)
Nondeductible interest expense .....	5	—	—	—
Amortization of investment tax credits .....	—	—	(11)	(15)
Preferred securities cost.....	—	—	—	6
Impairment of goodwill.....	2,800	—	—	—
State income taxes, net of federal tax benefit.....	29	(5)	11	—
Texas margin tax – deferred tax adjustments (Note 8) ..	—	—	(32)	43
Accrual of interest.....	22	6	12	6
Other, including audit settlements .....	<u>8</u>	<u>3</u>	<u>5</u>	<u>3</u>
Income tax expense (benefit) .....	<u>(411)</u>	<u>(651)</u>	<u>595</u>	<u>\$1,255</u>
Effective tax rate .....	4.4%	34.7%	32.1%	34.4%

**Deferred Income Tax Balances**

Deferred income taxes provided for temporary differences based on tax laws in effect at December 31, 2008 and 2007, balance sheet dates are as follows:

	Successor					
	December 31, 2008			December 31, 2007		
	Total	Current	Noncurrent	Total	Current	Noncurrent
<b>Deferred Income Tax Assets</b>						
Alternative minimum tax credit carryforwards....	\$ 389	\$ —	\$ 389	\$ 338	\$ 32	\$ 306
Net operating loss (NOL) carryforwards .....	56	—	56	9	—	9
Unfavorable purchase and sales contracts.....	259	—	259	269	—	269
Employee benefit obligations.....	58	26	32	39	15	24
Other .....	<u>196</u>	<u>30</u>	<u>166</u>	<u>106</u>	<u>2</u>	<u>104</u>
Total.....	<u>958</u>	<u>56</u>	<u>902</u>	<u>761</u>	<u>49</u>	<u>712</u>
<b>Deferred Income Tax Liabilities</b>						
Property, plant and equipment.....	4,460	—	4,460	4,770	—	4,770
Commodity contracts and interest rate swaps.....	643	32	611	257	32	225
Identifiable intangible assets .....	1,033	—	1,033	1,564	—	1,564
Debt fair value discounts.....	45	—	45	72	—	72
Other .....	<u>5</u>	<u>3</u>	<u>2</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total .....	<u>6,186</u>	<u>35</u>	<u>6,151</u>	<u>6,663</u>	<u>32</u>	<u>6,631</u>
<b>Net Deferred Income Tax (Asset) Liability .....</b>	<u>\$ 5,228</u>	<u>\$ (21)</u>	<u>\$ 5,249</u>	<u>\$ 5,902</u>	<u>\$ (17)</u>	<u>\$ 5,919</u>

At December 31, 2008, TCEH had \$389 million of alternative minimum tax credit carryforwards (AMT) available to offset future tax payments. The AMT credit carryforwards have no expiration date. At December 31, 2008, TCEH had net operating loss (NOL) carryforwards for federal income tax purposes of \$160 million that expire between 2023 and 2028. The NOL carryforwards can be used to offset future taxable income. TCEH expects to utilize all of its NOL carryforwards prior to their expiration dates.

The income tax effects of the components included in accumulated other comprehensive income at December 31, 2008 and 2007 totaled a net deferred tax asset of \$131 million and a net deferred tax asset of \$95 million, respectively.

See Note 7 for discussion regarding accounting for uncertain tax positions (FIN 48).

## 10. OTHER INCOME AND DEDUCTIONS

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Other income:				
Penalty received for nonperformance under a coal transportation agreement .....	—	\$ —	\$ 6	\$ —
Mineral rights royalty income .....	4	1	9	4
Net gain on sale of assets (a) .....	4	—	1	13
Sales tax refunds .....	—	—	3	3
Insurance recoveries (b) .....	21	—	—	2
Other .....	<u>5</u>	<u>1</u>	<u>3</u>	<u>1</u>
Total other income .....	<u>\$ 34</u>	<u>\$ 2</u>	<u>\$ 22</u>	<u>\$ 23</u>
Other deductions:				
Impairment of trade name intangible asset (Note 3) .....	\$ 481	\$ —	\$ —	\$ —
Impairment of emission allowances intangible assets (Note 3) .....	501	—	—	—
Charge for impairment of natural gas-fueled generation fleet (Note 5) .....	229	—	—	198
Charge related to Lehman bankruptcy (c) .....	26	—	—	—
Charge related to termination of rail car lease (d) .....	—	—	10	—
Credit related to impaired leases (e) .....	—	—	(48)	(2)
Equity losses of affiliate holding investment in Capgemini .....	10	2	5	10
Litigation/regulatory settlements .....	7	—	5	6
Inventory write-off related to natural gas-fueled generation plants .....	—	—	—	3
Other .....	<u>9</u>	<u>3</u>	<u>8</u>	<u>(5)</u>
Total other deductions .....	<u>\$ 1,263</u>	<u>\$ 5</u>	<u>\$ (20)</u>	<u>\$ 210</u>

(a) The 2006 period includes \$12 million in gains on land sales.

(b) 2008 amount represents insurance recovery for damage to mining equipment.

(c) 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.

(d) Represents costs associated with termination and refinancing of a rail car lease.

(e) In 2004, TCEH recorded a charge 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 \$48 million reduction in the related 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 intends to operate these assets for its own benefit.

## 11. 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, which is a special purpose entity created for the purpose of purchasing receivables from the originators and is a consolidated wholly-owned bankruptcy-remote direct subsidiary of EFH Corp. TXU Receivables Company sells undivided interests in the purchased accounts receivable for cash to special purpose entities established by financial institutions (the funding entities).

The maximum amount currently available under the accounts receivable securitization program is \$700 million, and the program funding to the originators was \$416 million at December 31, 2008. 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-. The originators' customer deposits, which totaled \$108 million, reduced funding availability as of December 31, 2008 because TCEH's credit ratings were lower than Ba3/BB-.

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 and 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 payable, which is reported in trade accounts receivable, totaled \$268 million and \$296 million at December 31, 2008 and 2007, respectively.

The discount from face amount on the purchase of receivables from the originators principally funds program fees paid to the funding entities. The program fees, which are also referred to as losses on sale of the receivables under SFAS 140, consist primarily of interest costs on the underlying financing. 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., which serves as the collection agent of the receivables. EFH Corp. maintains collection responsibilities through EFH Corporate Services Company in order to efficiently service and maintain the integrity of the receivables portfolio. The servicing fee compensates EFH Corporate Services Company for serving as the collection agent of the receivables. Responsibilities of the collection agent include, but are not limited to, maintaining detailed accounts receivable collection records and interfacing with customers regarding payment options and terms of current and past-due accounts. In the event EFH Corporate Services Company is relieved of its duties as collection agent because of default under the program, the funding entities assume responsibility as the collection agent.

The program fees represent essentially all the net incremental costs of the program on a consolidated basis and are reported in SG&A expenses. Fee amounts were as follows:

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Program fees.....	\$ 25	\$ 9	\$ 26	\$ 34
Program fees as a percentage of average funding (annualized) .....	5.2%	9.5%	6.4%	5.8%
Servicing fees.....	4	1	3	4

The accounts receivable balance reported in the December 31, 2008 consolidated balance sheet has been reduced by \$684 million face amount of trade accounts receivable sold to TXU Receivables Company, partially offset by the inclusion of \$268 million of subordinated notes receivable from TXU Receivables Company. Funding under the program increased \$53 million in 2008 and decreased \$178 million in 2007 and \$41 million in 2006. 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:

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Cash collections on accounts receivable.....	\$ 6,393	\$ 1,538	\$ 5,169	\$ 7,274
Face amount of new receivables purchased.....	(6,418)	(1,194)	(5,472)	(7,238)
Discount from face amount of purchased receivables.....	29	9	30	38
Program fees paid.....	(25)	(9)	(26)	(34)
Servicing fees paid.....	(4)	(1)	(3)	(4)
Increase (decrease) in subordinated notes payable.....	(28)	(120)	257	5
Operating cash flows used by (provided to) EFC Holdings under the program.....	<u>\$ (53)</u>	<u>\$ 223</u>	<u>\$ (45)</u>	<u>\$ 41</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	
	December 31, 2008	December 31, 2007
Gross wholesale and trade accounts receivable.....	\$ 1,474	\$ 1,214
Undivided interest in retail accounts receivable sold by TXU Receivables Company .....	(684)	(659)
Subordinated notes receivable from TXU Receivables Company .....	268	296
Allowance for uncollectible accounts.....	<u>(64)</u>	<u>(24)</u>
Trade accounts receivable — reported in balance sheet.....	<u>\$ 994</u>	<u>\$ 827</u>

Gross trade accounts receivable at December 31, 2008 and 2007 included unbilled revenues of \$427 million and \$404 million, respectively.

