

**LEGAL NOTICE REGARDING**  
**\$575,000,000**  
**TENNESSEE VALLEY AUTHORITY**  
**POWER BONDS 1998 SERIES D DUE JUNE 1, 2028**  
**(PUTABLE AUTOMATIC RATE RESET SECURITIES)**

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TVA is issuing this legal notice (1) to clarify the procedures that you should follow in order to put Tennessee Valley Authority Power Bonds 1998 Series D Due June 1, 2028 (Putable Automatic Rate Reset Securities) (the “Bonds”) back to TVA in the event that a Coupon Rate reset notice is given and (2) to clarify the procedures used to determine whether the Coupon Rate on the Bonds will be reset. Unless otherwise defined herein, all capitalized terms in this legal notice shall have the meanings assigned to them in the offering circular relating to the Bonds dated June 2, 1998, and supplemented June 10, 1998 (as supplemented, the “Offering Circular”).

**Changes to Put Procedures**

TVA has waived the requirement that the Summary Election Form and the Option to Elect Repayment Form be completed and submitted in accordance with the instructions regarding those two forms contained in the Offering Circular. Accordingly, you no longer need to notify TVA of your exercise of the put option, and no forms need to be provided to TVA regarding your exercise of this option.

If you wish to exercise the put option in the event that a Coupon Rate reset notice is given, you must still comply with the instructions provided by The Depository Trust Company (“DTC”) regarding the exercise of the put option. These instructions can be obtained from DTC through the Financial Institution through which you beneficially hold your Bonds.

It is your responsibility to notify your Financial Institution that you are requesting repayment and are authorizing your Financial Institution to make arrangements, on your behalf, with DTC for the exercise of the put option. These arrangements with DTC must be completed ***no earlier than*** the relevant Reset Notification Date and ***no later than*** May 22 (or the prior Business Day, if such date is not a Business Day) of the year of such Reset Notification Date.

It is also your responsibility to determine from your Financial Institution the amount of advance notice it needs from you to complete arrangements with DTC to properly exercise the put option within the time period described above. In addition, you are responsible for ensuring that your Financial Institution completes the necessary arrangements with DTC, including any timely notice to DTC and timely delivery of your Bonds to TVA through DTC's book-entry system. If your Financial Institution does not properly complete all necessary arrangements with DTC regarding the timely exercise of the put option, TVA shall not be obligated to honor your request to put your Bonds.

If you do not wish to exercise the put option in the event that a Coupon Rate reset notice is given, no action is required. However, it is recommended that you discuss any such option with a qualified financial advisor.

### **Changes in Coupon Rate Reset Procedures**

The Offering Circular provides that the CMT will be used to determine whether the Coupon Rate will be reset. The Offering Circular also provides that if the CMT is discontinued or materially altered while the Bonds are outstanding, TVA may, in its sole discretion, substitute an alternative index that TVA believes most closely resembles the CMT before it was discontinued or altered. Since the CMT was discontinued on February 18, 2002, and reintroduced on February 9, 2006, TVA substituted an estimated 30-year rate for the CMT during this time; however, effective immediately, TVA will begin using the CMT again as originally provided for in the Offering Circular to determine whether the Coupon Rate will be reset. The CMT can currently be found on the United States Treasury's web site at:

<http://www.treas.gov/offices/domestic-finance/debt-management/interest-rate/yield.shtml>

If you have any questions about the procedures for putting your Bonds back to TVA or the way in which TVA will determine whether the Coupon Rate will be reset, please call TVA Investor Relations at 888-882-4975.

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This legal notice was originally dated March 18, 2004, and was updated on March 31, 2005, and on February 24, 2006.

SUPPLEMENT TO OFFERING CIRCULAR DATED JUNE 2, 1998

**\$575,000,000**

## **Tennessee Valley Authority**

### **POWER BONDS 1998 SERIES D DUE JUNE 1, 2028 (Putable Automatic Rate Reset Securities)**

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The Offering Circular dated June 2, 1998 (the "Offering Circular") relating to Tennessee Valley Authority's offering of its Power Bonds 1998 Series D Due June 1, 2028 (Putable Automatic Rate Reset Securities) (the "Bonds") is hereby supplemented by the information contained herein. Unless otherwise defined herein, all capitalized terms in this Supplement shall have the meaning assigned thereto in the Offering Circular. You should rely on information in this Supplement over different information in the Offering Circular and current Information Statement, but you should continue to rely on information in the Offering Circular and current Information Statement that is not modified by information contained in this Supplement.

TVA has amended the Supplemental Resolution, which now allows the Bonds to be issued through the book-entry system of The Depository Trust Company ("DTC") as described herein. The Bonds will be issued, maintained and transferred only on DTC's book-entry system and not on the Federal Reserve Banks' book-entry system.

The Underwriters have exercised their option to purchase \$75,000,000 of the \$100,000,000 of Bonds available to cover over-allotments. It is expected that delivery of the Bonds will be made through the facilities of DTC, New York, New York on or about June 11, 1998, against payment therefor.

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**MORGAN STANLEY DEAN WITTER  
A.G. EDWARDS & SONS, INC.  
FIRST TENNESSEE BANK N.A.  
EDWARD D. JONES & CO., L.P.  
PRUDENTIAL SECURITIES INCORPORATED**

June 10, 1998

## DESCRIPTION OF BONDS

### General

The Bonds will be issued through the book-entry system of DTC as described herein. So long as the Bonds are in book-entry form, DTC, its nominee, a successor securities depository or its nominee, as the case may be, will be the sole registered holder (the “Holder”) of the Bonds for all purposes of the Resolutions. Accordingly, each person owning a beneficial interest in the Bonds (a “Beneficial Owner”) must rely on the procedures of DTC and, if such person is not a Participant (as defined below), on the procedures of the Participant through which such person owns its interest in order to exercise any rights of a Holder under the Resolutions. The laws of some jurisdictions require that certain purchasers of securities take physical delivery of such securities in certificated form. Such limits and such laws may impair the ability to transfer beneficial interests in the Bonds. The Federal Reserve Banks will not act as fiscal agent for the Bonds. See “Book-Entry System” below.

### Payment of Principal and Interest

The Bonds (and beneficial interests therein) will be issued in denominations of \$25 in book-entry form through DTC. So long as the Bonds are in book-entry form, payment of principal and interest will be made to DTC, its nominee, a successor securities depository or its nominee, as the case may be.

### Put Option

If the Coupon Rate on the Bonds is reset, you can put any of your Bonds to TVA for repayment. To exercise this put option, you must arrange for your Financial Institution to (i) notify TVA as described under “Put Option” — “Notification of Repayment Election” in the Offering Circular and (ii) return your Bonds as described below under “Return of Bond”. The Summary Election Form and Option to Elect Repayment Form referred to in the Offering Circular and the associated instructions have been modified and are contained in this Supplement. Additional copies of such forms may also be obtained from TVA. **You are responsible for arranging to have your Financial Institution send in the “Summary Election Form” and the “Option to Elect Repayment Form” to TVA in accordance with the procedures and the time limits set in the Offering Circular and in the instructions to such forms.**

*Return of Bond.* If you elect to put your Bonds to TVA your Financial Institution must return your Bonds to TVA by the close of business on June 1 (or the next succeeding Business Day, if such date is not a Business Day) following the relevant Reset Notification Date (the “Return Date”). Your Financial Institution must arrange for the delivery of your Bonds to TVA through DTC’s book-entry system. If there is a delay in repayment of the Bonds due to the fact that TVA cannot verify the receipt of Bonds by close of business on the Return Date, TVA shall not pay interest on such Bonds on or after the requested Return Date.

### Notices

TVA will send all notices about the Bonds, including notices regarding reset of the Coupon Rate, only to DTC. TVA has been advised that such notices will be given by DTC to its Direct Participants, by Direct Participants to Indirect Participants and by Direct and Indirect Participants to Beneficial Owners as described under “Book-Entry System” below. You are responsible for making arrangements with your Financial Institution to obtain all notices about the Bonds.

### Book-Entry System

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee). One or more fully-registered global certificates (the “Global Securities”) will be issued for the Bonds, in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants (“Participants”) deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Participants’ accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers (including certain of the Underwriters), banks, trust companies, clearing corporations, and certain other organizations (“Direct Participants”). DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). The rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, the Global Securities deposited by Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. The deposit of the Global Securities with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership of the Bonds. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Neither DTC nor Cede & Co. will consent or vote with respect to Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to an issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co., as nominee of DTC. DTC’s practice is to credit Direct Participants’ accounts, upon DTC’s receipts of funds and corresponding detail information from an issuer in accordance with their respective holdings shown on DTC’s records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in “street name,” and will be the responsibility of such Participant and not of DTC or TVA, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. is the responsibility of TVA, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.



**SUMMARY ELECTION FORM**  
**(To be completed by the Financial Institution)**  
**TENNESSEE VALLEY AUTHORITY**  
**POWER BONDS 1998 SERIES D DUE JUNE 1, 2028**  
**(PUTABLE AUTOMATIC RATE RESET SECURITIES)**  
**CUSIP NUMBER 880591 300**

*Capitalized terms used and not defined in  
this Summary Election Form shall have the meanings defined  
in the Offering Circular for the Bonds as supplemented on June 10, 1998.*

To: Tennessee Valley Authority

The financial institution named below (the "Financial Institution"), on behalf of each of the beneficial owners named below (the "Beneficial Owners"), hereby exercises the option for repayment of the aggregate principal amount of Bonds designated below. To be valid, this Summary Election Form must be received by TVA at the office specified in the instructions for completing this Summary Election Form (together with the Option to Elect Repayment Form for each Beneficial Owner) *no earlier than* the relevant date on which TVA sends a notice of reset of the Coupon Rate (the "Reset Notification Date") and *no later than* the May 22 (or the prior Business Day if such date is not a Business Day) following the Reset Notification Date. This election shall have no effect with respect to (i) any Bonds for which an Option to Elect Repayment Form is not properly completed and delivered to TVA or (ii) any Bonds which are not timely returned to TVA as required in the instructions accompanying this Summary Election Form.

(1) \_\_\_\_\_  
Name of Financial Institution Requesting Repayment

(2) \_\_\_\_\_  
Aggregate Principal Amount of Bonds to be Repaid

(3) \_\_\_\_\_  
Date

(4) Financial Institution Representative:  
Name:  
Phone Number:  
Fax Number:  
Mailing Address(No P.O. Boxes):

(5) Name of The Depository Trust Company direct participant (if other than the Financial Institution):

(6) Name of Beneficial Owner;	Principal Amount of Bonds to be Repaid:
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

(Continue on separate sheet if necessary.)

Election Number\* (to be completed by TVA): \_\_\_\_\_

\* Upon receipt of this Summary Election Form, TVA will assign an Election Number for the Bonds referred to above and return this Summary Election Form by facsimile to the party specified on line (4) above no later than two Business Days after receipt.

