

Understanding TVA

Over the last few years, the energy industry has gone through drastic changes, bringing some successes, some failures, and many new challenges. As the industry continues to move into a more competitive market-place, the challenge will be to ensure that fundamental public responsibilities such as reliability, equitable universal access, environmental stewardship, and economic development are not jeopardized.

TVA and many other public power providers are a source of stability, helping to provide an adequate supply of electricity while keeping prices low and benefiting the greater public good. For almost 70 years, TVA has carried out its responsibilities for providing reliable, affordable electric power, acting as a steward of the region's natural resources and the Tennessee River system, and supporting economic development in the Tennessee Valley.

Facts on TVA:

- **TVA is the nation's largest public power producer**
- **TVA has paid \$1.5 billion in tax-equivalent payments to Tennessee Valley governments over the past five years**
- **TVA has paid the U.S. government \$3.4 billion on its original \$1.4 billion investment in TVA's power system**
- **TVA receives no appropriations from the federal government**

TVA Is a Public Power Company

TVA is the largest public power system in the United States. In 2002, TVA sold more than 160 billion kilowatt-hours of electricity to 158 distributors, 62 industrial customers and government entities, and other utilities. TVA's service area stretches over 80,000 square miles and includes a population of over 8 million people. TVA acts as a steward of the fifth-largest river system in North America, managing the diverse demands of navigation, flood control, power production, water quality, and recreation. TVA also invests in the economic development of the Valley region.

TVA supports sustainable economic development by partnering with businesses and communities throughout the region to improve the quality of life in the region. In 2002, TVA helped create or retain more than 48,000 jobs and provided \$22 million in economic development loan funds that leveraged more than \$180 million in funding from other sources.

TVA enters the 21st century in a very strong position, built on the achievements of several generations, and will continue to be a federal corporation that is both flexible and reliable in serving the interests of the region and the nation.

TVA Is Self-Financed

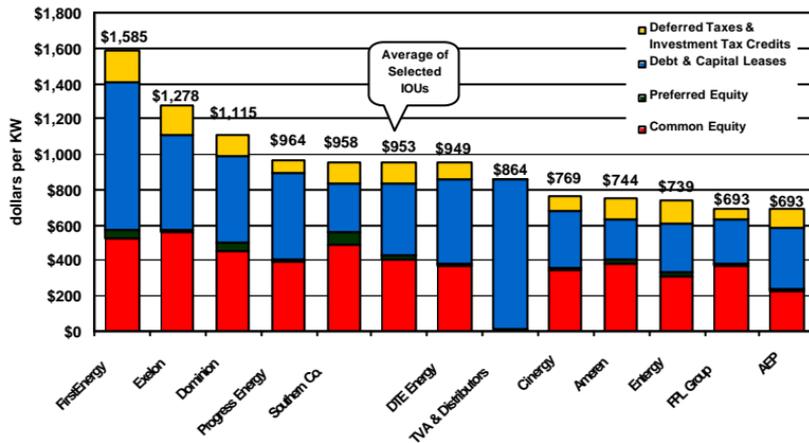
TVA is a self-financed, wholly owned federal corporation. However, TVA's federal charter, the TVA Act, limits the ways it can raise capital. This results in a capital structure that is very different from that of an investor-owned utility (IOU) and also helps explain why TVA's debt levels are generally higher than the debt levels of IOUs with similar levels of total capitalization.

The total amount of capital that TVA and its distributors actually use is comparable to IOUs of similar size, when all sources of capital that investor-owned utilities use in financing their operations are considered. A typical IOU raises capital through a mixture of common stock, preferred stock, short- and long-term debt, and deferred taxes and investment tax credits (ITCs). Deferred taxes and ITCs are long-term financial incentives, generally claimed over the life of the fixed assets. TVA is not authorized to issue stock and is obligated to charge rates as low as feasible, so it must meet the power needs of the Tennessee Valley primarily with electric revenues and through debt issuance.

Congress made TVA self-financing in 1959, and, since that time, TVA has primarily raised the capital needed to build the power plants and transmission lines in its power system by issuing power bonds and notes.

Electric Power System Market Value Capitalization Per Kilowatt (KW) of Installed Nameplate Capacity