**Allowance for Uncollectible Accounts Receivable**

<u>Predecessor:</u>	
Allowance for uncollectible accounts receivable as of December 31, 2005 ...	\$ 31
Increase for bad debt expense.....	67
Decrease for account write-offs.....	(79)
Changes related to receivables sold.....	4
Other (a) .....	<u>(15)</u>
Allowance for uncollectible accounts receivable as of December 31, 2006 ...	8
Increase for bad debt expense.....	44
Decrease for account write-offs.....	(54)
Changes related to receivables sold.....	<u>25</u>
Allowance for uncollectible accounts receivable as of October 10, 2007 .....	<u>\$ 23</u>
<u>Successor:</u>	
Allowance for uncollectible accounts receivable as of October 11, 2007 .....	\$ 23
Increase for bad debt expense.....	13
Decrease for account write-offs.....	<u>(12)</u>
Allowance for uncollectible accounts receivable as of December 31, 2007 ...	24
Increase for bad debt expense.....	81
Decrease for account write-offs.....	(67)
Charge related to Lehman bankruptcy .....	<u>26</u>
Allowance for uncollectible accounts receivable as of December 31, 2008 ...	<u>\$ 64</u>

- (a) Reflects an allowance established in 2005 for a coal contract dispute that was reversed upon settlement in 2006. (Allowance and subsequent reversal are recorded in other deductions.)

## 12. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

### *Short-Term Borrowings*

At December 31, 2008, TCEH had outstanding short-term borrowings of \$900 million at a weighted average interest rate of 3.95%, excluding certain customary fees, at the end of the period. At December 31, 2007, TCEH and its subsidiaries 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 December 31, 2008 are presented below. The facilities are all senior secured facilities.

Authorized Borrowers and Facility	Maturity Date	At December 31, 2008			
		Facility Limit	Letters of Credit	Cash Borrowings	Availability
TCEH Delayed Draw Term Loan Facility (a) .....	October 2014	\$ 4,100	\$ —	\$ 3,562	\$ 522
TCEH Revolving Credit Facility (b).....	October 2013	2,700	7	900	1,767
TCEH Letter of Credit Facility (c).....	October 2014	1,250	—	1,250	—
Subtotal TCEH (d) .....		<u>\$ 8,050</u>	<u>\$ 7</u>	<u>\$ 5,712</u>	<u>\$ 2,289</u>
TCEH Commodity Collateral Posting Facility (e)	December 2012	Unlimited	\$ —	\$ —	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. Availability amount excludes \$9 million of undrawn commitments from a subsidiary of Lehman Brothers Holding Inc. (Lehman) that has filed for bankruptcy under Chapter 11 of the US Bankruptcy Code and \$7 million of requested draws that have not been funded by the Lehman subsidiary.
- (b) Facility to be used for letters of credit and borrowings for general corporate purposes. Borrowings are classified as short-term borrowings. Availability amount includes \$144 million of undrawn commitments from the Lehman subsidiary that is only available from the fronting banks in the form of letters of credit and excludes \$26 million of requested draws that have not been funded by the Lehman subsidiary.
- (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 \$760 million issued as of December 31, 2008 are supported by the restricted cash, and the remaining letter of credit availability totals \$490 million.
- (d) Pursuant to PUCT rules, TCEH is required to maintain available capacity under its credit facilities to assure adequate credit worthiness of TCEH's REP subsidiaries, including the ability to return retail customer deposits, if necessary. As a result, at December 31, 2008, the total availability under the TCEH credit facilities should be further reduced by \$266 million.
- (e) Revolving facility to be used to fund cash collateral posting requirements for specified volumes of natural gas hedges. As of December 31, 2008, cash borrowings under the facility had been repaid. See "TCEH Senior Secured Facilities" below for additional information.

## Long-Term Debt

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

	Successor	
	December 31, 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
1.400% Floating Series 2001D-2 due May 1, 2033 (c) .....	97	97
2.500% Floating Taxable Series 2001I due December 1, 2036 (d).....	62	62
1.400% 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 (e).....	(161)	(175)
Senior Secured Facilities:		
5.456% TCEH Initial Term Loan Facility maturing October 10, 2014 (f)(g).....	16,244	16,409
5.150% TCEH Delayed Draw Term Loan Facility maturing October 10, 2014 (f)(g).....	3,562	2,150
3.986% TCEH Letter of Credit Facility maturing October 10, 2014 (g).....	1,250	1,250
0.449% TCEH Commodity Collateral Posting Facility maturing December 31, 2012 (h).....	—	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.....	159	161
Unamortized fair value discount (e).....	(6)	(9)
Total.....	29,470	28,604
Less amount due currently.....	(261)	(195)
Total long-term debt.....	<u>\$ 29,209</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 December 31, 2008. These series are in a daily interest rate mode and are classified as long-term as they are supported by long-term irrevocable letters of credit.
- (d) Interest rate in effect at December 31, 2008. This series is in a weekly interest rate mode and is classified as long-term as it is supported by long-term irrevocable letters of credit.
- (e) Amount represents unamortized fair value adjustments recorded under purchase accounting.
- (f) Interest rate swapped to fixed on \$17.55 billion principal amount.
- (g) Interest rates in effect at December 31, 2008.

- (h) Interest rates in effect at December 31, 2008, excluding quarterly maintenance fee discussed below. See "Credit Facilities" above for more information.

**Debt-Related Activity in 2008** — Repayments of long-term debt in 2008 totaling \$854 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, repayment of \$413 million of borrowings under the TCEH Commodity Collateral Posting Facility, which fully repaid borrowings under the facility, and other repayments totaling \$34 million, principally related to leases. Payments at scheduled maturity dates included \$165 million repaid under the TCEH Initial Term Loan Facility.

Increases in long-term debt during 2008 totaling \$1.685 billion consisted of borrowings under the TCEH Delayed Draw Term Loan Facility of \$1.412 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.

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 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. TCEH 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 more than offsets the liquidity that was effectively lost as a result of the default by affiliates of Lehman under TCEH's Senior Secured Facilities.

TCEH will make its May 2009 interest payment by using the PIK feature of the TCEH Toggle Notes. The election will increase the interest rate on the TCEH Toggle Notes from 10.50% to 11.25% during the interest period covered by the PIK election and require TCEH to issue an additional approximately \$98.5 million principal amount of TCEH Toggle Notes on May 1, 2009. In addition, the election will increase liquidity by an amount equal to approximately \$92 million, constituting the amount of cash interest that otherwise would have been payable on May 1, 2009, and increase the expected annual cash interest expense by approximately \$10 million, constituting the additional cash interest that would be payable with respect to the \$98.5 million of additional toggle notes.

**Maturities** — Long-term debt maturities as of December 31, 2008 are as follows:

<u>Year</u>	
2009 .....	\$ 251
2010 .....	214
2011 .....	630
2012 .....	215
2013 .....	273
Thereafter.....	27,895
Unamortized fair value discount .....	(167)
Capital lease obligations.....	159
Total .....	<u>\$ 29,470</u>

**Long-Term Debt-Related Activity in 2007** — TCEH issued, reacquired or made scheduled principal payments on long-term debt in 2007 as follows (all amounts presented are principal):

	Successor				Predecessor	
	Post-Merger		Merger-Date		Issuances	Repayments / Repurchases
	Issuances	Repayments / Repurchases	Issuances	Repayments / Repurchases		
Senior secured facilities:						
Initial term loan facility.....	\$ —	\$ (41)	\$16,450	\$ —	\$ —	\$ —
Delayed draw term loan facility.....	—	—	2,150	—	—	—
Letter of credit facility.....	—	—	1,250	—	—	—
Commodity collateral posting facility .....	—	—	382	—	—	—
Senior unsecured interim facilities:						
Initial cash-pay loans.....	—	(5,000)	5,000	—	—	—
Initial toggle loans.....	—	(1,750)	1,750	—	—	—
Senior notes:						
Senior cash-pay notes.....	5,000	—	—	—	—	—
Senior toggle notes.....	1,750	—	—	—	—	—
Floating rate senior notes (a).....	—	—	—	(1,000)	1,000	—
Fixed senior notes.....	—	—	—	(1,242)	—	—
Secured promissory note.....	—	—	—	—	65	—
Pollution control revenue bonds.....	—	—	—	—	—	(143)
Capital lease obligations.....	16	(4)	—	—	59	(8)
Other long-term debt.....	—	—	—	—	—	(7)
Total.....	<u>\$ 6,766</u>	<u>\$ (6,795)</u>	<u>\$26,982</u>	<u>\$ (2,242)</u>	<u>\$ 1,124</u>	<u>\$ (158)</u>

(a) Notes were subject to mandatory redemption upon closing of the Merger.

**Other Debt-Related Activity in 2007** — In September 2007, EFH Corp. commenced offers to purchase and consent solicitations with respect to \$250 million in aggregate principal amount of TCEH's outstanding 6.125% Senior Notes due 2008 and \$1.0 billion in aggregate principal amount of TCEH's outstanding 7.000% Senior Notes due 2013. The offers were contingent upon the closing of the Merger. In October 2007, TCEH purchased an aggregate of \$247 million and \$995 million principal amounts of these notes, respectively, for \$248 million and \$1.097 billion, respectively, excluding unpaid interest. An interest rate swap related to \$250 million principal amount of these notes was settled for \$2 million upon extinguishment of the debt.

In September 2007, subsidiaries of TCEH acquired certain assets of Alcoa Inc. relating to the operation of a lignite mine near Sandow, including partial ownership of the lignite reserves in the mine, for a purchase price of \$135 million, including cash of \$70 million and a promissory note of \$65 million that was paid at maturity on January 5, 2009 at a fixed interest rate of 7.100%, which is reported as a current liability as of December 31, 2008.