**TVA is an agency and instrumentality of the United States Government. The making of any false or fraudulent statement or representation to TVA is a violation of federal criminal law punishable by fine, imprisonment or both.**

**OPTION TO ELECT REPAYMENT FORM  
(To be completed by the Financial Institution)**

**TENNESSEE VALLEY AUTHORITY  
POWER BONDS 1998 SERIES D DUE JUNE 1, 2028  
(PUTABLE AUTOMATIC RATE RESET SECURITIES)  
CUSIP NUMBER 880591 300**

*Capitalized terms used and not defined in  
this election form shall have the meanings defined  
in the Offering Circular for the Bonds as supplemented on June 10, 1998.*

To: Tennessee Valley Authority

The undersigned financial institution (the "Financial Institution") represents that (1) it has received a valid request for repayment from the beneficial owner listed below (the "Beneficial Owner") of Tennessee Valley Authority Power Bonds 1998 Series D Due June 1, 2028 (Putable Automatic Rate Reset Securities) (the "Bonds" — sometimes called "PARRS") and is currently authorized by the Beneficial Owner to put the Bonds listed below to TVA; and (2) the Beneficial Owner currently owns Bonds in the principal amount listed below, and the Financial Institution currently holds such Bonds through its account or through its agents with The Depository Trust Company.

The Financial Institution agrees to return the Bonds specified below through the book-entry system of The Depository Trust Company to TVA by the close of business on June 1 of the year of election (or the next succeeding Business Day, if such date is not a Business Day). The Financial Institution also agrees that (1) it shall follow the instructions accompanying this form; (2) it shall maintain records in accordance with reasonable industry practice and applicable law with respect to the request and authorization from the Beneficial Owner described in the preceding paragraph for a period of three years from the date of election listed below and shall allow TVA to inspect such records upon request; and (3) the Financial Institution shall indemnify and hold harmless TVA against and from any and all claims, liabilities, costs, losses, expenses, suits and damages resulting from any misrepresentation in this election form or other improper action by the Financial Institution in connection with the request for repayment.\*

- (1) \_\_\_\_\_  
Name of Beneficial Owner Requesting Repayment
- (2) \_\_\_\_\_  
Name of Financial Institution Requesting Repayment
- (3) \_\_\_\_\_  
Signature of Representative of Financial Institution Requesting Repayment  
(Must Be Notarized)
- (4) \_\_\_\_\_  
Principal Amount to be Repaid
- (5) \_\_\_\_\_  
Date of Election

\* TVA may, in its sole discretion, impose any additional authentication requirements on any Financial Institution that fails to meet the record-keeping requirements set forth above.

**TVA is an agency and instrumentality of the United States Government. The making of any false or fraudulent statement or representation to TVA is a violation of federal criminal law punishable by fine, imprisonment or both.**

**INSTRUCTIONS FOR EXERCISING THE REPAYMENT OPTION AND  
COMPLETING THE SUMMARY ELECTION FORM AND THE  
OPTION TO ELECT REPAYMENT FORM FOR  
TENNESSEE VALLEY AUTHORITY  
POWER BONDS 1998 SERIES D DUE JUNE 1, 2028  
(PUTABLE AUTOMATIC RATE RESET SECURITIES)  
CUSIP NUMBER 880591 300**

*Capitalized terms used and not defined in  
these Instructions shall have the meanings defined  
in the Offering Circular for the Bonds as supplemented on June 10, 1998.*

**General Instructions for Exercising the Repayment Option:**

The Financial Institution must:

1. Deliver a completed Summary Election Form, together with an original copy of the completed Option to Elect Repayment Form for each beneficial owner listed on such Summary Election Form, to:

Tennessee Valley Authority  
ATTN: Vice President and Treasurer  
400 West Summit Hill Dr.  
Knoxville, Tennessee 37902.

FACSIMILE TRANSMISSIONS WILL NOT BE ACCEPTED. To be valid, a properly completed Summary Election Form must be received by TVA at the above specified office *no earlier than* the relevant Reset Notification Date and *no later than* May 22 (or the prior Business Day, if such date is not a Business Day) following the Reset Notification Date.

Upon receipt of a Summary Election Form, TVA will assign an Election Number for the Bonds referred to therein and return the Summary Election Form by facsimile to the representative of the Financial Institution specified therein no later than two Business Days after receipt. *If a copy of the Summary Election Form, with the assigned Election Number, is not received by May 27, contact TVA at (423) 632-3366.*

2. Arrange for the aggregate principal amount of the Bonds set forth on the Summary Election Form to be returned to TVA through the book-entry system of The Depository Trust Company by the close of business on June 1 of the year of election (or the next succeeding Business Day, if such date is not a Business Day). If there is a delay in repayment of Bonds due to the fact that TVA cannot verify the receipt of Bonds by the close of business on the Return Date, TVA will not pay interest on such Bonds on or after the requested Return Date.

**Instructions for Completing the Summary Election Form:**

1. Indicate name of Financial Institution completing the Summary Election Form on line (1).
2. Indicate the aggregate principal amount of Bonds of all beneficial owners covered by the Summary Election Form on line (2).
3. Indicate the date the Summary Election Form was completed on line (3).
4. Indicate the name, mailing address (no P.O. boxes, please), telephone number and facsimile transmission number of the person to whom confirmation of these elections may be sent on line (4).
5. Indicate the name of The Depository Trust Company participant through which the Financial Institution holds the Bonds (if the Financial Institution is not a direct participant in The Depository Trust Company).
6. Indicate the name of each beneficial owner requesting repayment and the principal amount of Bonds of each such beneficial owner to be repaid on line (6).

**Instructions for Completing the Option to Elect Repayment Forms:**

1. Indicate the name of the beneficial owner requesting repayment on line (1).
2. Indicate the name of the Financial Institution completing the Option to Elect Repayment Form on line (2).
3. Affix authorized signature of the Financial Institution's representative on line (3). *The signature must be notarized.*
4. Indicate the principal amount of Bonds to be repaid on line (4).
5. Indicate the date the Option to Elect Repayment Form was completed on line (5).

*For assistance with the Summary Election Form  
or the Option to Elect Repayment Forms or any questions relating thereto,  
please telephone TVA at (423) 632-3366.*

**OFFERING CIRCULAR**

**\$500,000,000**



**Tennessee Valley Authority**  
**POWER BONDS 1998 SERIES D DUE JUNE 1, 2028**  
**(PUTABLE AUTOMATIC RATE RESET SECURITIES)**

*The Tennessee Valley Authority Power Bonds 1998 Series D Due June 1, 2028 (Putable Automatic Rate Reset Securities) (the "Bonds" — sometimes called "PARRS") will have the following terms. For more detail, see "Description of Bonds".*

- *The Tennessee Valley Authority ("TVA") — a corporation owned by the United States of America — is the issuer.*
- *Payment of principal and interest will come solely from TVA's Net Power Proceeds (as defined in "Description of Bonds" — "General").*
- *The Federal Reserve Banks will maintain and transfer the Bonds as book-entry securities.*
- *The Bonds will be available for purchase in denominations of \$25.*
- *The Bonds have been approved for listing, subject to notice of issuance, on the New York Stock Exchange. See "Underwriters".*
- *The Bonds will be rated Aaa by Moody's Investors Service and AAA by Standard & Poor's.*
- *Principal and interest on the Bonds are generally exempt from State and local income taxes. See "Tax Matters".*
- *TVA may not redeem the Bonds prior to maturity.*
- *Interest will be paid each March 1, June 1, September 1 and December 1, beginning September 1, 1998.*
- *The rate at which the Bonds bear interest (the "Coupon Rate") may be reset to a lower rate beginning June 1, 2003 and annually thereafter.*
- *The initial Coupon Rate will be 6 3/4%.*
- *If the Coupon Rate is reset to a lower rate, you can put (return) any or all of your Bonds to TVA and receive \$25 for each Bond you put.*

*Investment in the Bonds involves certain risks. You bear all risks associated with investment in the Bonds. See "Risk Factors" on page C-8.*

*The Bonds are not obligations of the United States of America, and it does not guarantee the payment of the principal of or the interest on the Bonds. TVA is not required to register the Bonds under the Securities Act of 1933 or to make reports to the Securities and Exchange Commission. TVA will not register the Bonds or file any reports with the Securities and Exchange Commission.*

	<u>Price to Public (1)</u>	<u>Underwriting Discounts and Commissions</u>	<u>Proceeds to TVA (1) (2)</u>
Per Bond .....	100.00%	3.10%	96.90%
Total (3) .....	\$500,000,000	\$15,500,000	\$484,500,000

(1) Plus accrued interest from June 9, 1998 to date of delivery.  
(2) Before deducting expenses payable by TVA estimated at \$250,000.  
(3) TVA has granted to the Underwriters a three Business Day option to purchase, on the same terms set forth above, up to \$100,000,000 aggregate principle amount of additional PARRS at the initial Price to Public (less the Underwriting Discounts and Commissions) solely to cover over-allotments, if any. If the option is exercised in full, the total initial Price to Public, Underwriting Discounts and Commissions and Proceeds to TVA will be \$600,000,000, \$18,600,000 and \$581,400,000, respectively.

*The Underwriters are required to purchase all of the Bonds if they purchase any of the Bonds. Morgan Stanley & Co. Incorporated expects the Bonds will be delivered to purchasers on June 9, 1998.*