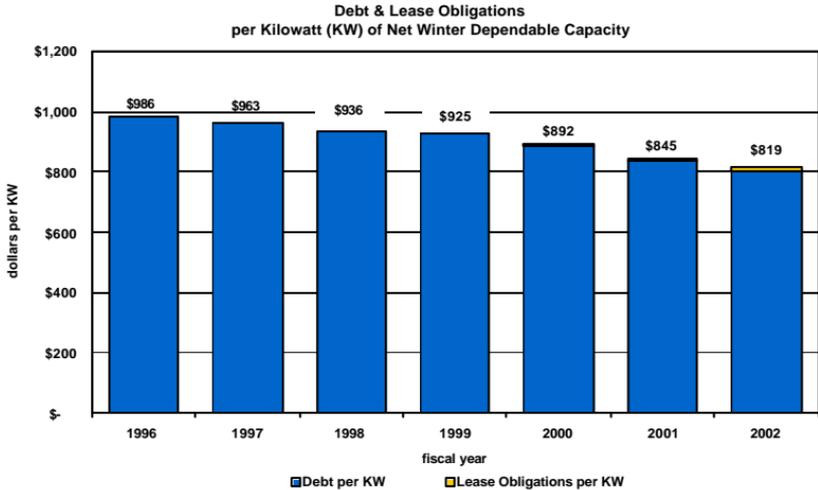
at September 30, 2002



Sources: TVA 2002 Annual Report, TVA Distributors 2002 Statistical Summary, Company 10-Q Filings & 2001 Annual Reports. Note: Capitalization and capacity data include regulated and nonregulated operations. All components of capitalization included at book value, except common equity, which reflects market value at September 30, 2002. Total capital for each company was adjusted to reflect only capitalization relevant to electric operations.

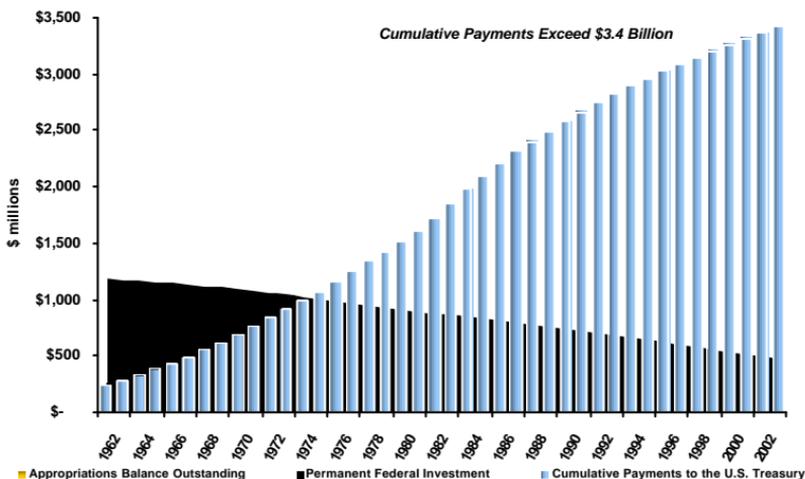
Understanding TVA

In order to provide for increasing demand in the Valley while continuing the trend of debt reduction, TVA has entered into three lease-leaseback arrangements to provide new generating capacity from 20 combustion-turbine units. These lease transactions have provided TVA with funds to pay down debt and for use in other power program purposes.



TVA has been steadily paying back the government's original investment that was outstanding at the time TVA was made self-financing. TVA pays back a portion of this original investment each year along with a dividend-like return payment at a market rate of interest. In 2002, these combined payments equaled \$50 million. Since 1959, TVA has made total principal and return payments of \$3.4 billion. TVA will pay down the government's original investment in its power system to under \$300 million, with this amount then remaining as the government's permanent equity in TVA.

Power Program Appropriations Repayment:
Cumulative Principal & Dividend-Like Return Payments to the U.S. Treasury



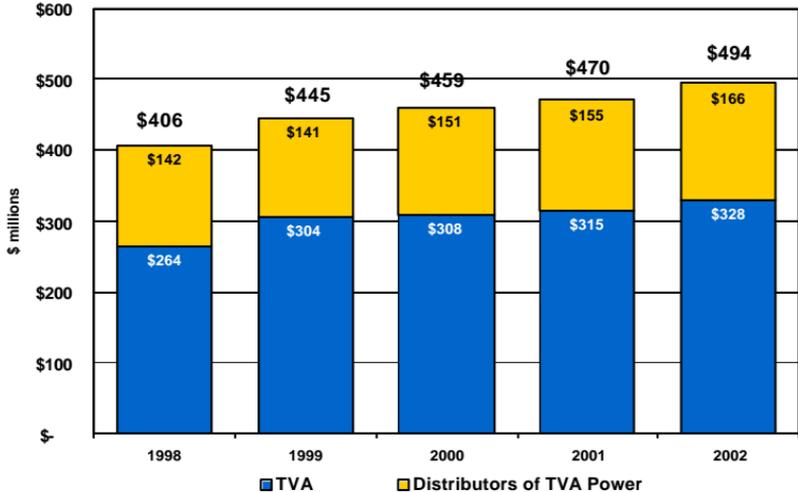
TVA Pays “Taxes”

Due to its chartered goal to provide power at the lowest feasible rate, TVA is a profit-neutral entity. TVA would generate very little, if any, income taxes if it were a taxable corporation. Nevertheless, TVA's founding charter, the TVA Act, specifies that TVA make tax-equivalent payments to the areas where its power property is located.

Understanding TVA

TVA paid a record \$328 million in tax-equivalent payments in 2002. Together, TVA and distributors of TVA power paid almost \$500 million in tax and tax-equivalent payments in 2002.

TVA and Distributor Tax and Tax-Equivalent Payments



TVA has paid almost \$1.5 billion to the areas it serves in just the last five years. When this figure is combined with tax and tax-equivalent dollars that distributors of TVA power have paid, the total amount is almost \$2.3 billion over the same time period.