In September 2007, TCEH refinanced an existing lease of rail cars, which had been accounted for as an operating lease, with a lease with another party that has been accounted for as a capital lease, resulting in \$52 million reported as long-term debt. In late 2007, TCEH also entered into leases related to mining equipment that have been accounted for as capital leases totaling \$23 million reported as long-term debt.

In May 2007, TCEH redeemed at par the Sabine River Authority of Texas Series 2006A and 2006B pollution control revenue bonds with aggregate principal amounts of \$47 million and \$46 million, respectively, and the Trinity River Authority of Texas Series 2006 pollution control revenue bonds with an aggregate principal amount of \$50 million. All three bond series were issued in November 2006 in conjunction with the development of eight coal-fueled generation units, which has been cancelled. Restricted cash retained upon issuance of the bonds was used to fund substantially all of the redemption amounts.

In March 2007, TCEH issued floating rate senior notes with an aggregate principal amount of \$1.0 billion with a floating rate based on LIBOR plus 50 basis points. The notes were to mature in September 2008, but in accordance with their terms, were redeemed upon closing of 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 \$21.956 billion at December 31, 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 December 31, 2008 levels. The applicable rate on each facility as of December 31, 2008 is provided in the long-term debt 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 December 31, 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. See "Debt Related Activity in 2008" above for discussion of TCEH's election to use the PIK option for the May 1, 2009 payment.

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 with registration rights. Notes having substantially identical terms as the TCEH Notes were registered with the SEC by the Co-Issuers in December 2008 as part of an offer to exchange freely tradable exchange notes for the TCEH Notes. The exchange offer was completed in January 2009. Because the exchange offer was not completed within 360 days after the issue date of the TCEH Notes (a TCEH Registration Default), the annual interest rate on the TCEH Notes increased for the period during which the TCEH Registration Default continued (October 26, 2008 to January 30, 2009 for the Senior Notes and November 30, 2008 to January 30, 2009 for the Series B Senior Notes and Senior Toggle Notes), resulting in incremental interest of \$3.7 million.

**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. The interest rate swaps were being accounted for as cash flow hedges related to variable interest rate cash flows until August 29, 2008, at which time 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 the redesignation date 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.

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.

In October 2008, TCEH entered into interest rate swap transactions pursuant to which payment of the floating interest rates on an aggregate of an additional \$1.0 billion of senior secured term loans of TCEH were exchanged for interest payments at fixed rates of between 7.5% and 7.6% on debt maturing in 2014.

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 at 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.

In November 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 \$3.0 billion of senior secured term loans of TCEH were exchanged for floating interest rates of LIBOR plus spreads ranging from 0.21% to 0.292%, receivable monthly.

The interest rate swap counterparties are secured proportionally with the lenders under the TCEH Senior Secured Facilities. Subsequent to the redesignation in August 2008 discussed above, changes in the fair value of the swaps discussed in the above paragraphs are being reported in the income statement in interest expense and related charges, and such unrealized mark-to-market net losses totaled \$1.477 billion in 2008.

***TCEH Long-Term Debt Fair Value Hedges*** — TCEH has used fair value hedging strategies to manage its exposure to fixed interest rates on long-term debt. These swaps qualified for and were designated as fair value hedges in accordance with SFAS 133 (under the “short-cut method” entities are allowed under SFAS 133 to assume no hedge ineffectiveness in a hedging relationship of interest rate risk if certain conditions are met).

***Long-Term Debt Fair Value Adjustments Related to Interest Rate Swaps (fixed to variable rate)*** —

Predecessor:

Long-term debt fair value adjustments at January 1, 2007 — net reduction in debt carrying value .....	10
Fair value adjustments during the period .....	5
Recognition of net gains on settled fair value hedges (a) .....	<u>(1)</u>

Successor:

Long-term debt fair value adjustments at October 10, 2007 — net reduction in debt carrying value .....	14
Purchase accounting adjustment (b) .....	<u>(14)</u>
Long-term debt fair value adjustments related to interest rate swaps at December 31, 2007 .....	<u>\$ —</u>

- 
- (a) Net value of settled in-the-money fixed-to-variable swaps recognized in net income when the hedged transactions are recognized. Amount is pretax.
  - (b) Reflects the fair-valuing of debt as part of purchase accounting.

Changes in market values of unsettled fair value hedge positions are accounted for as adjustments to the carrying value of related debt amounts, offset by changes in commodity and other derivative contractual asset or liability amounts.

### 13. COMMITMENTS AND CONTINGENCIES

#### *Generation Development*

EPC agreements have been executed for the development of three lignite coal-fueled generation units in Texas, two units at Oak Grove and one at Sandow, and construction of the units is well underway.

Subsidiaries of TCEH have received the air permits for the Sandow and Oak Grove units. However, the Oak Grove air permit remains the subject of litigation as discussed below under “Litigation Related to Generation Development.”

Construction work-in-process asset balances for the Oak Grove units totaled approximately \$2.8 billion as of December 31, 2008, which includes the effects of the fair value adjustments related to purchase accounting and capitalized interest. In the unexpected event the development of the Oak Grove units was cancelled, the cancellation exposure as of December 31, 2008 totaled \$3.1 billion, which includes the carrying value of the project and up to approximately \$300 million of termination obligations. This estimated exposure amount 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.

#### *Contractual Commitments*

At December 31, 2008, TCEH had noncancellable commitments under energy-related contracts, leases and other agreements as follows:

	<b>Coal purchase agreements and coal transportation agreements</b>	<b>Pipeline transportation and storage reservation fees</b>	<b>Capacity payments under power purchase agreements (a)</b>	<b>Nuclear Fuel Contracts</b>	<b>Water Rights Contracts</b>
2009.....	\$ 263	\$ 41	\$ 3	\$ 153	\$ 8
2010.....	54	38	—	91	8
2011.....	44	37	—	113	8
2012.....	—	37	—	182	8
2013.....	—	42	—	120	8
Thereafter .....	—	22	—	272	45
Total .....	<u>\$ 361</u>	<u>\$ 217</u>	<u>\$ 3</u>	<u>\$ 931</u>	<u>\$ 85</u>

- (a) On the basis of TCEH’s current expectations of demand from its electricity customers as compared with its capacity and take-or-pay payments, management does not consider it likely that any material payments will become due for electricity not taken beyond capacity payments.

Future minimum lease payments under both capital leases and operating leases are as follows:

	<u>Capital Leases</u>	<u>Operating Leases (a)</u>
2009 .....	29	41
2010 .....	29	40
2011 .....	71	39
2012 .....	14	40
2013 .....	9	40
Thereafter.....	<u>50</u>	<u>331</u>
Total future minimum lease payments.....	202	<u>\$ 531</u>
Less amounts representing interest.....	<u>43</u>	
Present value of future minimum lease payments.....	159	
Less current portion .....	<u>19</u>	
Long-term capital lease obligation.....	<u>\$ 140</u>	

- (a) Includes operating leases with initial or remaining noncancellable lease terms in excess of one year. Excludes future minimum lease payments for combustion turbines owned by a TCEH lease trust of \$17 million in each of 2009 through 2013 and \$17 million thereafter.

Rent charged to operating cost, fuel cost and SG&A totaled \$73 million for the year ended December 31, 2008, \$20 million for the period October 11, 2007 through December 31, 2007, \$50 million for the period January 1, 2007 through October 10, 2007 and \$65 million for the year ended December 31, 2006.

#### ***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 TCEH was filed in September 2007 in the State District Court of Travis County, Texas. Plaintiffs asked that the District Court reverse the 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. 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. One of the plaintiffs has asked the court to consolidate all these proceedings, and the Attorney General of Texas, on behalf of TCEQ, has filed pleas to the jurisdiction that would, if granted, dismiss all but the administrative appeal. TCEH does not know when the court will rule on these requests. TCEH believes 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 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. In December 2008, Luminant reached a settlement with the Sierra Club regarding its allegations relating to Oak Grove. Pursuant to the settlement, Luminant has filed for a Maximum Achievable Control Technology determination for hazardous air pollutant emissions by the TCEQ and has agreed to offset any emissions above the levels set in that review; in exchange the Sierra Club will not pursue legal action to obstruct construction or commencement of operation of the Oak Grove units. TCEH cannot predict whether the Sierra Club will actually file suit relating to Martin Lake or the outcome of any such proceeding.

### ***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 an indirect 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 TCEH is unable to estimate any possible loss or predict the outcome of this litigation, TCEH believes the claims made in this litigation are without merit and, accordingly, intends to vigorously defend this litigation.

### ***Regulatory Investigations and Reviews***

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.

### ***Commitment to Fund Demand Side Management Initiatives***

In connection with the Merger, Texas Holdings committed to spend \$100 million over the five-year period ending December 31, 2012 on demand side management or other energy efficiency initiatives. This commitment is expected to be funded by EFH Corp. or TCEH.