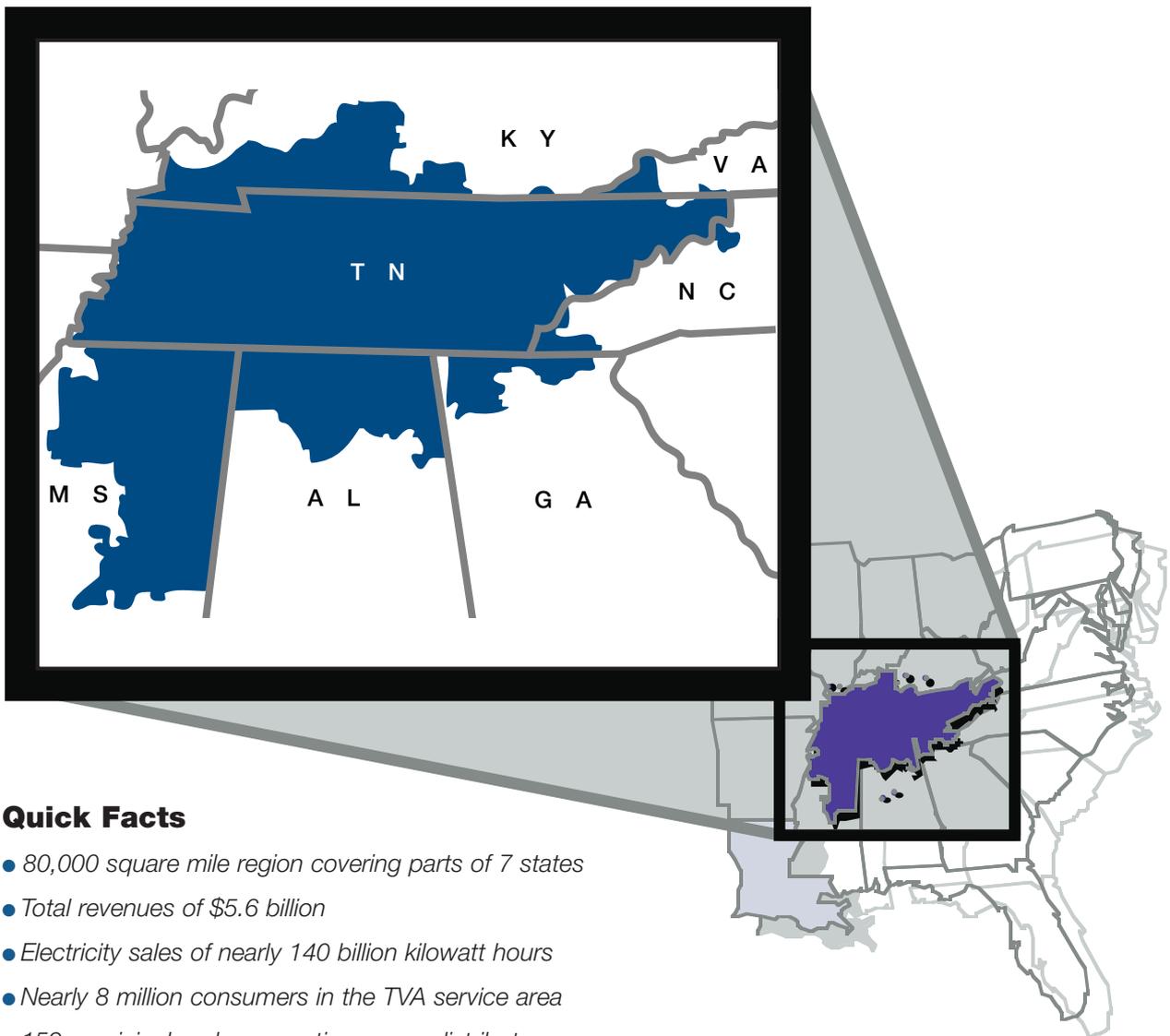
**MORGAN STANLEY DEAN WITTER**  
**A.G. EDWARDS & SONS, INC.**  
**FIRST TENNESSEE BANK N.A.**  
**EDWARD D. JONES & CO., L.P.**  
**PRUDENTIAL SECURITIES INCORPORATED**

June 2, 1998

## TVA Overview

The Tennessee Valley Authority (“TVA”) is a U.S. Government-owned corporation established by Congress in 1933. It is one of the nation’s largest wholesale power producers and maintains a net winter dependable capacity of 28,417 megawatts. TVA also maintains about 17,000 miles of transmission lines, and manages the nation’s fifth-largest river system for flood control, navigation, power production and recreation.

## The Tennessee Valley Authority Service Area



### Quick Facts

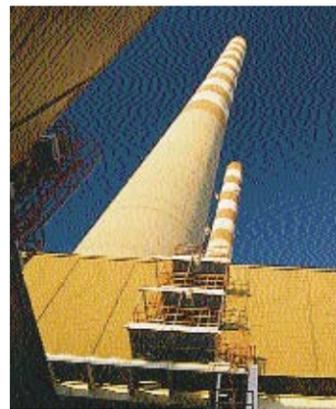
- 80,000 square mile region covering parts of 7 states
- Total revenues of \$5.6 billion
- Electricity sales of nearly 140 billion kilowatt hours
- Nearly 8 million consumers in the TVA service area
- 159 municipal and cooperative power distributors
- 68 directly-served industrial and federal customers
- New York Stock Exchange symbols
  - Bond market symbol: “TVA” (Power Bonds)
  - Equity symbols: “TVA” (8% QIDS) and “TVB” (7.5% QIDS)



# PROVIDING POWER IN THE PUBLIC INTEREST

The Tennessee Valley Authority is more than just a power company.

TVA is one of the nation's largest



wholesalers of electricity, a national model for watershed management,

and a model for regional development programs around the world.



TVA provides reliable, universal access to electricity at competitive prices and provides stewardship of the lands and waters of the Tennessee River Valley. TVA power enriches lives, promotes economic growth, and improves the overall quality of life in the Tennessee Valley.



TVA's power system is entirely self-funded and not supported by any U.S. federal tax dollars. The power system is running better today than at any time in the past decade. TVA has made substantial improvements to its nuclear program over the last decade, restarting four nuclear units, completing and starting a fifth and bringing its total nuclear generation to over 40 billion kWh in fiscal 1997. TVA's fossil and hydro plants increased their productivity by about 20 percent systemwide between fiscal 1994 and 1997. TVA carries out other programs mandated by the U.S. Congress, such as eco-

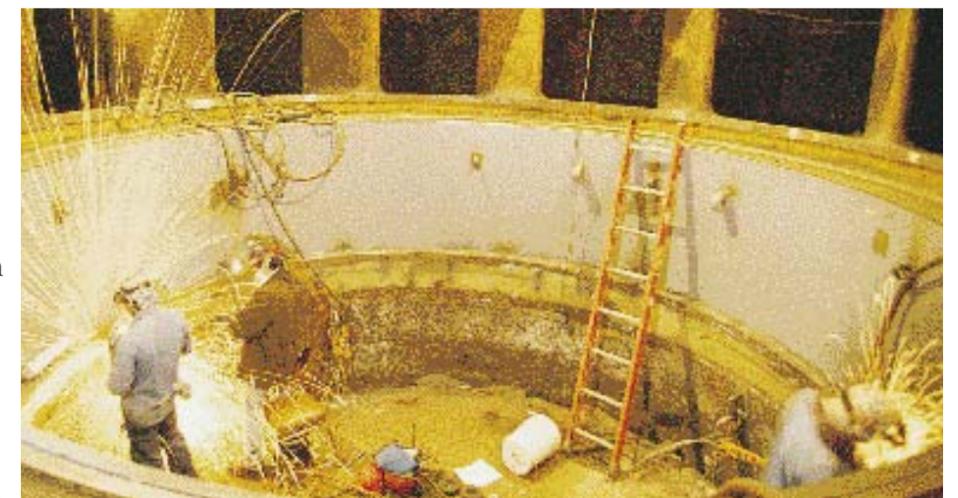
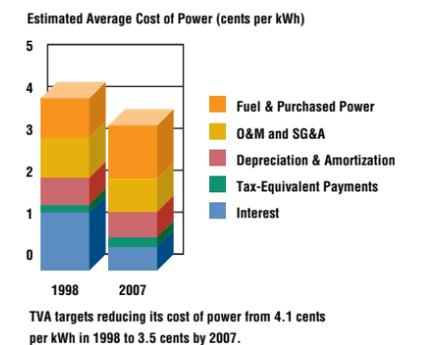
nomie development, flood control, navigation and natural resource development on the Tennessee River.

TVA unveiled an ambitious 10-year Business Plan in July 1997 that is designed to strengthen it financially, position the electric power operations to meet the competitive challenges of a restructured marketplace, promote economic development and provide power to its customers at the lowest feasible rates. This plan sets a focused course for TVA to reduce its debt by half by 2007 and lower its average cost of power to 3.5 cents per kilowatt hour.

The 10-year Business Plan is designed to accomplish long-term objectives that would enable TVA to be competitive in the coming restructured marketplace by:

- Reducing the cost of power as needed to meet the lower market prices anticipated in a more competitive market.
- Altering TVA's cost structure from a high fixed-to-variable cost relationship to a more flexible structure better suited to a volatile, competitive market.
- Strengthening customer allegiance and satisfaction by developing opportunities for mutual support and partnerships.

TVA is committed to serving the public good—through economic development, reliable service, environmental stewardship and universal access. TVA, as a government owned power entity, is an advocate for the public interest in electricity generation, transmission and distribution as the electric utility industry is restructured.



**THE UNDERWRITERS OF THE BONDS MAY ENGAGE IN TRANSACTIONS THAT STABILIZE, MAINTAIN, OR OTHERWISE AFFECT THE PRICE OF THE BONDS. SPECIFICALLY, THE UNDERWRITERS MAY OVERALLOT IN CONNECTION WITH THE OFFERING AND MAY BID FOR, AND PURCHASE, BONDS IN THE OPEN MARKET. FOR A DESCRIPTION OF THESE ACTIVITIES, SEE “UNDERWRITERS”.**

*You should rely only on the information contained in this document. We have not authorized anyone to provide you with information that is different.*

You should read this Offering Circular together with the attached Information Statement, dated February 27, 1998 (the “current Information Statement”). This Offering Circular and the current Information Statement are accurate only as of the date of each. TVA assumes no duty to update the Offering Circular or the current Information Statement after the date of each. You should rely on information in the Offering Circular if there is different information in the current Information Statement.

You may request additional copies of this Offering Circular and the current Information Statement in writing or by telephone:

Tennessee Valley Authority  
400 West Summit Hill Drive  
Knoxville, Tennessee 37902  
Attention: Vice President and Treasurer  
Telephone: (423) 632-3366.

You may inspect the Offering Circular and the current Information Statement and other information concerning TVA at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

This Offering Circular does not constitute an offer to sell or a solicitation of an offer to buy the Bonds in any jurisdiction to any person to whom it is unlawful to make an offer or solicitation.

## **FORWARD-LOOKING STATEMENTS**

This Offering Circular and the current Information Statement contain forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions or assumptions or otherwise relating to future events or performance may be forward-looking.

Some examples of forward-looking statements include statements regarding TVA's projections of future power and energy requirements, future costs related to environmental compliance and targets for TVA's future competitive position. Although TVA believes that these statements are accurate, TVA does not guarantee their accuracy.

Numerous factors could cause actual results to differ materially from those in the forward-looking statements. Some of these factors are: new laws and regulations, especially those related to the deregulation of electric utilities, the status of TVA as a government agency, and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial environment; performance of TVA's generating facilities; fuel prices; the demand for electricity; weather conditions; changes in accounting standards; and unforeseeable adverse events.

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## SUMMARY OF OFFERING

*Because this is a summary, it does not contain all the information that may be important to you. You should carefully read the entire Offering Circular together with the current Information Statement. Capitalized terms used and not defined in this section have the meanings defined elsewhere in the Offering Circular and current Information Statement.*

### **Issuer**

TVA is a wholly owned corporate agency and instrumentality of the United States of America established by the Tennessee Valley Authority Act of 1933, as amended.

### **Securities Offered**

\$500,000,000 aggregate principal amount of Tennessee Valley Authority Power Bonds 1998 Series D Due June 1, 2028 (Putable Automatic Rate Reset Securities).