At the federal level, TVA's activities do generate income for the U.S. government, even though TVA is not a taxable corporation. Interest on TVA's bonds is taxed at the federal level but is generally exempt from state and local taxation. An investor-owned utility (IOU), which is financed primarily with common or preferred stock, might or might not generate the same level of federally taxable dividends. The dollars that the federal government potentially receives from income tax paid on the interest from TVA's bonds, combined with TVA's payments to the government on its original investment in the TVA power system, equate to about seven percent of TVA's total revenue.

Comparison of Ultimate Federal Revenue
(\$ millions)

| Federally Taxable Revenue Streams | TVA | | | All IOUs | |
|------------------------------------|------------|------------|------------|------------|------------|
| | 2002 | 2001 | 2000 | 2001 | 2000 |
| Total Revenue | \$ 6,835 | \$ 6,999 | \$ 6,762 | \$ 567,800 | \$ 458,139 |
| Net Interest Expense | \$ 1,429 | \$ 1,633 | \$ 1,736 | \$ 22,966 | \$ 21,172 |
| Common & Preferred Dividends | - | - | - | 13,200 | 13,514 |
| <i>Total:</i> | \$ 1,429 | \$ 1,633 | \$ 1,736 | \$ 36,166 | \$ 34,686 |
| <i>Assumed Individual Tax Rate</i> | <i>28%</i> | <i>28%</i> | <i>28%</i> | <i>28%</i> | <i>28%</i> |
| Effective Federal Tax Revenue | \$ 400 | \$ 457 | \$ 486 | \$ 10,126 | \$ 9,712 |
| Corporate Income Taxes Expensed | - | - | - | 13,044 | 8,421 |
| Return to U.S. Treasury | 50 | 55 | 54 | - | - |
| <i>Ultimate Federal Revenue:</i> | \$ 450 | \$ 512 | \$ 540 | \$ 23,170 | \$ 18,133 |
| Percent of Total Revenue: | 7% | 7% | 8% | 4% | 4% |

Source: EEI 2001 Financial Review Plus Preview of 2002 & TVA Annual Report 2002

TVA Operates Under Strong Regulation and Oversight

TVA was created to help generate prosperity in the Tennessee Valley by providing reliable, affordable power, acting as a steward of the region's resources, and fostering economic development of the region. TVA is committed to conducting its business in a manner that warrants the confidence and support of its investors, customers, Congress, and the Administration.

TVA is a wholly owned federal corporation that is required by its charter, the TVA Act, to charge "rates as low as are feasible" for its power. Because of this, TVA is exempt from regulations that are intended to limit excessive prices. While TVA is exempt from certain laws that are not applicable, it is subject to a number of laws, regulations, and controls that do not apply to IOUs.

Understanding TVA

TVA has an Office of the Inspector General (IG) that has broad powers to conduct audits and investigations related to TVA programs and operations. The IG keeps the TVA Board and Congress fully and currently informed about any problems and deficiencies relating to such programs and operations. TVA's next Inspector General will be appointed by the President under recently enacted legislation.



In addition, the U.S. House of Representatives has oversight through the Committee on Transportation & Infrastructure. The U.S. Senate maintains oversight through the Committee on Environment & Public Works. Also, TVA provides information to members of various congressional committees upon request.

Other government bodies that review TVA's activities on a regular basis include the Office of Management & Budget (OMB), the Congressional Budget Office (CBO), the General Accounting Office (GAO), the Environmental Protection Agency (EPA), the Department of Energy (DOE), and the Nuclear Regulatory Commission (NRC). Certain TVA activities are also subject to state environmental regulation. TVA's investors are well-protected by the existing oversight provided by TVA's Inspector General, Congress, and these federal agencies.

TVA Corporate Governance

TVA has adopted a Corporate Accountability & Disclosure Plan to demonstrate its commitment to conducting its business in a manner that warrants the confidence and support of its investors, customers, Congress, and the Administration. This plan will ensure that TVA's disclosure and financial procedures and reports provide an accurate description of its financial condition. The plan does so by:

- *Establishing a certification process for TVA's financial reporting documents,*
- *Establishing procedures to increase the independence of TVA's outside auditor,*
- *Establishing a code of financial ethics,*
- *Creating a Disclosure Control Committee that will develop and implement disclosure controls and procedures and review material information about TVA, both of an operational and financial nature, and determine how best to disclose appropriate information, and*
- *Creating a program to train the appropriate people within TVA about these matters.*

Accurate and timely disclosure of material information about TVA's operations and finances will provide the holders of TVA securities and other stakeholders with the type of financial information that a corporation of TVA's scope customarily provides to its investors.

TVA Tomorrow

For almost 70 years, TVA has carried out its mandate to provide reliable, affordable electric power, acting as a steward of the region's natural resources and the Tennessee River system, and supporting economic development in the Tennessee Valley.

Going forward, TVA will continue to carry out these objectives, working to ensure that fundamental public responsibilities such as reliability, equitable access, environmental stewardship, and economic development are not jeopardized as the energy industry evolves.