### ***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.

### ***Labor Contracts***

Certain personnel engaged in TCEH activities are represented by labor unions and covered by collective bargaining agreements with varying expiration dates. In January 2008, new one-year labor agreements were reached covering bargaining unit personnel engaged in the natural gas-fueled generation operations and were again renegotiated and completed in January 2009. Also in January 2008, a new two-year agreement was reached covering bargaining unit personnel engaged in lignite mining operations. In June 2008, a new labor agreement effective until October 2010 was reached covering bargaining unit personnel engaged in the Sandow lignite-fueled generation operations. In July 2008, a new labor agreement effective until September 2010 was reached covering bargaining unit personnel engaged in the Three Oaks lignite mining operations. In August 2008, a new labor agreement effective until August 2010 was reached covering bargaining unit personnel engaged in nuclear generation. Negotiations are currently underway with respect to the collective bargaining agreements covering bargaining unit personnel engaged in the Big Brown, Martin Lake and Oak Grove lignite-fueled generation operations and the natural gas-fueled generation operations. The current lignite-fueled generation operations contract, which expired November 2008, is in effect until either party gives notice to terminate. TCEH expects that any changes in collective bargaining agreements will not have a material effect on its financial position, results of operations or cash flows; however, TCEH is unable to predict the ultimate outcome of these labor negotiations.

### ***Environmental Contingencies***

The federal Clean Air Act, as amended (Clean Air Act) includes provisions which, among other things, place limits on sulfur dioxide and nitrogen oxide emissions produced by electricity generation plants. The capital requirements of TCEH and its subsidiaries have not been significantly affected by the requirements of the Clean Air Act. In addition, all air pollution control provisions of the 1999 Restructuring Legislation have been satisfied.

TCEH and its subsidiaries must comply with environmental laws and regulations applicable to the handling and disposal of hazardous waste. TCEH and its subsidiaries believe that they are in compliance with current environmental laws and regulations; however, the impact, if any, of changes to existing regulations or the implementation of new regulations is not determinable.

The costs to comply with environmental regulations can be significantly affected by the following external events or conditions:

- enactment of state or federal regulations regarding CO<sub>2</sub> emissions;
- other changes to existing state or federal regulation regarding air quality, water quality, control of toxic substances and hazardous and solid wastes, and other environmental matters, and
- the identification of sites requiring clean-up or the filing of other complaints in which TCEH or its subsidiaries may be asserted to be potential responsible parties.

### ***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*** — Subsidiaries of TCEH are the lessee under various operating leases that guarantee the residual values of the leased assets. At December 31, 2008, the aggregate maximum amount of residual values guaranteed was approximately \$50 million with an estimated residual recovery of approximately \$56 million. These leased assets consist primarily of mining equipment and rail cars. The average life of the residual value guarantees under the lease portfolio is approximately four years.

See Note 12 for discussion of guarantees and security for certain TCEH indebtedness.

### ***Letters of Credit***

At December 31, 2008, TCEH had outstanding letters of credit under its credit facilities totaling \$767 million as follows:

- \$342 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 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
- \$96 million for miscellaneous credit support requirements.

## *Nuclear Insurance*

Nuclear insurance includes liability coverage, property damage, decontamination and premature decommissioning coverage and accidental outage and/or extra expense coverage. The liability coverage is governed by the Price-Anderson Act (Act), while the property damage, decontamination and premature decommissioning coverage are promulgated by the rules and regulations of the NRC. TCEH intends to maintain insurance against nuclear risks as long as such insurance is available. TCEH is self-insured to the extent that losses (i) are within the policy deductibles, (ii) are not covered per policy exclusions, terms and limitations, (iii) exceed the amount of insurance maintained, or (iv) are not covered due to lack of insurance availability. Such losses could have a material adverse effect on TCEH's financial condition and its results of operations and cash flows.

With regard to liability coverage, the Act provides financial protection for the public in the event of a significant nuclear generation plant incident. The Act sets the statutory limit of public liability for a single nuclear incident at \$12.5 billion and requires nuclear generation plant operators to provide financial protection for this amount. The US Congress could impose revenue-raising measures on the nuclear industry to pay claims exceeding the \$12.5 billion limit for a single incident mandated by the Act. As required, TCEH provides this financial protection for a nuclear incident at Comanche Peak resulting in public bodily injury and property damage through a combination of private insurance and industry-wide retrospective payment plans. As the first layer of financial protection, TCEH has \$300 million of liability insurance from American Nuclear Insurers (ANI), which provides such insurance on behalf of a major stock insurance company pool, Nuclear Energy Liability Insurance Association. The second layer of financial protection is provided under an industry-wide retrospective payment program called Secondary Financial Protection (SFP).

Under the SFP, in the event of an incident at any nuclear generation plant in the US, each operating licensed reactor in the US is subject to an assessment of up to \$117.5 million plus a 3% insurance premium tax, subject to increases for inflation every five years. Assessments are limited to \$17.5 million per operating licensed reactor per year per incident. TCEH's maximum potential assessment under the industry retrospective plan would be \$235 million (excluding taxes) per incident but no more than \$35 million in any one year for each incident. The potential assessment is triggered by a nuclear liability loss in excess of \$300 million per accident at any nuclear facility. The SFP and liability coverage are not subject to any deductibles.

With respect to nuclear decontamination and property damage insurance, the NRC requires that nuclear generation plant license-holders maintain at least \$1.1 billion of such insurance and require the proceeds thereof to be used to place a plant in a safe and stable condition, to decontaminate it pursuant to a plan submitted to and approved by the NRC before the proceeds can be used for plant repair or restoration or to provide for premature decommissioning. TCEH maintains nuclear decontamination and property damage insurance for Comanche Peak in the amount of \$2.25 billion (subject to \$5 million deductible per accident), above which TCEH is self-insured. This insurance coverage consists of a primary layer of coverage of \$500 million provided by Nuclear Electric Insurance Limited (NEIL), a nuclear electric utility industry mutual insurance company and \$1.75 billion of premature decommissioning coverage also provided by NEIL.

TCEH maintains Accidental Outage Insurance through NEIL to cover the additional costs of obtaining replacement electricity from another source if one or both of the units at Comanche Peak are out of service for more than twelve weeks as a result of covered direct physical damage. The coverage provides for weekly payments of \$3.5 million for the first fifty-two weeks and \$2.8 million for the next 110 weeks for each outage, respectively, after the initial twelve-week waiting period. The total maximum coverage is \$490 million per unit. The coverage amounts applicable to each unit will be reduced to 80% if both units are out of service at the same time as a result of the same accident.

If NEIL's losses exceeded its reserves for the applicable coverage, potential assessments in the form of a retrospective premium call could be made up to a total of \$11.7 million for primary property, \$14.1 million for excess property and \$8.9 million for accidental outage.

Also, under the NEIL policies, if there were multiple terrorism losses occurring within a one-year time frame, NEIL would make available one industry aggregate limit of \$3.2 billion plus any amounts it recovers from other sources up to the limits for each claimant. If terrorism losses occurred beyond the one-year period, a new set of limits and resources would apply.

#### 14. MEMBERSHIP INTERESTS

##### *Successor*

**Dividend to Parent to Fund Merger** — On October 10, 2007, TCEH distributed \$21.0 billion to EFC Holdings, which amounts were ultimately distributed to EFH Corp. to provide partial funding of the Merger. TCEH paid no cash distributions to EFC Holdings in 2008 or in the period from October 11, 2007 through December 31, 2007.

**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.

See Note 19 for discussion of stock-based compensation plans.

##### *Predecessor*

In conjunction with the Merger, TCEH recorded a \$4.1 billion reduction in capital contributions from parent as the result of settlement of advances to, notes receivable from, and taxes payable to affiliates, as well as the net capital contribution to TCEH resulting from the contributions of entities and net assets discussed in Note 4.

**Cash Distributions to Parent** — During 2007, TCEH declared and paid the following cash distributions to EFC Holdings:

<u>Declaration Date</u>	<u>Payment Date</u>	<u>Distribution Amount</u>
October 1, 2007	October 1, 2007	\$284
July 1, 2007	July 2, 2007	\$284
April 1, 2007	April 2, 2007	\$284
January 1, 2007	January 2, 2007	\$283

**Recapitalization of Exchangeable Preferred Membership Interests** — Effective September 30, 2006, TCEH's exchangeable preferred membership interests, which were held entirely by subsidiaries of EFH Corp., were recapitalized into common equity membership interests of TCEH. The principal amount of these preferred interests, net of the related discount, were reported as a noncurrent liability in the condensed consolidated balance sheet.

The following amounts were reclassified to membership interests at September 30, 2006:

Principal amount of the preferred interests.....	\$ 750
Remaining unamortized discount recorded at issuance.....	(208)
Remaining unamortized issuance costs .....	<u>(21)</u>
Total amount recapitalized .....	<u>\$ 521</u>

***Noncash contributions*** — Under SFAS 123(R), expense related to EFH Corp.'s stock-based incentive compensation awards granted to TCEH's employees is accounted for as a noncash capital contribution from EFH Corp. Accordingly, TCEH recorded a credit to its membership interests account of \$31 million in the period January 1, 2007 through October 10, 2007, and \$22 million for the year ended December 31, 2006.