### **Interest Rate**

TVA will pay interest on the Bonds from June 9, 1998, quarterly in arrears on each March 1, June 1, September 1, and December 1, beginning September 1, 1998. The initial Coupon Rate of the Bonds will be 6 3/4%. Beginning June 1, 2003 and on the same date each year thereafter, the Coupon Rate will be reset to a lower rate, if on the Calculation Date the CMT (as defined in "Description of Bonds" — "Interest Computation") plus 0.94% is lower than the Coupon Rate in effect on the Calculation Date. The new Coupon Rate will apply until there is another reset, if any. See "Risk Factors" and "Description of Bonds" — "Interest Computation".

### **Redemption**

The Bonds will not be subject to redemption by TVA prior to maturity.

### **Put Option**

Whenever the Coupon Rate is reset to a lower rate, you can put (return) your Bonds to TVA. TVA will pay \$25 for each Bond you properly put. To put your Bonds to TVA, you must arrange for the broker or other financial institution through which you hold your Bonds (your "Financial Institution") to notify TVA. Your Financial Institution will also be required to have any Bonds you decide to put delivered by the deadlines set forth under

"Description of Bonds" — "Put Option" and to comply with the instructions accompanying the Summary Election Form and the Option to Elect Repayment Form attached to this Offering Circular. See "Description of Bonds" — "Put Option".

### **Repayment**

The Bonds will be repaid at par (\$25) on the Maturity Date or on the date you properly put your Bonds to TVA. Interest will be paid separately as described in "Description of Bonds" — "Payment of Principal and Interest".

### **Fiscal Agent**

The Federal Reserve Banks will act as TVA's Fiscal Agent.

### **Listing**

The Bonds have been approved for listing, subject to notice of issuance, on the New York Stock Exchange. See "Underwriters".

### **Ratings**

The Bonds will be rated Aaa by Moody's Investors Service and AAA by Standard & Poor's.

### **Use of Proceeds**

TVA will use the net proceeds from the sale of the Bonds to retire existing debt.

### **Source of Payment**

TVA will pay the interest and principal on the Bonds solely from its Net Power Proceeds. The Bonds are not obligations of or guaranteed by the United States. See "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" in the current Information Statement.

### **Form and Denomination of Bonds**

The Bonds will be issued and maintained, and may be transferred only by Holders, on the book-

entry system of the Federal Reserve Banks. See “Description of Bonds” — “Book-Entry System”. You will not be able to exchange the Bonds for definitive securities. The Bonds will be issued, maintained and transferred in principal amounts of \$25.

### **Legality of Investment**

The laws of some jurisdictions limit the type and amount of securities that certain institutional investors may acquire. You should consult with your own counsel regarding legality of investment in the Bonds. The Bonds could be subject to certain restrictions or requirements as to legality of investment that do not apply to Power Bonds with fixed rates of interest. Generally, Power Bonds *with fixed rates of interest* are:

- acceptable as security for all fiduciary, trust and public funds, the investment or deposit of which is under the authority or control of any officer or agency of the United States;
- eligible as collateral for Treasury tax and loan accounts;
- obligations that national banks may deal in, underwrite and buy for their own accounts in amounts up to ten percent of their unimpaired capital and surplus;
- eligible as collateral for advances by Federal Reserve Banks to member banks;
- legal investments for federal savings associations and federal savings banks to the extent specified in applicable regulations;
- eligible as collateral for advances by Federal Home Loan Banks to members for which Power Bonds are legal investments; and
- legal investments for federal credit unions.

See “Legality of Investment”.

### **No Acceleration Right**

Holders may not accelerate the maturity of the Bonds upon any default.

### **Taxation**

The Bonds are subject to various tax consequences. Principal and interest on the Bonds are generally exempt from State and local income taxes. See “Tax Matters”.

### **CUSIP Number**

880591 300

## **RISK FACTORS**

If you invest in the Bonds, you are subject to risk factors not associated with investments in typical fixed-interest rate or floating-interest rate securities:

- The Coupon Rate at which the Bonds bear interest, though initially set at 6¾%, may be reset beginning June 1, 2003 and annually thereafter to a lower rate. The Coupon Rate will never be adjusted upward. For details on how the Coupon Rate is calculated, see “Description of Bonds” — “Interest Computation”.
- The Bonds are a new product with no established trading market. TVA has been advised by the Underwriters that they presently intend to make a market in the Bonds, as permitted by applicable laws and regulations. The Underwriters are not obligated, however, to make a market in the Bonds, and any such market making may be discontinued at any time at the sole discretion of the Underwriters. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the Bonds.
- The Option to Elect Repayment Form and the accompanying instructions require the broker or other financial institution through which you beneficially hold your Bonds (your “Financial Institution”) to make certain representations and agree to certain terms, including the indemnification of TVA against certain losses and costs. If your Financial Institution will not make such representations or will not agree to such terms, TVA shall not be obligated to honor your request for repayment. See “Description of Bonds” — “Put Option”.
- If your Financial Institution does not put your Bonds to TVA in accordance with the procedures and time limits described in “Description of Bonds” — “Put Option” and in the Summary Election Form and the accompanying instructions, TVA will not be obligated to honor your request to put the Bonds.

You bear these and all other risks which may be associated with investment in the Bonds.

## QUESTIONS AND ANSWERS ABOUT TVA'S PARRS

*These questions and answers do not provide all information that may be important to you. You should carefully read the entire Offering Circular together with the current Information Statement. Capitalized terms used herein and not defined shall have the same meanings defined elsewhere in the Offering Circular and current Information Statement.*

**Q: Are Principal and Interest Taxable?**

Both principal and interest on the Bonds are generally exempt from State and local tax, except estate, inheritance and gift taxes. The Bonds are not exempt from federal income tax.

**Q: Can I receive a certificate for my Bond?**

No. The Bonds will be held only on the Federal Reserve Banks' book-entry system in book-entry form. Unless you are a Holder on the Federal Reserve Banks' book-entry system, you will hold your Bonds indirectly through one or more financial intermediaries such as banks, brokerage firms and securities clearing organizations.

**Q: How will the Coupon Rate change over the life of the Bond?**

Beginning June 1, 2003 and on the same date each year, the Coupon Rate will be reset to a lower rate if the 30 year CMT, for the week ending the last Friday in April, plus 0.94% is less than the Coupon Rate then in effect.

**Q: How can I calculate the reset Coupon Rate?**

The rate used to calculate the reset is the CMT for the week ending the last Friday in April beginning with the week ending April 25, 2003. The CMT is the rate published in "Statistical Release H.15(519), 'Selected Interest Rates'" or any successor publication, published by the Board of Governors of the Federal Reserve System under the heading "U.S. government securities — Treasury constant maturities — 30-year". This publication is located on the Internet at [www.bog.frb.fed.us/releases/h15](http://www.bog.frb.fed.us/releases/h15). The 30 year CMT average for the week can also be found every Tuesday in *The Wall Street Journal*, Section C, under "Key Interest Rates". The reset Coupon Rate will be the sum of the relevant CMT plus 0.94%.

**Q: If the Coupon Rate is reset downward, can it go up later?**

No. The Coupon Rate may only be adjusted downward. If the Coupon Rate is reset to a lower rate, you have the option to put your Bonds to TVA and receive \$25 for each Bond.

**Q: What happens to the Coupon Rate on the Bond in the first five years?**

The Coupon Rate on the Bond will not change in the first five years.

**Q: Can TVA call my Bonds?**

No. TVA cannot call the Bonds.

**Q: How will I be notified if the Coupon Rate is reset?**

Unless you are a Holder on the Federal Reserve Banks' book-entry system, you should make arrangements with your Financial Institution holding your Bonds to receive reset notices. TVA will send notice of reset to the Federal Reserve Bank of New York. The Federal Reserve Bank of New York will then broadcast notice of reset over the Federal Reserve Banks' broadcast system.

**Q: When can I put (return) the Bonds?**

You can put your Bonds to TVA on any date when the Coupon Rate is reset (or the next succeeding Business Day, if such date is not a Business Day).

You are responsible for arranging to have your Financial Institution send the "Summary Election Form" and the "Option to Elect Repayment Form" (found in this Offering Circular) to TVA. TVA must receive these forms no later than May 22 of the year the relevant Coupon Rate reset will occur (or the prior Business Day, if such date is not a Business Day).

**Q: How will the Bonds rank compared to TVA's other debt?**

The Bonds will rank equal to TVA's other outstanding Power Bonds.

**Q: When is the last day to purchase the Bonds to receive the next quarterly interest payment?**

To receive payment, you must hold your Bonds on the record date (the Business Day immediately before the relevant Interest Payment Date).

**Q: Can I purchase Bonds directly from TVA?**

No. You must purchase your Bonds through a broker or other proper financial intermediary.

**Q: Are the Bonds backed by the U.S. Government?**

No. The Bonds are not obligations of or guaranteed by the U.S. Government.

## TENNESSEE VALLEY AUTHORITY

The Tennessee Valley Authority is one of the largest power producers in the United States of America, having produced nearly 153 billion kilowatt-hours (“kWh”) of electricity in fiscal 1997. The TVA system supplies electric power to a region containing nearly eight million people located in parts of Tennessee, Kentucky, Mississippi, Alabama, Georgia, North Carolina and Virginia.

TVA is a wholly owned corporate agency and instrumentality of the United States of America established pursuant to the Tennessee Valley Authority Act of 1933, as amended (the “Act”), primarily to develop and manage the resources of the Tennessee Valley region. The programs at TVA consist of power and nonpower programs. The Act requires TVA’s electric system operations to be self-supporting from power system revenues, which were about \$5.6 billion in fiscal 1997. No tax dollars fund TVA’s power program. The Act authorizes TVA to issue Evidences of Indebtedness (as defined in “Description of Bonds”), the proceeds of which TVA may only use to finance its power program. TVA’s nonpower activities include responsibilities associated with operation of the Tennessee River System, land management, economic development and the environment. Congress provided \$70 million for TVA’s nonpower programs in fiscal 1998. Appropriations legislation enacted in October 1997 anticipates no further appropriations to TVA in fiscal years following 1998. See “The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness” — “Recent Legislation” in the current Information Statement.

For over six decades, TVA has been associated with bringing prosperity to a significant region of the United States. Its dams have averted an estimated \$4 billion in flood damage; its power program has brought electricity to a large undeveloped area of the country; and its economic development program has contributed to a vast increase in the number of jobs in the Tennessee Valley.

Electric power industry restructuring is changing the way TVA and utilities across the nation generate, transmit and distribute electricity. TVA is

positioning itself to successfully compete in a restructured marketplace by sustaining excellent operational performance and achieving greater financial flexibility. For the years 1995 and 1996, TVA ranked as the second lowest-cost producer among the nation’s largest 50 utilities according to information published in the October 1996 and 1997 issues of *Electric Light & Power* magazine. Building on its operational soundness, TVA implemented its Ten-Year Business Plan in October 1997 to reduce its total delivered cost of power consistent with the forecast future market price of power and adopt a more flexible cost structure suitable for an increasingly volatile marketplace. See “Competition” in the current Information Statement.