## 15. 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			Total
	December 31, 2008			
	Commodity contracts	Cash flow hedges and other derivatives	Reclassification (a)	
Assets:				
Current assets .....	\$ 2,385	\$ 14	\$ (8)	\$ 2,391
Noncurrent assets .....	<u>962</u>	<u>—</u>	<u>—</u>	<u>962</u>
Total .....	<u>\$ 3,347</u>	<u>\$ 14</u>	<u>\$ (8)</u>	<u>\$ 3,353</u>
Liabilities:				
Current liabilities .....	\$ 2,235	\$ 503	\$ (8)	\$ 2,730
Noncurrent liabilities .....	<u>682</u>	<u>1,413</u>	<u>—</u>	<u>2,095</u>
Total .....	<u>\$ 2,917</u>	<u>\$ 1,916</u>	<u>\$ (8)</u>	<u>\$ 4,825</u>
Net assets (liabilities) .....	<u>\$ 430</u>	<u>\$ (1,902)</u>	<u>\$ —</u>	<u>\$ (1,472)</u>

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

	Successor		Total
	December 31, 2007		
	Commodity contracts	Cash flow hedges and other derivatives	
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 deposit net liabilities of \$190 million and net assets of \$445 million under master netting arrangements at December 31, 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 FSP FIN 39-1.

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, and the associated unrealized gains and losses are reported in the income statement in net gain (loss) from commodity hedging and trading activities.

A multi-year power sales agreement was entered into with Alcoa Inc. in the 2007 Predecessor period. The agreement was determined to have a “day one” out-of-the-money value of \$235 million. The agreement was entered into concurrently with the transfer of an air permit from Alcoa Inc. to an TCEH subsidiary as well as other agreements with Alcoa Inc. that provide, among other things, access to real property and a supply of lignite fuel, all of which provides value to TCEH by providing the right and ability to develop, construct and operate a new lignite coal-fueled generation unit at Sandow. In consideration of this right and ability, the initial out-of-the-money value of the sales agreement, as well as a \$29 million out-of-the-money value of a related interim power sales agreement entered into in late 2006, were recorded as part of the construction work-in-process asset balance for the Sandow unit. The out-of-the-money values were recorded as commodity contract liabilities. The contracts were revalued applying the principles of SFAS 157 as part of purchase accounting, and subsequent changes in the value of the contracts continue to be marked-to-market in net income.

Successor results include net “day one” losses of \$68 million in the 2008 period and \$8 million in the 2007 period, and predecessor results include net “day one” losses of \$201 million in the 2007 period, primarily associated with 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 2007 predecessor period amount is net of a \$30 million “day one” gain associated with a long-term power purchase agreement. The net losses are reported in net gain (loss) from commodity hedging and trading activities.

### ***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 12 for details of interest rate swaps previously designated as cash flow hedges.

A summary of cash flow hedge and other derivative assets and liabilities follows:

	<u>Successor</u>	
	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Current and noncurrent assets:		
Interest rate swaps (a) .....	\$ (1)	\$ 5
Commodity-related cash flow hedges .....	<u>15</u>	<u>8</u>
Total .....	<u>\$ 14</u>	<u>\$ 13</u>
Current and noncurrent liabilities:		
Interest rate swaps (a) .....	\$ 1,908	\$ 285
Commodity-related cash flow hedges .....	<u>8</u>	<u>1</u>
Total .....	<u>\$ 1,916</u>	<u>\$ 286</u>

(a) The 2008 amount includes \$1.868 billion in net liabilities related to interest rate hedges on \$17.55 billion principal amount of debt and \$41 million in net liabilities related to interest rate basis swaps on \$13.045 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 \$4 million in net losses in 2008, \$111 million in net gains in 2007 (essentially all of which was in the Predecessor period) and \$231 million in net gains in 2006. 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 \$4 million in net losses in the 2008 Successor period, \$90 million in net gains in 2007 (essentially all of which was in the Predecessor period) and \$239 million in net gains in 2006.

Accumulated other comprehensive income related to cash flow hedges at December 31, 2008 totaled \$236 million in net losses (after-tax), substantially all of which relates to interest rate swaps. TCEH expects that \$112 million of net losses related to cash flow hedges included in accumulated other comprehensive income as of December 31, 2008 will be reclassified into net income during the next twelve months as the related hedged transactions affect net income.

## 16. INVESTMENTS

The balance of investments consists of the following:

	Successor	
	December 31, 2008	December 31, 2007
Nuclear decommissioning trust .....	\$ 385	\$ 484
Assets related to employee benefit plans, including employee savings programs .....	35	54
Land.....	42	42
Investment in affiliate holding Capgemini-related assets .....	17	28
Miscellaneous other .....	4	4
Total investments .....	<u>\$ 483</u>	<u>\$ 612</u>

### *Nuclear Decommissioning Trust*

Investments in a trust that will be used to fund the costs to decommission the Comanche Peak nuclear generation plant are carried at fair value. Decommissioning costs are being recovered from Oncor's customers as a delivery fee surcharge over the life of the plant and deposited in the trust fund. Net gains and losses on investments in the trust fund are offset by a corresponding adjustment to a regulatory asset/liability. A summary of investments in the fund follows:

	Successor			
	December 31, 2008			
	Cost (a)	Unrealized gain	Unrealized loss	Fair market value
Debt securities .....	\$ 203	\$ 4	\$ (14)	\$ 193
Equity securities .....	181	46	(35)	192
Total.....	<u>\$ 384</u>	<u>\$ 50</u>	<u>\$ (49)</u>	<u>\$ 385</u>

	Successor			
	December 31, 2007			
	Cost (a)	Unrealized gain	Unrealized loss	Fair market value
Debt securities .....	\$ 193	\$ 3	\$ (1)	\$ 195
Equity securities .....	168	129	(8)	289
Total.....	<u>\$ 361</u>	<u>\$ 132</u>	<u>\$ (9)</u>	<u>\$ 484</u>

(a) Includes realized gains and losses of securities sold.

Debt securities held at December 31, 2008 mature as follows: \$73 million in one to five years, \$33 million in five to ten years and \$87 million after ten years.

### *Assets Related to Employee Benefit Plans*

The majority of these assets represent cash surrender values of life insurance policies that are purchased to fund liabilities under deferred compensation plans. EFH Corp. pays the premiums and is the beneficiary of these life insurance policies. As of December 31, 2008 and 2007, the face amount of these policies allocated to subsidiaries of TCEH totaled \$109 million and \$125 million, and the net cash surrender values totaled \$32 million and \$38 million, respectively. Changes in cash surrender value are netted against premiums paid. Other investment assets held to satisfy deferred compensation liabilities are recorded at fair value.

## 17. NOTICE OF TERMINATION OF OUTSOURCING ARRANGEMENTS

In connection with the closing of the Merger, EFH Corp. and TCEH commenced a review, under the change of control provisions, of certain outsourcing arrangements with Capgemini Energy LP (Capgemini), Capgemini America, Inc. and Capgemini North America, Inc. (collectively, CgE). During the fourth quarter of 2008, EFH Corp. and TCEH executed a Separation Agreement with CgE. Simultaneous with the execution of that Separation Agreement, Oncor entered into a substantially similar Separation Agreement with CgE. The Separation Agreements principally provide for (i) notice of termination of each of the Master Framework Agreements, dated as of May 17, 2004, as each has been amended, between Capgemini and each of TCEH and Oncor and the related service agreements under each of the Master Framework Agreements and (ii) termination of the joint venture arrangements between EFH Corp. (and its applicable subsidiaries) and CgE. Under the Master Framework Agreements and related services agreements, Capgemini provides to TCEH and its subsidiaries outsourced support services, including information technology, customer care and billing, human resources, procurement and certain finance and accounting activities.

The Separation Agreement acts as a notice of termination under the Master Framework Agreement and the related services agreements. As a result of the “change of control” of EFH Corp. that occurred as a result of the Merger, TCEH had the contractual right to terminate, without penalty, its Master Framework Agreement. TCEH has elected to exercise such right. Consistent with the Master Framework Agreement, to provide for an orderly transition of the services, the Separation Agreements requires that Capgemini provide termination assistance services until the services are transitioned back to TCEH and/or to another service provider. The Separation Agreement provides that the services be transitioned by December 31, 2010 (June 30, 2011, in the case of the information technology services). Each Master Framework Agreement will actually terminate when these termination assistance services are completed. TCEH previously provided a termination notice to Capgemini in respect of human resources services and customer care and revenue management services for TXU Energy.

The Separation Agreements provide for the termination of the joint venture arrangement between EFH Corp. (and its applicable subsidiaries) and CgE. As a result, during the fourth quarter of 2008:

- EFH Corp. received approximately \$70 million in exchange for the termination of a purchase option agreement pursuant to which subsidiaries of EFH Corp. had the right to “put” to Capgemini (and Capgemini had the right to “call” from a subsidiary of EFH Corp.) EFH Corp.’s 2.9% limited partnership interest in Capgemini and the licensed assets upon the expiration of the Master Framework Agreements in 2014 or, in some circumstances, earlier. TCEH received \$41 million of such proceeds reflecting its share of the put option value.
- The parties entered into a mutual release of all claims under the Master Framework Agreement and related services agreements subject to certain defined exceptions, and EFH Corp. received \$10 million in settlement of such claims. TCEH received \$5.6 million of such proceeds.

The carrying value of TCEH's share of the purchase option was \$98 million prior to the application of purchase accounting (recorded as a noncurrent asset). The effects of the termination of the outsourcing arrangements, including an accrual of \$38 million for incremental costs to exit and transition the services, were included in the final purchase price allocation (see Note 2).

## 18. PENSION AND OTHER POSTRETIREMENT EMPLOYEE BENEFITS

### *Pension Plan*

TCEH is a participating employer in the EFH Retirement Plan (Retirement Plan), a defined benefit pension plan sponsored by EFH Corp. The Retirement Plan is a qualified pension plan under Section 401(a) of the Internal Revenue Code of 1986, as amended (Code) and is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). Eligible employees may participate in the Retirement Plan upon their completion of one year of service and the attainment of age 21. All benefits are funded by the participating employers. The Retirement Plan provides benefits to participants under one of two formulas: (i) a Cash Balance Formula under which participants earn monthly contribution credits based on their compensation and a combination of their age and years of service, plus monthly interest credits or (ii) a Traditional Retirement Plan Formula based on years of service and the average earnings of the three years of highest earnings. The interest component of the Cash Balance Formula is variable and is determined using the yield on 30-year Treasury bonds.

All eligible employees hired after January 1, 2001 participate under the Cash Balance Formula. Certain employees who, prior to January 1, 2002, participated under the Traditional Retirement Plan Formula, continue their participation under that formula. Under the Cash Balance Formula, future increases in earnings will not apply to prior service costs. Effective October 1, 2007, all new employees are not eligible to participate in the Retirement Plan. It is EFH Corp.'s policy to fund the plans on a current basis to the extent deductible under existing federal tax regulations.

TCEH also participates in EFH Corp.'s supplemental retirement plans for certain employees, whose retirement benefits cannot be fully earned under the qualified Retirement Plan, the information for which is included below.

### *Other Postretirement Employee Benefit (OPEB) Plan*

TCEH 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. For employees retiring on or after January 1, 2002, the retiree contributions required for such coverage vary based on a formula depending on the retiree's age and years of service.

### *Pension and OPEB Costs Recognized as Expense*

The following details net pension and OPEB costs recognized as expense.

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Pension costs under SFAS 87.....	\$ 6	\$ 1	\$ 4	\$ 8
OPEB costs under SFAS 106.....	8	2	9	10
Total benefit costs recognized as expense.....	<u>\$ 14</u>	<u>\$ 3</u>	<u>\$ 13</u>	<u>\$ 18</u>

Consistent with SFAS 87, EFH Corp. uses the calculated value method to determine the market-related value of the assets held in its trust. EFH Corp. includes the realized and unrealized gains or losses in the market-related value of assets over a rolling four-year period. Each year, 25% of such gains and losses for the current year and for each of the preceding three years is included in the market-related value. Each year, the market-related value of assets is increased for contributions to the plan, and investment income and is decreased for benefit payments and expenses for that year.

The pension and OPEB amounts provided represent allocations to TCEH of amounts related to EFH Corp.'s plans.

TCEH has not been allocated any overfunded asset or underfunded liability related to its participation in EFH Corp.'s pension and OPEB plans.

### ***Regulatory Recovery of Pension and OPEB Costs***

In 2005, an amendment to PURA relating to EFH Corp.'s pension and OPEB costs was enacted by the Legislature of the State of Texas. This amendment, which was retroactively effective January 1, 2005, provides for the recovery by Oncor of pension and OPEB costs for all applicable former employees of the regulated predecessor integrated electric utility. In addition to Oncor's active and retired employees, these former employees consist largely of active and retired personnel engaged in TCEH's activities, related to service of those additional personnel prior to the deregulation and disaggregation of EFH Corp.'s business effective January 1, 2002. Accordingly, Oncor and TCEH entered into an agreement whereby Oncor assumed responsibility for applicable pension and OPEB costs related to those personnel.

### ***Assumed Discount Rate***

The discount rates reflected in net pension and OPEB costs are 6.55% for the year ended December 31, 2008, 6.45% for the period October 11, 2007 through December 31, 2007, 5.90% for the period January 1, 2007 through October 10, 2007 and 5.75% for the year ended December 31, 2006. 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 other postretirement benefits.

### ***Pension and OPEB Plan Cash Contributions***

Pension plan contributions were \$1 million, \$358 thousand and \$30 thousand in 2008, 2007 and 2006, respectively. OPEB plan contributions were \$196 thousand, \$1 million and \$1 million in 2008, 2007 and 2006, respectively. Estimated funding to EFH Corp. in 2009 of the pension plan and OPEB plan total \$1 million and \$612 thousand, respectively.

### ***Thrift Plan***

Employees of TCEH may participate in a qualified savings plan, the EFH Thrift Plan (Thrift Plan). This plan is a participant-directed defined contribution plan intended to qualify under Section 401(a) of the Code, and is subject to the provisions of ERISA. The Thrift Plan included an employee stock ownership component until October 10, 2007. Under the terms of the Thrift Plan, employees who do not earn more than the IRS threshold compensation limit used to determine highly compensated employees may contribute, through pre-tax salary deferrals and/or after-tax applicable payroll deductions, the lesser of 75% of their regular salary or wages or the maximum amount permitted under law. Employees who earn more than such threshold may contribute from 1% to 16% of their regular salary or wages. Employer matching contributions are also made in an amount equal to 100% of the first 6% of employee contributions for employees who are covered under the Cash Balance Formula of the Retirement Plan, and 75% of the first 6% of employee contributions for employees who are covered under the Traditional Retirement Plan Formula of the Retirement Plan. Prior to January 1, 2006, employer matching contributions were invested in EFH Corp. common stock. Effective January 1, 2006 through the October 10, 2007, employees could reallocate or transfer all or part of their accumulated or future employer matching contributions to any of the plan's other investment options. As of October 10, 2007, employer matching contributions are made in cash and may be allocated by participants to any of the plan's investment options.

## 19. STOCK-BASED COMPENSATION PLANS

### *Successor*

In December 2007, EFH Corp. established the 2007 Stock Incentive Plan for Key Employees of EFH Corp. and its Affiliates (2007 SIP). TCEH bears the costs of EFH Corp.'s 2007 SIP for applicable management personnel engaged in their business activities. Incentive awards under the 2007 SIP may be granted to directors and officers and qualified managerial employees of EFH Corp. or its subsidiaries or affiliates in the form of non-qualified stock options, stock appreciation rights, restricted shares, deferred shares of common stock, the opportunity to purchase shares of common stock and other awards that are valued in whole or in part by reference to, or are otherwise based on the fair market value of EFH Corp.'s shares of common stock.

Under the terms of the 2007 SIP, options to purchase 14.7 million and 14.1 million shares of EFH Corp. common stock were issued to certain TCEH management employees in 2008 and December 2007, respectively. The options provide the holder the right to purchase EFH Corp. common stock for \$5.00 per share. Vested awards must be exercised within 10 years of the grant date. The terms of the options were fixed at grant date.

**Stock Options** — The stock option awards under the 2007 SIP consist of two types of stock options. One-half of the options awarded vest solely based upon continued employment over a specific period of time, generally five years, with the options vesting ratably on an annual basis over the period (“Time-Based Options”). One-half of the options awarded vest based upon both continued employment and the achievement of a predetermined level of EFH Corp. EBITDA over time, generally ratably over five years based upon annual EBITDA levels, with provisions for vesting if the annual levels are not achieved but cumulative two- or three-year total EBITDA levels are achieved (“Performance-Based Options”). The Performance-Based Options may also vest in part or in full upon the occurrence of certain specified liquidity events. All options remain exercisable for ten years from the date of grant. Prior to vesting, expenses are recorded if the achievement of the EBITDA levels is probable, and amounts recorded are adjusted or reversed if the probability of achievement of such levels changes. Probability of vesting is evaluated at least each quarter.

The fair value of the Time-Based and Performance-Based Options granted was estimated using the Black-Scholes option pricing model and the assumptions noted in the table below.

Assumptions	Successor			
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007
	Time-Based Options		Performance-Based Options	
Expected volatility.....	30% – 33%	30%	30% – 33%	30%
Expected annual dividend .....	—	—	—	—
Expected life (in years).....	6.0 – 6.5	6.4	5.0 – 7.3	5.4 – 7.4
Risk-free rate .....	1.51% – 3.41%	3.81%	1.35% – 3.57%	3.92%

The weighted average grant-date fair value of the Time-Based Options granted in 2008 was \$1.92 and in December 2007 was \$1.92 per option. The grant-date fair value of the Performance-Based Options granted in 2008 and December 2007 ranged from \$1.72 to \$2.25 and \$1.74 to \$2.09, respectively, depending upon the performance period.

Compensation expense for Time-Based and Performance-Based Options is based on the grant-date fair value and recognized over the vesting period as employees perform services.

During 2008 and the 2007 Successor period, \$5.8 million and less than \$60 thousand, respectively, was recognized by TCEH for Time-Based Options, essentially all to expense.

As of December 31, 2008, there was approximately \$20.0 million of unrecognized compensation expense related to nonvested Time-Based Options, which is expected to be recognized ratably over a weighted-average period of approximately four years.