TVA is an advocate for the public’s interest in universal access, customer service and reliability, economic development and environmental protection. TVA will continue to work actively with Congress to ensure that these standards are upheld through the development of an equitable, effective framework for success in a restructured marketplace.

### USE OF PROCEEDS

TVA will use the net proceeds from the sale of the Bonds to retire existing debt.

### RECENT DEVELOPMENTS

#### Financial Results

TVA has derived the condensed financial statements for TVA’s power program for the fiscal years ended September 30, 1997 and 1996 from TVA’s audited financial statements. The condensed financial statements for TVA’s power program for the six months ended March 31, 1998 and 1997 are unaudited but in the opinion of management of TVA include all adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of results for such periods. You should read the following information together with the audited financial statements and notes thereto in the current Information Statement. Results for the six months ended March 31, 1998 and for past years are not necessarily indicative of future results.

**TENNESSEE VALLEY AUTHORITY  
POWER PROGRAM  
CONDENSED BALANCE SHEETS  
At March 31, 1998 and September 30, 1997**

	March 31, 1998	September 30, 1997
	(Millions)	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents .....	\$ 643	\$ 299
Accounts receivable .....	593	701
Inventories and other, at average cost .....	465	399
Total current assets .....	1,701	1,399
<b>PROPERTY, PLANT, AND EQUIPMENT</b>		
Completed plant .....	28,704	28,528
Less accumulated depreciation .....	(7,537)	(7,178)
Net completed plant .....	21,167	21,350
Construction in progress .....	565	605
Deferred nuclear generating units .....	6,306	6,303
Nuclear fuel and capital lease assets .....	938	1,040
Total property, plant, and equipment .....	28,976	29,298
INVESTMENT FUNDS .....	643	561
DEFERRED CHARGES AND OTHER ASSETS(1) .....	2,496	2,426
Total assets .....	\$33,816	\$33,684
<b>LIABILITIES AND PROPRIETARY CAPITAL</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable .....	\$ 354	\$ 468
Accrued liabilities .....	126	161
Accrued interest .....	499	499
Short-term debt .....	1,717	2,151
Current maturities of long-term debt .....	203	574
Total current liabilities .....	2,899	3,853
OTHER LIABILITIES(1) .....	2,197	1,704
<b>LONG-TERM DEBT</b>		
Public bonds — senior .....	20,999	20,354
Federal Financing Bank — senior .....	3,200	3,200
Public bonds — subordinated .....	1,100	1,100
Unamortized discount and other adjustments .....	(568)	(502)
Total long-term debt .....	24,731	24,152
<b>PROPRIETARY CAPITAL</b>		
Appropriation investment .....	578	588
Retained earnings reinvested in power program .....	3,411	3,387
Total proprietary capital .....	3,989	3,975
Total liabilities and proprietary capital .....	\$33,816	\$33,684

(1) Effective October 1, 1997 TVA changed its method of accounting for decommissioning costs and related liabilities. See “Nuclear Power Program” — “Decommissioning” in the current Information Statement. The effect of the change for the six months ended March 31, 1998 was to increase Deferred Charges and Other Assets by \$381 million, increase Other Liabilities by \$436 million and increase Depreciation and Amortization by \$55 million.

**TENNESSEE VALLEY AUTHORITY  
POWER PROGRAM**

**CONDENSED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS  
For the Six Months Ended March 31, 1998 and 1997  
and for the Years Ended September 30, 1997 and 1996**

	Six Months Ended March 31,		Years Ended September 30,	
	1998	1997	1997	1996
	(Millions)			
<b>OPERATING REVENUES</b>				
Sales of electricity				
Municipalities and cooperatives . . . . .	\$2,580	\$2,350	\$4,811	\$4,980
Industries directly served . . . . .	242	227	464	452
Federal agencies . . . . .	86	97	179	172
Other . . . . .	34	40	98	89
Total operating revenues . . . . .	2,942	2,714	5,552	5,693
<b>OPERATING EXPENSES</b>				
Fuel and purchased power, net . . . . .	643	555	1,211	1,278
Operating and maintenance . . . . .	614	603	1,201	1,218
Depreciation and amortization(1) . . . . .	517	488	1,014	904
Tax-equivalents . . . . .	131	135	272	256
Total operating expenses . . . . .	1,905	1,781	3,698	3,656
<b>OPERATING INCOME . . . . .</b>	<b>1,037</b>	<b>933</b>	<b>1,854</b>	<b>2,037</b>
<b>OTHER INCOME (EXPENSE), NET . . . . .</b>	<b>(5)</b>	<b>1</b>	<b>157</b>	<b>(10)</b>
Income before interest charges . . . . .	1,032	934	2,011	2,027
<b>INTEREST CHARGES</b>				
Interest expense . . . . .	1,017	1,046	2,084	2,083
Allowance for funds used during construction . . . . .	(29)	(42)	(81)	(117)
Net interest charges . . . . .	988	1,004	2,003	1,966
<b>NET INCOME (LOSS) . . . . .</b>	<b>44</b>	<b>(70)</b>	<b>8</b>	<b>61</b>
Return on appropriation investment . . . . .	(20)	(21)	(41)	(43)
Increase (decrease) in retained earnings . . . . .	24	(91)	(33)	18
Retained earnings reinvested at beginning of period . . . . .	3,387	3,420	3,420	3,402
Retained earnings reinvested at end of period . . . . .	\$3,411	\$3,329	\$3,387	\$3,420

(1) See Note 1 to Condensed Balance Sheets.

**TENNESSEE VALLEY AUTHORITY  
POWER PROGRAM**

**CONDENSED STATEMENTS OF CASH FLOWS  
For the Six Months Ended March 31, 1998 and 1997  
and for the Years Ended September 30, 1997 and 1996**

	Six Months Ended March 31,		Years Ended September 30,	
	1998	1997	1997	1996
	(Millions)			
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Net income (loss) (1) .....	\$ 44	\$ (70)	\$ 8	\$ 61
Items not requiring cash(1) .....	646	601	1,030	1,125
Other, net .....	<u>(132)</u>	<u>11</u>	<u>28</u>	<u>(276)</u>
Net cash provided by operating activities .....	<u>558</u>	<u>542</u>	<u>1,066</u>	<u>910</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Construction expenditures .....	(240)	(331)	(722)	(1,107)
Allowance for funds used during construction .....	29	42	81	117
Other, net .....	<u>(35)</u>	<u>(41)</u>	<u>61</u>	<u>(264)</u>
Net cash used in investing activities .....	<u>(246)</u>	<u>(330)</u>	<u>(580)</u>	<u>(1,254)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Borrowings, net(2) .....	(163)	(395)	(352)	637
Other(2) .....	<u>195</u>	<u>(33)</u>	<u>(73)</u>	<u>(107)</u>
Net cash provided by (used in) financing activities .....	<u>32</u>	<u>(428)</u>	<u>(425)</u>	<u>530</u>
Net change in cash and cash equivalents .....	<u>\$ 344</u>	<u>\$ (216)</u>	<u>\$ 61</u>	<u>\$ 186</u>

(1) See Note 1 to Condensed Balance Sheets. The effect on the Condensed Statements of Cash Flows for the six months ended March 31, 1998 was to decrease Net income by \$55 million and to increase Items not requiring cash by \$55 million.

(2) The six months ended March 31, 1997 has been reclassified to conform to fiscal 1998 presentation.

**Results of Operations for the Six Months Ended March 31, 1998**

Net income of \$44 million for the six months ended March 31, 1998 represented an increase of \$114 million from the net loss of \$70 million for the six months ended March 31, 1997. Operating revenues increased \$228 million from \$2,714 million for the six months ended March 31, 1997 to \$2,942 million for the six months ended March 31, 1998. This improvement was primarily due to a rate increase effective October 1, 1997, coupled with an increase in kilowatt-hour sales of 3 percent, from 68 billion kilowatt-hours for the six months ended March 31, 1997 to 70 billion kilowatt-hours for the same period in fiscal 1998.

Operating expenses for the six months ended March 31, 1998 were \$1,905 million compared with \$1,781 million for the same period in fiscal 1997. The \$124 million increase consists primarily of higher net fuel and purchased power expense related to higher overall generation and higher coal prices, higher depreciation and amortization expenses related to capital project completions, higher operating and maintenance expenses attributable to the timing of certain nuclear plant outages and a decrease in the amount of general and corporate costs allocated to construction projects.

Net interest expense decreased \$16 million for the six months ended March 31, 1998 compared to the same period in fiscal 1997. These reductions resulted from both a lower level of total outstanding debt and lower average interest rates during the first six months of fiscal 1998.

**Liquidity and Capital Resources**

In March 1998, TVA issued in the public market \$1,000 million in Global Power Bonds (due 2013) to retire existing debt. In April 1998, TVA increased short-term debt owed to the U.S. Treasury by \$134 million.

Net cash provided by operations increased \$16 million for the six months ended March 31, 1998 compared with the same period in fiscal 1997. Cash used for construction activities declined \$91 million for the six months ended March 31, 1998 compared with the same period in fiscal 1997. These reductions reflect, in part, the continued emphasis on cost control and process improvement initiatives. Operating cash flow, net of cash used for construction activities, was \$312 million for the six months ended March 31, 1998 and will be applied toward TVA's debt reduction efforts.

## Other Matters

In the spring of 1998, TVA's Allen Fossil Plant team received the Rochester Institute of Technology/*USA Today* Quality Cup award in the government category for their work in reducing the cost of compliance with environmental rules requiring coal plants to emit less sulfur dioxide. The team's work resulted in (1) a drop in sulfur dioxide emissions from 80,000 tons annually to 26,000 tons annually, (2) an 80 percent drop in losses from shutdowns in fiscal 1997 and (3) \$3 million in savings during fiscal 1997 from switching to low-sulfur coal. The team's plan is being adopted by TVA at other fossil fuel plants.

On April 24, 1998, the TVA Board consolidated TVA's power production, transmission and resource stewardship functions as part of TVA's continuing actions to prepare for success in the restructured utility industry. The Board named Ike Zeringue, previously TVA's Chief Nuclear Officer, to head the functions as President and Chief Operating Officer. John Scalice, TVA's Senior Vice President of Nuclear Operations, will serve as TVA's acting Chief Nuclear Officer. TVA believes that consolidating these functions will allow TVA to serve the Tennessee Valley and the nation better in a competitive market. The Board also announced that it would consolidate all of TVA's financial functions under the Chief Financial Officer, David N. Smith.

On March 6, 1998, the U.S. General Accounting Office (the "GAO") released a report discussing federal power marketing administrations. Although this report was not focused on TVA, an appendix to the report repeats comments regarding TVA's competitive position that the GAO initially made in reports released in August 1995 and September 1997. For a discussion of these two reports, see "Competition" in the current Information Statement.

On March 31, 1998, the GAO released a report entitled "Tennessee Valley Authority: Information on Nonpower Programs". The report, which was requested by Senators Fred Thompson and Bill Frist of Tennessee, analyzes TVA's various nonpower activities and compares them to those performed by four investor-owned utilities ("IOUs") around the country. The GAO report concludes that (1) the selected IOUs do not have nonpower roles and responsibilities that are as comprehensive in nature as TVA's; (2) activities

such as flood control and navigation tend to be viewed by TVA, the selected IOUs and other officials as the responsibility of the federal government; (3) TVA's land management responsibilities, especially with regard to the Land Between The Lakes, exceed the selected IOUs' land management activities; and (4) the selected IOUs have some programs, such as ones for dam safety, that are similar to nonpower programs operated by TVA.

On March 25, 1998, the Clinton administration proposed a Comprehensive Electricity Competition Plan (the "Plan"), which addresses various aspects of national retail competition in the electric power industry, including extension of FERC's general regulatory authority to cover transmission service by cooperatives and all government-owned electric systems, including TVA. In addition, the Plan notes that the Clinton administration is considering issues relating to the role that the TVA power system should play in the electric power industry after nationwide competition has begun. The Plan further notes that the administration expects the recommendations of the Tennessee Valley Electric System Advisory Committee (the "Advisory Committee") regarding TVA to provide the administration with a broad framework for bringing competition to TVA and restructuring its operations. The Advisory Committee is a subcommittee of the Secretary of Energy's Advisory Board and includes representatives of TVA, TVA employees, TVA customers, TVA Watch, power marketers and various interest groups in the Tennessee Valley.

Shortly after the release of the Plan, the Advisory Committee released its recommendations regarding TVA. The Advisory Committee members agreed, among other things, that (1) TVA should be subject to FERC transmission jurisdiction comparable to that imposed on other transmitting utilities; (2) TVA should, to some extent, be subject to federal antitrust laws; (3) distributors or their customers should pay some type of excise tax in place of taxes on gross receipts or "in lieu of tax" payments by producers; (4) TVA should relinquish its role of regulating retail power sales; (5) the anti-cherry picking provision and the fence (as both terms are defined in the "Competition" section of the current Information Statement) should be removed concurrently with the implementation of retail competition; (6) TVA should remain primarily a wholesaler of electricity; and (7) any stranded costs resulting from mandated competition should be borne by the customers of

TVA or its distributors for whom TVA incurred the costs, subject to review by FERC or another federal authority. The Advisory Committee members did not agree on numerous other issues such as (1) the conditions under which TVA should become subject to FERC transmission jurisdiction; (2) TVA's ability to set its wholesale rates; (3) the extent to which TVA should be subject to federal antitrust laws, labor laws, and income tax; (4) the identity of the entity or entities responsible for regulating retail rates; (5) the nature of TVA's mission; (6) the authority of TVA to build new generation capacity; (7) the extent to which the anti-cherry picking provision and the fence should be removed if retail competition is delayed; (8) the terms of TVA's wholesale power contracts; (9) the extent to which TVA should be able to serve retail customers; and (10) certain other issues regarding the status and powers of TVA.

On April 29, 1998, Kentucky Senator Mitch McConnell introduced a bill that would define TVA as a "public utility" for purposes of the Federal Power Act, thereby making TVA subject to regulation by FERC generally to the same degree as if TVA were a private power company. In addition, the bill would, among other things, make the anti-trust laws applicable to TVA, restrict TVA's authority to recover costs incurred from doing business outside the United States, remove TVA's federal immunity from retail rate regulation by states, and limit TVA's authority to sell power to new retail customers.

With the expiration of parts of the collective bargaining agreement between TVA and the Tennessee Valley Trades and Labor Council (the "Council") on December 31, 1997, TVA exercised its right to give a 90-day notice to reopen the remainder of the agreement with the Council and potentially to cancel the agreement. In April 1998, negotiations pursuant to this reopener ended in impasse. To date, TVA has not exercised its right to cancel the agreement. However, it has notified the Council that a dispute exists concerning the employees who constitute an appropriate bargaining unit and has scheduled a hearing in June on this matter. (There are currently six separate bargaining units which represent trades and labor employees covered by the Council agreement.)

TVA submitted a proposal to the U.S. Department of Energy ("DOE") to complete Bellefonte as a nuclear plant and to operate it to produce

tritium for DOE in addition to electricity. See "Nuclear Power Program" in the current Information Statement. In this proposal, Unit One of Watts Bar Nuclear Plant could be used as a backup to Bellefonte, if necessary. TVA's second proposal to DOE to provide irradiation services to produce tritium at only Unit One of the Watts Bar Nuclear Plant has expired.

On May 21, 1998, the House of Representatives passed the National Defense Authorization Act for Fiscal Year 1999. The bill includes a section that would prohibit tritium production for weapons purposes in commercial nuclear reactors, including those operated by TVA.

## DESCRIPTION OF BONDS

### General

TVA will issue the Bonds under authority of the Tennessee Authority Act of 1933, as amended (the "Act") and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution adopted on October 6, 1960, as amended on September 28, 1976, October 17, 1989 and March 25, 1992 (the "Basic Resolution"), and the Supplemental Resolution authorizing the Bonds adopted on March 2, 1998 (the "Supplemental Resolution" and together with the Basic Resolution, the "Resolutions"). TVA entered into a Fiscal Agency Agreement dated October 7, 1997 (the "Fiscal Agency Agreement") with the Federal Reserve Banks, as fiscal agents (together, the "Fiscal Agent"). The Secretary of the Treasury has approved the time of issuance of and the maximum rate of interest to be borne by the Bonds, in compliance with Section 15d(c) of the Act. The Bonds are obligations of TVA only, payable solely from TVA's Net Power Proceeds. The Bonds are not obligations of or guaranteed by the United States of America.

The Act authorizes TVA to issue and sell bonds, notes and other evidences of indebtedness (collectively, "Evidences of Indebtedness") to assist in financing its power program and to refund such Evidences of Indebtedness. Section 2.2 of the Basic Resolution designates certain Evidences of Indebtedness as Tennessee Valley Authority Power Bonds ("Power Bonds"). The aggregate amount of Evidences of Indebtedness outstanding at one time cannot exceed \$30 billion. As of March 31, 1998 TVA had approximately U.S. \$26.2 billion and Deutsche Mark 1.5 billion (issued in September 1996) of Evidences of Indebtedness outstanding.

When TVA issued its Deutsche Mark Evidences of Indebtedness, it entered into a currency swap agreement to hedge against fluctuation in such currency. For information regarding Power Bonds and the Basic Resolution, see “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Issuance of Additional Bonds and Other Evidences of Indebtedness” in the current Information Statement.

The summaries of certain provisions of the Act, the Resolutions and the Fiscal Agency Agreement are not complete and are entirely qualified by reference to the complete Act, Resolutions and Fiscal Agency Agreement. You may obtain complete copies of these documents by writing to **Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902, Attention: Vice President and Treasurer, or by calling (423) 632-3366.**

The Bonds will be Power Bonds. TVA will pay all interest and principal on the Bonds solely from its Net Power Proceeds. “Net Power Proceeds” are the remainder of TVA’s Gross Power Revenues (as defined in the Basic Resolution),

*after deducting*

- the costs of operating, maintaining and administering its power properties (including multiple-purpose properties in the proportion that multiple-purpose costs are allocated to power) and
- payments to states and counties in lieu of taxes,

*but before deducting*

- depreciation accruals or other charges representing the amortization of capital expenditures,

*plus*

- the net proceeds of the sale or other disposition of any Power Facility (as defined in the Basic Resolution) or interest therein.

The Act also requires that TVA make certain payments to the Treasury each year — as a return on and reduction of the Appropriation Investment (as defined in the Basic Resolution) — from Net Power Proceeds in excess of those required for debt service. See “Certain Provisions of the Tennessee Valley Authority Act” — “Payments to the Treasury” in the current Information Statement.

The Bonds will rank equally with all other Power Bonds in application of Net Power Proceeds. Power Bonds currently rank *senior to* other Evidences of Indebtedness as to *principal*, and *senior to or on parity with* other Evidences of Indebtedness as to *interest*. It is possible at some time prior to the maturity of the Bonds that Evidences of Indebtedness other than Power Bonds may also rank on parity with Bonds as to principal. See “The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness” — “Amendments to the Basic Resolution to Become Effective in the Future” in the current Information Statement. For a further discussion of the application of the Net Power Proceeds, see “Certain Provisions of the Tennessee Valley Authority Act” and “The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness” — “Application of Net Power Proceeds” in the current Information Statement.

Except as provided under the Act, the Basic Resolution and the Supplemental Resolution, there is no limit on other indebtedness or securities that TVA may issue and no financial or similar restrictions on TVA. TVA issues Discount Notes pursuant to Section 15d of the Act and in accordance with Section 2.5 of the Basic Resolution. TVA may also issue other indebtedness in addition to Power Bonds and Discount Notes. TVA issues other indebtedness, such as Quarterly Income Debt Securities, pursuant to Section 15d of the Act and under appropriate authorizing resolutions. See “The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness” — “Recent Legislation” in the current Information Statement.

Under the Supplemental Resolution, actions taken pursuant to Public Law No. 105-62 shall not be considered an event of default or breach under the Resolutions. Public Law No. 105-62 provides, among other things, that TVA is required, beginning October 1, 1998, to fund nonpower programs that constitute “essential stewardship activities” with revenues derived from one or more of various sources, including power revenues, notwithstanding provisions of the Act and power bond covenants to the contrary. See the discussion of Public Law No. 105-62 in “The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness” — “Recent Legislation” in the current Information Statement.

## Possible Future Issuances

The Supplemental Resolution provides that TVA may issue additional Bonds in one or more future installments. TVA may do so, without consent of the Holders (as defined in “Book-Entry System”) of the Bonds, by amending the Supplemental Resolution. Additional Bonds so issued must be identical in all respects to the Bonds originally issued, except for differences in the issue date, issue price and interest commencement date.

## Payment of Principal and Interest

The Bonds will consist of \$500,000,000 aggregate principal amount of Tennessee Valley Authority Power Bonds 1998 Series D Due June 1, 2028 (Putable Automatic Rate Reset Securities). TVA will issue the Bonds in \$25 denominations in book-entry form only through the Federal Reserve Banks, as described below in “Book-Entry System”. TVA will pay interest quarterly in arrears on March 1, June 1, September 1 and December 1 (each an “Interest Payment Date”) beginning September 1, 1998. Such interest payments will include any interest accrued from and including June 9, 1998, or the preceding Interest Payment Date, to but excluding the relevant Interest Payment Date. Interest will be computed as described in “Interest Computation” below. TVA will repay the principal amount of all outstanding Bonds, together with accrued but unpaid interest, on June 1, 2028 (the “Maturity Date”). TVA will make principal and interest payments on the Bonds on the applicable payment dates to parties that are Holders of Bonds as of the close of business on the Business Day (as defined herein) preceding such payment dates. TVA will make such payments by crediting the payment amount to the Holders’ accounts at the Federal Reserve Banks. **Holders and other financial intermediaries in the chain to beneficial owners are responsible for remitting payments to their customers.**

If any Interest Payment Date or the Maturity Date is not a Business Day, TVA shall make payment on the next succeeding Business Day, and such payment shall have the same force and effect as if made on such Interest Payment Date or Maturity Date. A “Business Day” is any day except a Saturday, Sunday or day on which banking institutions in New York City are authorized or required by law or executive order to be closed.