Compensation expense for Performance-Based Options is based on the grant date fair value and recognized over the requisite performance and service periods for each tranche of options depending upon the achievement of financial performance, or if certain liquidity events occur, as discussed above. In 2008, Performance Based Option expenses totaled \$4.3 million. No amounts were expensed in the 2007 Successor period by TCEH for Performance-Based Options because the performance period for the first tranche of the options did not begin until January 1, 2008.

As of December 31, 2008, there was approximately \$21.4 million of unrecognized compensation expense related to nonvested Performance-Based Options, which TCEH could record as an expense over a weighted-average period of approximately four years, subject to the achievement of financial performance being probable. Pursuant to an amendment to the 2007 SIP Plan terms in February 2009, a total of 2.6 million Performance-Based Options related to the period ended December 31, 2008 were declared vested in recognition that the established 2008 EBITDA target was substantially achieved.

***Other Share and Share-Based Awards*** — In 2008, EFH Corp. granted 1.75 million deferred share awards, each of which represents the right to receive one share of EFH Corp. stock, to certain management employees of TCEH who agreed to forego share-based awards that vested at the Merger date. The deferred share awards are fully vested and are payable in cash or stock upon the earlier of change of control or separation of service. No expense was recorded in 2008 related to these awards. An additional 150 thousand deferred share awards were granted to certain management employees of TCEH in 2008, which are payable in cash or stock; these awards vest over periods of two to three years, and \$122 thousand in expense was recorded in 2008 to recognize the vesting. These deferred share awards are accounted for as liability awards; therefore, the effect of changes in value of EFH Corp. shares are recognized in earnings.

#### ***Predecessor***

Prior to the Merger, TCEH bore the costs of the EFH Corp. shareholder-approved long-term incentive plans for applicable management personnel engaged in their business activities. EFH Corp. provided discretionary awards of performance units to qualified management employees that were payable in its common stock. The awards generally vested over a three year period and the number of shares ultimately earned was based on the performance of EFH Corp.'s stock over the vesting period as compared to peer companies and established thresholds. EFH Corp. established restrictions that limited certain employees' opportunities to liquidate vested awards.

EFH Corp. determined the fair value of its stock-based compensation awards utilizing a valuation model that took into account three principal factors: expected volatility of the stock price of EFH Corp. and peer group companies, dividend rate of EFH Corp. and peer group companies and the restrictions limiting liquidation of vested stock awards. Based on the fair values determined under this model, TCEH's reported expense related to the awards totaled \$6 million (\$4 million after tax) for the period from January 1, 2007 through October 10, 2007 and \$9 million (\$6 million after-tax) in 2006. The number of awards granted, net of forfeitures, totaled 37 thousand for the period from January 1, 2007 through October 10, 2007 and 185 thousand in 2006.

With respect to awards to personnel engaged in TCEH's activities, the fair value of awards that vested in the period from January 1, 2007 through October 10, 2007 totaled \$152 million and for the year ended December 31, 2006 totaled \$50 million based on the vesting date share prices.

## 20. 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 and impairment testing of goodwill, indefinite-lived intangible assets and long-lived assets. 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.

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 one quote from two brokers 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 reliable estimates of actively traded markets. 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 December 31, 2008, assets and liabilities measured at fair value on a recurring basis consisted of the following:

	<b>Successor</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3 (a)</b>	<b>Total</b>
<b>Assets:</b>				
Commodity-related contracts.....	\$ 1,010	\$ 2,061	\$ 283	\$ 3,354
Interest rate swaps.....	—	(1)	—	(1)
Nuclear decommissioning trust (b).....	109	276	—	385
Total assets .....	<u>\$ 1,119</u>	<u>\$ 2,336</u>	<u>\$ 283</u>	<u>\$ 3,738</u>
<b>Liabilities:</b>				
Commodity-related contracts.....	\$ 1,288	\$ 1,274	\$ 355	\$ 2,917
Interest rate swaps.....	—	1,908	—	1,908
Total liabilities.....	<u>\$ 1,288</u>	<u>\$ 3,182</u>	<u>\$ 355</u>	<u>\$ 4,825</u>

- (a) Level 3 assets and liabilities consist primarily of more complex long-term power purchases and sales agreements, including longer-term wind and other power purchase and sales contracts and certain natural gas positions in the long-term hedging program.
- (b) TCEH's nuclear decommissioning trust investment is included in the Investments line on the balance sheet.

At December 31, 2007, 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>Reclassification (a)</u>	<u>Total</u>
Assets:					
Commodity-related contracts.....	\$ 511	\$ 683	\$ 148	\$ 23	\$ 1,365
Interest rate swaps.....	—	5	—	—	5
Nuclear decommissioning trust (b).....	<u>165</u>	<u>319</u>	<u>—</u>	<u>—</u>	<u>484</u>
Total assets .....	<u>\$ 676</u>	<u>\$ 1,007</u>	<u>\$ 148</u>	<u>\$ 23</u>	<u>\$ 1,854</u>
Liabilities:					
Commodity-related contracts.....	\$ 559	\$ 2,372	\$ 321	\$ 23	\$ 3,275
Interest rate swaps.....	—	<u>285</u>	<u>—</u>	<u>—</u>	<u>285</u>
Total liabilities.....	<u>\$ 559</u>	<u>\$ 2,657</u>	<u>\$ 321</u>	<u>\$ 23</u>	<u>\$ 3,560</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 investment is 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, as well as interest rate basis swaps designed to further reduce fixed borrowing costs. See Note 12 for discussion of interest rate swaps.

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.

The following table presents the changes in fair value of TCEH's Level 3 assets and liabilities (all related to commodity contracts) for the year ended December 31, 2008 and the period from October 11, 2007 through December 31, 2007:

	<b>Year Ended December 31, 2008</b>	<b>Period from October 11, 2007 through December 31, 2007</b>
Balance at December 31, 2008 and October 11, 2007, respectively (net liability).....	\$ (173)	\$ (133)
Total realized and unrealized gains (losses) (a):		
Included in net income (loss) .....	(12)	(112)
Included in other comprehensive income .....	7	7
Purchases, sales, issuances and settlements (net) (b) .....	(13)	14
Net transfers in and/or out of Level 3 (c).....	<u>119</u>	<u>51</u>
Balance at end of period (net liability).....	<u>\$ (72)</u>	<u>\$ (173)</u>
Net change in unrealized gains (losses) included in net income relating to instruments held at end of period (d) .....	\$ 85	\$ (70)

- (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) Settlements represent reversals of unrealized mark-to-market valuations of these positions previously recognized in net income. Generally, purchases have no value at inception and subsequent changes in value from these transactions are reflected in unrealized gains and losses. Issuances represent new transactions valued at the assessment date.
- (c) Includes transfers due to changes in the observability of significant inputs. Transfers in are assumed to transfer in at the beginning of the quarter and transfers out at the end of the quarter, which is when the assessments were performed. Any changes in value during the period are reported as unrealized gains and losses in net gain (loss) from commodity hedging and trading activities.
- (d) Includes unrealized gains and losses related to the periods in which the instrument was classified as a Level 3 asset or liability.

## 21. FAIR VALUE OF NONDERIVATIVE FINANCIAL INSTRUMENTS

The carrying amounts and related estimated fair values of significant nonderivative financial instruments were as follows:

	Successor			
	December 31, 2008		December 31, 2007	
	Carrying Amount	Fair Value (a)	Carrying Amount	Fair Value (a)
<b>On balance sheet assets (liabilities):</b>				
Long-term debt (including current maturities) (b).....	\$ (29,311)	\$ (20,331)	\$ (28,443)	\$ (28,102)
<b>Off balance sheet assets (liabilities):</b>				
Financial guarantees .....	\$ —	\$ (3)	\$ —	\$ (1)

(a) Fair value determined in accordance with SFAS 157.

(b) Excludes capital leases.

See Note 15 for discussion of accounting for financial instruments that are derivatives.

## 22. RELATED-PARTY TRANSACTIONS

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

- TCEH incurs electricity delivery fees charged by Oncor. These fees totaled \$1.0 billion for the year ended December 31, 2008, \$209 million for the period from October 11, 2007 through December 31, 2007, \$827 million for the period from January 1, 2007 through October 10, 2007 and \$1.1 billion for the year ended December 31, 2006.
- Oncor's bankruptcy-remote financing subsidiary has issued securitization 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 \$289 million (\$35 million reported as current liabilities) at December 31, 2008 and \$323 million (\$34 million reported as current liabilities) at December 31, 2007.
- TCEH reimburses Oncor for interest expense on Oncor's bankruptcy-remote financing subsidiary's securitization bonds. This interest expense totaled \$46 million for the year ended December 31, 2008, \$11 million for the period from October 11, 2007 through December 31, 2007, \$38 million for the period from January 1, 2007 through October 10, 2007 and \$52 million for the year ended December 31, 2006.
- Current and noncurrent advances to parent totaled \$2.7 billion at December 31, 2006 (\$700 million reported as noncurrent). The average daily balances of the advances to parent totaled \$3.3 billion for the period from January 1, 2007 through October 10, 2007 and \$1.9 billion for the year ended December 31, 2006. Interest income earned on the advances totaled \$162 million for the period from January 1, 2007 through October 10, 2007, and \$105 million for the year ended December 31, 2006. The weighted average annual interest rates were 6.3% for the period from January 1, 2007 through October 10, 2007 and 5.4% for the year ended December 31, 2006. See Note 14 regarding the settlement of these advances in conjunction with the Merger.
- In December 2005, TCEH received a \$1.5 billion note from EFH Corp. in partial settlement of outstanding advances to parent. EFH Corp. settled the note in connection with the Merger (see Note 14). 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 \$71 million for the period from January 1, 2007 through October 10, 2007 and \$82 million for the year ended December 31, 2006.
- Notes receivable from EFH Corp. are payable to TCEH on demand and arise from borrowings used for working capital and general corporate purposes of EFH Corp. The notes totaled \$584 million and \$25 million at December 31, 2008 and 2007, respectively. In November 2008, EFH Corp. repaid \$253 million of such notes, which related to payments of principal and interest on EFH Corp. debt, in connection with distributions received by EFH Corp. from the sale of minority interests in Oncor. The average daily balance of the notes for the year ended December 31, 2008 was \$410 million and from the issuance date until December 31, 2007 was \$20 million. The notes carry interest at a rate based on the one-month LIBOR rate plus 5.00%, and interest income totaled \$32 million for the year ended December 31, 2008 and \$257 thousand for the period from October 11, 2007 through December 31, 2007. 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 \$14 million at December 31, 2008, and the average daily balance of the notes from the issuance date until December 31, 2008 was \$4 million. The notes carry interest at a rate based on the one-month LIBOR rate plus 5.00%, and interest income totaled \$309 thousand for the year ended December 31, 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 \$66 million for the year ended December 31, 2008, \$16 million for the period from October 11, 2007 through December 31, 2007, \$45 million for the period from January 1, 2007 through October 10, 2007 and \$65 million for the year ended December 31, 2006.

- Under Texas regulatory provisions, the trust fund for decommissioning the 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 December 31, 2008, the excess of the decommissioning liability over the trust fund balance resulted in a regulatory asset of \$127 million. At December 31, 2007, the excess of the trust fund balance over the estimated decommissioning liability resulted in a regulatory liability of \$13 million.
- TCEH had posted cash collateral of \$15 million as of December 31, 2008 and 2007 to Oncor related to interconnection agreements for three generation units being developed by TCEH. The collateral is reported in TCEH's balance sheet in other current assets.
- TCEH has a 53.1% limited partnership interest, with a carrying value of \$17 million and \$28 million at December 31, 2008 and 2007, respectively, in an EFH Corp. subsidiary holding software and other computer-related assets. Equity losses related to this interest totaled \$10 million for the year ended December 31, 2008, \$2 million for the period from October 11, 2007 through December 31, 2007, \$5 million for the period from January 1, 2007 through October 10, 2007, and \$10 million for the year ended December 31, 2006. 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 payable to EFH Corp. of \$33 million at December 31, 2008 and an income tax receivable of \$190 million at December 31, 2007.
- 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 downgrade to below investment grade, TCEH is required to post collateral support in an amount equal to estimated transition charges over specified time periods. Accordingly, as of December 31, 2008 and 2007, TCEH had posted a letter of credit in the amount of \$13 million and \$14 million, respectively, 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.
- 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 (a member of the Sponsor Group). In November and December 2007, TCEH offered the TCEH Notes. Affiliates of GS Capital Partners served as initial purchasers in such offerings. 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 GS Capital Partners 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 11 for information regarding the accounts receivable securitization program and related subordinated notes receivable from TXU Receivables Company, Note 14 for cash distributions to EFC Holdings and Note 18 for the assumption by Oncor of certain TCEH pension and OPEB costs.

## 23. SUPPLEMENTARY FINANCIAL INFORMATION

### *Interest Expense and Related Charges*

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Interest.....	\$ 2,609	\$ 586	\$ 354	\$ 347
Unrealized mark-to-market net (gain) loss on interest rate swaps.....	1,477	—	—	—
Distributions on exchangeable preferred membership interests (a).....	—	—	—	51
Amortization of debt fair value discount resulting from purchase accounting.....	17	5	—	—
Amortization of debt discount and issuance costs.....	119	54	10	24
Interest capitalized in accordance with SFAS 34.....	(304)	(58)	(41)	(30)
Total interest expense and related charges.....	<u>\$ 3,918</u>	<u>\$ 587</u>	<u>\$ 323</u>	<u>\$ 392</u>

(a) Effective September 30, 2006, TCEH's exchangeable preferred membership interests, which were held entirely by subsidiaries of EFH Corp., were recapitalized into common equity membership interests of TCEH.

### *Restricted Cash*

	Successor			
	At December 31, 2008		At December 31, 2007	
	Current Assets	Noncurrent Assets	Current Assets	Noncurrent Assets
Amounts related to TCEH's senior secured letter of credit facility (See Note 12).....	\$ —	\$ 1,250	\$ —	\$ 1,250
Pollution control revenue bond funds held by trustee (See Note 12).....	—	—	—	29
Amounts related to margin deposits held.....	4	—	—	—
Total restricted cash.....	<u>\$ 4</u>	<u>\$ 1,250</u>	<u>\$ —</u>	<u>\$ 1,279</u>

### *Inventories by Major Category*

	Successor	
	December 31, 2008	December 31, 2007
Materials and supplies.....	\$ 134	\$ 121
Fuel stock.....	162	138
Natural gas in storage.....	65	93
Total inventories.....	<u>\$ 361</u>	<u>\$ 352</u>

## Property, Plant and Equipment

	Successor	
	December 31, 2008	December 31, 2007
Generation .....	\$16,842	\$16,981
Other assets .....	<u>126</u>	<u>109</u>
Total .....	16,968	17,090
Less accumulated depreciation .....	<u>1,270</u>	<u>242</u>
Net of accumulated depreciation .....	15,698	16,848
Construction work in progress .....	4,771	3,246
Nuclear fuel (net of accumulated amortization of \$235 and \$47) .....	<u>433</u>	<u>451</u>
Property, plant and equipment — net .....	<u>\$20,902</u>	<u>\$20,545</u>

Assets related to capitalized leases included above totaled \$167 million at December 31, 2008 and \$161 million at December 31, 2007, net of accumulated depreciation.

## Asset Retirement Obligations

These liabilities 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 years ended December 31, 2008 and 2007:

Asset retirement liability at January 1, 2007 .....	\$ 585
Additions:	
Accretion – January 1, 2007 through October 10, 2007 .....	29
Accretion – October 11, 2007 through December 31, 2007 .....	11
Purchase accounting adjustment .....	176
Reductions:	
Mining reclamation cost adjustments .....	(2)
Mining reclamation payments – January 1, 2007 through October 10, 2007 .....	(19)
Mining reclamation payments – October 11, 2007 through December 31, 2007 .....	<u>(7)</u>
Asset retirement liability at December 31, 2007 .....	<u>\$ 773</u>
Additions:	
Accretion .....	48
Incremental mining reclamation costs .....	59
Reductions:	
Payments, essentially all mining reclamation .....	<u>(21)</u>
Asset retirement liability at December 31, 2008 .....	<u>\$ 859</u>

**Other Noncurrent Liabilities and Deferred Credits**

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

	<b>Successor</b>	
	<b>December 31,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>
Unfavorable purchase and sales contracts .....	\$ 727	\$ 751
Uncertain tax positions (including accrued interest) .....	864	798
Asset retirement obligations .....	859	773
Retirement plan and other employee benefits .....	56	50
Other .....	<u>21</u>	<u>52</u>
Total other noncurrent liabilities and deferred credits .....	<u>\$ 2,527</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 \$30 million in 2008 and \$5 million in the 2007 Successor period. 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, 2008 is as follows:

<b>Year</b>	<b>Successor Amount</b>
2009 .....	27
2010 .....	27
2011 .....	27
2012 .....	27
2013 .....	26

**Supplemental Cash Flow Information**

	Successor		Predecessor	
	Year Ended December 31, 2008	Period from October 11, 2007 through December 31, 2007	Period from January 1, 2007 through October 10, 2007	Year Ended December 31, 2006
Cash payments related to:				
Interest paid.....	\$ 2,582	\$ 285	\$ 359	\$ 405
Capitalized interest.....	(304)	(58)	(41)	(30)
Interest paid (net of capitalized interest).....	2,278	227	318	375
Income taxes.....	(236)	—	916	2
Noncash investing and financing activities:				
Below market values of power sales agreements (a)	—	—	264	—
Noncash contribution from EFH Corp. related to Merger financing and other activities.....	—	301	—	—
Promissory note issued in conjunction with acquisition of mining-related assets.....	—	—	65	—
Capital leases.....	16	16	59	—
Noncash contribution related to EFH Corp. stock-based compensation.....	10	—	6	9
Noncash construction expenditures (b).....	132	129	134	57
Noncash contribution related to allocated pension adjustment.....	—	—	8	65
Recapitalization of exchangeable preferred membership interests.....	—	—	—	521
Transfer of Luminant Enterprise Holdings Company LLC.....	—	—	—	6
Purchase accounting adjustment.....	48	—	—	—

(a) Multi-year power sales agreement entered into with Alcoa Inc. and recorded as part of the construction work-in-process asset balance for the Sandow 5 coal-fueled generation unit.

(b) Represents end-of-period accruals.