## Interest Computation

The rate at which the Bonds bear interest (the “Coupon Rate”) will be computed based on a 360-day year of twelve 30-day months using the following rules:

*Initial Coupon Rate.* Initially, the Bonds shall bear interest at an annual Coupon Rate of  $6\frac{3}{4}\%$  (which is equal to a 30 year Treasury rate interpolated by TVA and the Underwriters, as the equivalent of the CMT (as defined below), as of the time and date of pricing plus 0.94%) from and including June 9, 1998 to but excluding June 1, 2003.

*Reset of Coupon Rate.* The Wednesday following the last Friday in April of 2003 and each such Wednesday annually thereafter (or the next succeeding Business Day, if any such date is not a Business Day) shall be a “Calculation Date”. If the sum of the CMT (as defined below) for the week ending the last Friday in April plus 0.94% is lower than the Coupon Rate of the Bonds on such Calculation Date, then the Coupon Rate will be reset to the lower rate equal to such sum. The Bonds shall begin to bear interest at this new Coupon Rate on the June 1 following such Calculation Date.

The “CMT” is the rate published in “Statistical Release H.15(519), ‘Selected Interest Rates’”, or any successor publication, published by the Board of Governors of the Federal Reserve System under the heading “U.S. government securities — Treasury constant maturities — 30-year”.

The Bonds shall continue to bear interest at this new Coupon Rate until the next reset, if any. For a summary of risks associated with Coupon Rate resets, see “Risk Factors”. TVA will send notice of any reset by the close of business on the first Business Day after the Calculation Date (the “Reset Notification Date”). TVA will send the notice to the Federal Reserve Bank of New York only. TVA anticipates that, on the first Business Day after receipt of TVA’s notice, the Federal Reserve Bank of New York will broadcast such notice to Holders of the Bonds and users of the Federal Reserve Banks’ book-entry system. Notice of Coupon Rate resets will be given only on the Federal Reserve Banks’ broadcast system. **Beneficial owners of Bonds that are not also Holders are responsible for making arrangements with their**

### **Financial Institutions to obtain all notices, including reset notices.**

*CMT Contingencies.* If a previously reported CMT figure for a Calculation Date is revised after such date, this shall not affect the Coupon Rate. If the CMT is discontinued or materially altered while the Bonds are outstanding, TVA may, in its sole discretion, substitute an alternative index that TVA believes most closely resembles the CMT before it was discontinued or altered. If a substitution is necessary, TVA shall use the alternative index in place of the CMT for future Coupon Rate reset calculations. TVA may at any time substitute a different index for the alternative index if TVA determines, in its sole discretion, that the different index more closely resembles the CMT before it was discontinued or altered.

### **Redemption**

The Bonds will not be subject to redemption by TVA prior to maturity.

### **Put Option**

If the Coupon Rate on the Bonds is reset, you can put (return) any of your Bonds to TVA for repayment. You will receive \$25 for each Bond you put to TVA. TVA will pay separately any accrued interest due on a returned Bond on the appropriate Interest Payment Date.

To exercise this put (repayment) option, you are responsible for having your Financial Institution (1) notify TVA and (2) have the Bond returned, as described below.

*Notification of Repayment Election.* If you want to put a Bond to TVA, you must inform your broker or other financial institution through which you beneficially hold your Bond (your “Financial Institution”) and **give your Financial Institution authorization** to submit notice of exercise of the put option on your behalf. Your Financial Institution must then complete the Summary Election Form and the Option to Elect Repayment Form, substantially in the form — and in accordance with the instructions — contained in this Offering Circular. (See pages beginning at C-29.) TVA will provide copies of these forms and instructions to you or your Financial Institution upon request. The Option to Elect Repayment Form requires your Financial Institution to make certain representations and to agree to certain terms, including the indemnifica-

tion of TVA against certain losses and costs. If your Financial Institution will not make these representations and agree to these terms, TVA shall not be obligated to honor your request to put the Bond. See “Risk Factors”. **It is your responsibility to determine from your Financial Institution whether it will make the representations and agree to the terms in the Option to Elect Repayment Form and instructions.** After completion of the Summary Election Form and the Option to Elect Repayment Form, your Financial Institution must submit these forms to TVA. TVA must **receive** both forms at the office specified in the instructions *no earlier than* the relevant Reset Notification Date and *no later than* May 22 (or the prior Business Day, if such date is not a Business Day) of the year of such Reset Notification Date. **It is your responsibility to determine from your Financial Institution the amount of advance notice it needs from you to comply with the notice provisions described above.** A properly submitted notice of exercise of the put option by your Financial Institution shall be *irrevocable*. After receiving such notice, TVA will assign a number (an “Election Number”) to the notice and provide the Election Number to your Financial Institution.

*Return of Bond.* After TVA has provided the Election Number to your Financial Institution, as described above, your Financial Institution must arrange for your Bonds to be returned to TVA. The Option to Elect Repayment Form and instructions direct your Financial Institution to make necessary arrangements with your Holder (as defined in “Book-Entry System” below) to return your Bonds. Your Bonds must be returned to TVA on June 1 between 11 A.M. and 1 P.M. New York City time (or the next succeeding Business Day, if such date is not a Business Day) following the relevant Reset Notification Date (the “Return Date”). Your Financial Institution must arrange for the delivery of your Bonds to TVA using the method supported by the Federal Reserve Banks. The return of the Bonds must be: (1) by free delivery — without simultaneous payment, (2) between 11 A.M. and 1 P.M. New York City time on the delivery date and (3) delivered to TVA’s account on the Federal Reserve Banks’ book-entry system. After delivery, the Holder delivering your Bonds will not be listed on the Federal Reserve Banks’ book-entry system as the Holder or owner of such Bonds. TVA will make payment equal to the appropriate principal amount of your Bonds by wire

transfer to the account specified by the Holder. If a delivery of a Bond for repayment is not accompanied with the correct Election Number, the Bond may be returned and be ineligible for repayment on the requested Return Date. If there is a delay in repayment of Bonds due to the fact that (1) TVA cannot verify the receipt of Bonds by the close of business on the Return Date or (2) the transfer of Bonds to TVA is rejected by the Federal Reserve Banks, TVA shall not pay interest on such Bonds on or after the requested Return Date.

### Repayment

The Bonds will be repaid at par (\$25) on the Maturity Date or on the date you properly put your Bonds to TVA. Interest will be paid separately as described in “Payment of Principal and Interest”.

### Notices

TVA will send all notices about the Bonds and reset of the Coupon Rate, *only* through the Federal Reserve Banks’ broadcast system to Holders of Bonds. **Beneficial owners of Bonds that are not also Holders are responsible for making arrangements with their Financial Institutions to obtain notices from their Holders.**

### Book-Entry System

Pursuant to the Fiscal Agency Agreement, the Bonds will be issued and maintained and will be transferred only on the book-entry system of the Federal Reserve Banks in principal amounts of \$25. The Federal Reserve Banks will maintain book-entry accounts for the Bonds and make principal and interest payments on the Bonds to Holders on behalf of TVA. The Federal Reserve Banks will make such payments by crediting Holders’ Federal Reserve Bank accounts. You may not have Bonds exchanged for definitive securities. You should refer to the entire Fiscal Agency Agreement for a complete statement of its terms.

Regulations governing the use of the book-entry system for the Bonds are contained in 18 C.F.R. Part 1314, as modified by 62 *Federal Register* 29287-29288 (May 30, 1997). These regulations relate primarily to the registration, transfer, exchange and pledge of the Bonds. Applicable Federal Reserve Bank operating circulars govern the accounts of Holders. Applicable Federal Reserve Bank operating circulars, TVA’s book-entry regulations and any other federal book-entry regula-

tions that may apply exclusively govern the Federal Reserve Banks’ handling of, and rights, duties and obligations with respect to, the Bonds, notwithstanding inconsistent procedures or requirements of any depository or exchange.

Only entities eligible to maintain book-entry accounts with the Federal Reserve Banks may be record holders of the Bonds. “Holders” are such entities whose names appear on the book-entry records of a Federal Reserve Bank as the entities for whose accounts Bonds have been deposited. Though beneficial owners of Bonds may be Holders, beneficial owners will ordinarily hold Bonds indirectly through one or more financial intermediaries such as banks, brokerage firms and securities clearing organizations. Holders and other financial intermediaries in the chain to beneficial owners will be responsible for establishing and maintaining accounts of their respective customers. A beneficial owner of a Bond may exercise its rights respecting TVA and the Federal Reserve Banks only through the Holder. TVA and the Federal Reserve Banks will have no obligation to a beneficial owner of a Bond that is not also the Holder. The Federal Reserve Banks will act only upon the instructions of Holders in recording transfers of Bonds.

### Governing Law

The Fiscal Agency Agreement and the Bonds shall be governed by and construed in accordance with the laws of the State of New York, to the extent such law is not inconsistent with federal law.

### Listing

The Bonds have been approved for listing, subject to notice of issuance, on the New York Stock Exchange. See “Underwriters”.

### Rating

The Bonds will be rated Aaa by Moody’s Investors Service and AAA by Standard & Poor’s.

### LEGALITY OF INVESTMENT

The laws of some jurisdictions limit the type and amount of securities that certain institutional investors may acquire. TVA advises each entity or person to consult its own counsel respecting the legality of investment in the Bonds. The Bonds could be subject to certain restrictions or require-

ments as to legality of investment that do not apply to Power Bonds with fixed rates of interest. Generally, the following describes the legality of investment in Power Bonds *with fixed rates of interest*:

- Power Bonds are lawful investments and are acceptable as security for all fiduciary, trust and public funds, the investment or deposit of which shall be under the authority or control of any officer or agency of the United States. 16 U.S.C. § 831n-4(d).
- Power Bonds are acceptable as collateral for Treasury tax and loan accounts. 31 C.F.R. § 203.14(d)(1).
- National banks may deal in, underwrite and purchase Power Bonds for their own accounts in an amount not to exceed ten percent of unimpaired capital and surplus. 12 U.S.C. § 24, seventh paragraph.
- Federal Reserve Banks may accept Power Bonds as eligible collateral for advances to member banks. 12 U.S.C. § 347 and 12 C.F.R. § 201.108(b)(13).
- Federal savings associations and federal savings banks may, to the extent specified in applicable regulations, invest in Power Bonds without regard to limitations generally applicable to investments. 12 U.S.C. § 1464(c)(1)(F).
- Power Bonds are eligible as collateral for advances by Federal Home Loan Banks to members for which Power Bonds are legal investments. 12 U.S.C. § 1430(a) and 12 C.F.R. § 935.9(a)(2).
- Federal credit unions may purchase Power Bonds. 12 U.S.C. § 1757(7)(E).
- Power Bonds are “obligations of a corporation which is an instrumentality of the United States” within the meaning of Section 7701(a)(19)(C)(ii) of the Internal Revenue Code for purposes of the 60 percent of assets limitation applicable to building and loan associations.

## TAX MATTERS

The following summary of certain federal income and estate tax and certain limited State and local tax consequences (where specifically noted) of the purchase, ownership, and disposition of the Bonds has been prepared by Orrick, Herrington & Sutcliffe LLP, as special tax counsel to TVA

(“Tax Counsel”), and is based upon laws, regulations, rulings and decisions, which are subject to change at any time, possibly with retroactive effect. The discussion does not address all aspects of federal income and estate taxation that may be relevant to a particular investor in light of its personal investment circumstances or to certain types of investors subject to special treatment under the federal income tax laws (for example, brokers, security dealers, traders in securities that elect to mark to market, banks, life insurance companies, tax-exempt organizations and, with limited exceptions, foreign investors), and generally does not address State and local taxation. Further, the discussion is limited to persons who will hold the Bonds as capital assets and does not deal with the federal income tax consequences applicable to persons who will hold the Bonds in the ordinary course or as an integral part of their trade or business, or as part of a hedging, straddle, integrated, or conversion transaction or persons whose functional currency is not the U.S. dollar. Furthermore, it does not address alternative minimum tax consequences or the indirect effects on the holders of equity interests in a beneficial owner of a Bond. Each prospective owner of a Bond is urged to consult with its own tax advisor with respect to the federal, State and local tax consequences associated with the purchase, ownership, and disposition of a Bond, as well as the tax consequences arising under the laws of any other taxing jurisdiction, and may not construe the following discussion as legal advice.

For purposes of this section, “U.S. Person” means a citizen or resident of the United States, a corporation or (except as may be provided in Treasury Regulations) partnership organized in or under the laws of the United States or any political subdivision thereof, an estate the income of which is includible in gross income for United States tax purposes regardless of its source or a trust if a United States court is able to exercise primary supervision over administration of the trust and one or more U.S. Persons have authority to control all substantial decisions of the trust. The term “U.S. beneficial owner” means a U.S. Person that is a beneficial owner of a Bond.

### U.S. Beneficial Owners

A U.S. beneficial owner is subject to federal income taxation on income on a Bond. The Act, however, provides that bonds issued by TVA are

“exempt both as to principal and interest from all taxation now or hereafter imposed by any State or local taxing authority except estate, inheritance and gift taxes”. This exemption might not extend to franchise or other non-property taxes in lieu thereof imposed on corporations or to gain or loss realized upon the sale or exchange of a Bond, notwithstanding that such gain might in some cases be treated as interest income for federal income tax purposes.

The rules relating to the accrual of original issue discount (“OID”) are exceedingly complex and their application to debt instruments similar to the Bonds is not certain. Nevertheless, Tax Counsel believes that it is reasonable for TVA and the beneficial owners of the Bonds to treat the Bonds as variable rate debt instruments for purposes of the OID rules. Tax Counsel’s opinion is premised on the assumptions that it is reasonably expected that the interest on the Bonds will not be significantly front-loaded and that the issue price of the Bonds will not be significantly less than the price that would have obtained had no ceiling limitation applied to the interest rate reset feature of the Bonds (that is, if the rate on the Bonds was adjustable upwards as well as downwards). It is possible that the Internal Revenue Service (“IRS”) might disagree with the characterization of the Bonds as variable rate debt instruments, and assert that the Bonds constitute contingent payment debt instruments. If the IRS were successful in this assertion, all beneficial owners of Bonds would, *inter alia*, be required to account for interest on the Bonds under the accrual method of accounting (computed pursuant to special rules applicable to contingent payment debt instruments), any gain realized on a disposition of a Bond would be characterized as ordinary income and special rules would apply relating to the accrual of market discount and acquisition premium. As indicated above (and based on the assumptions previously stated), Tax Counsel believes that it is reasonable to characterize the Bonds as variable rate debt instruments, and TVA and, by purchasing the Bonds, each beneficial owner of the Bonds agree they will treat the Bonds as such. Each beneficial owner of a Bond is urged to consult its own tax advisor with respect to this issue. The remainder of this section is premised on the assumption that the Bonds are properly characterized as variable rate debt instruments under the OID rules.

Interest on a Bond will be taxable to a U.S. beneficial owner at the time that it is received or

accrued, depending upon the U.S. beneficial owner’s method of accounting for federal income tax purposes. Accordingly, similar to other Power Bonds issued by TVA without OID, a cash-method U.S. beneficial owner of the Bonds will not be required to include interest on the Bonds in income prior to the U.S. beneficial owner’s receipt of such interest. There is no special exemption for a Bond from federal income, estate and gift tax.

Upon a sale or exchange of a Bond, a U.S. beneficial owner generally will recognize capital gain or loss equal to the difference between the amount realized on the sale or exchange (not including any amounts attributable to accrued and unpaid interest) and the U.S. beneficial owner’s adjusted basis for the Bond for federal income tax purposes.

If a U.S. beneficial owner purchases a Bond for less than its stated redemption price at maturity, in general, that difference will be market discount (unless the discount is less than  $\frac{1}{4}$  of 1% of the stated redemption price at maturity of the Bond multiplied by the number of complete years remaining to maturity). In general, under the market discount rules, unless the U.S. beneficial owner elects to include market discount in income currently, any gain on a disposition of a market discount Bond will be ordinary income to the extent of accrued market discount, and deductions for some or all of the interest on any indebtedness incurred or continued to purchase or carry the Bond may be deferred until the disposition of the Bond. Any election to include market discount in income currently generally applies to all debt instruments acquired by the electing U.S. beneficial owner during or after the first taxable year to which the election applies and is irrevocable without the consent of the IRS. A U.S. beneficial owner should consult a tax advisor before making the election.

A U.S. beneficial owner who purchases a Bond for an amount greater than the amount payable at maturity of the Bond may elect to amortize the bond premium. In the case of a U.S. beneficial owner that makes an election to amortize bond premium or has previously made an election that remains in effect, amortizable bond premium on the Bond generally will be treated as a reduction of the interest income on a Bond on a constant yield basis (except to the extent regulations may provide otherwise) over the term of the Bond. The basis of a debt obligation purchased at a premium is re-

duced by the amount of amortized bond premium. An election to amortize bond premium generally applies to all debt instruments (other than tax-exempt obligations) held by the electing U.S. beneficial owner on the first day of the first taxable year to which the election applies or thereafter acquired by such owner, and is irrevocable without consent of the IRS. A U.S. beneficial owner should consult a tax advisor before making the election.

A U.S. beneficial owner may elect to include in gross income all interest that accrues on a debt instrument using the constant yield method. For purposes of this election, interest includes stated interest, OID, market discount, de minimis market discount and unstated interest, as adjusted by any amortizable bond premium or acquisition premium. If this election is made with respect to a debt instrument with amortizable bond premium, the electing U.S. beneficial owner will be deemed to have elected to apply amortizable bond premium against interest with respect to all debt instruments with amortizable bond premium (other than debt instruments the interest on which is excludible from gross income) which are held by the electing U.S. beneficial owner as of the beginning of the taxable year in which the debt instrument with respect to which the election is made is acquired or which are thereafter acquired by the U.S. beneficial owner. The deemed election with respect to amortizable bond premium may not be revoked without the consent of the IRS. If this election is made with respect to a debt instrument with market discount, the electing U.S. beneficial owner will be deemed to have elected to include market discount in income currently (as discussed above) with respect to all debt instruments acquired by the electing U.S. beneficial owner during or after the first taxable year to which the election applies, which election may not be revoked without the consent of the IRS.

### **Non-U.S. Beneficial Owners**

Generally, a beneficial owner that is not a U.S. Person and that had no connection with the United States other than holding the Bond (a “non-U.S. beneficial owner”) will not be subject to federal withholding tax on interest on a Bond. To qualify for the exemption from withholding, the last U.S. Person in the chain of payment prior to payment to a non-U.S. beneficial owner (the “Withholding Agent”) must have received in the year in which such a payment occurs, or in either of the two

preceding years, a statement that (i) is signed by the beneficial owner under penalties of perjury, (ii) certifies that such owner is not a U.S. beneficial owner and (iii) provides the name and address of the beneficial owner. The statement may be made on an IRS Form W-8 or substantially similar substitute form, and the beneficial owner must inform the Withholding Agent of any change in the information on the statement within 30 days of such change. If a Bond is held through a securities clearing organization or certain other financial institutions, the organization or institution may provide a signed statement to the Withholding Agent. However, in such case, the signed statement must be accompanied by a copy of a Form W-8 or substitute form provided by the beneficial owner to the organization or institution holding the Bond on behalf of the beneficial owner.

Recently issued regulations would provide alternative methods for satisfying the certification requirements described above (the “New Regulations”). The New Regulations also would require, in the case of Bonds held by a foreign partnership, that (i) the certification described above be provided by the partners rather than by the foreign partnership and (ii) the partnership provide certain information, including a taxpayer identification number. A look-through rule would apply in the case of tiered partnerships. The New Regulations are generally effective for payments made after 1999. There can be no assurance that the New Regulations will not be amended prior to the date they first become effective.

Generally, any amount which constitutes capital gain to a non-U.S. beneficial owner upon retirement or disposition of a Bond will not be subject to federal income taxation in respect of such amount. Certain exceptions may be applicable and individual non-U.S. beneficial owners are particularly urged to consult a tax advisor. Generally, the Bonds will not be includible in the federal estate of a non-U.S. beneficial owner.

### **Backup Withholding**

Backup withholding of federal income tax at a rate of 31% may apply to payments made in respect of the Bonds to beneficial owners who are not exempt recipients and who fail to provide certain identifying information (such as the beneficial owner’s taxpayer identification number) in the manner required. Generally, individuals are not exempt

recipients, whereas corporations and certain other entities generally are exempt recipients. Payments made in respect of the Bonds to a U.S. beneficial owner must be reported to the IRS, unless such U.S. beneficial owner is an exempt recipient or establishes an exemption. Compliance with the identification procedures (described in the preceding section) would generally establish an exemption from backup withholding for those non-U.S. beneficial owners who are not exempt recipients.

In addition, upon the sale of a Bond to (or through) a broker, the broker must withhold at a rate of 31% of the reportable payment, unless either (i) the broker determines that the seller is a corporation or other exempt recipient or (ii) the seller provides, in the required manner, certain identifying information and, in the case of a non-U.S. beneficial owner, certifies that such seller is a non-U.S. beneficial owner (and certain other conditions are met). Such a sale must also be reported by the broker to the IRS, unless either (i) the broker determines that the seller is an exempt recipient or (ii) the seller certifies its non-U.S. status (and certain other conditions are met). Certification of the beneficial owner's non-U.S. status usually would be made on Form W-8 under penalties of perjury, although in certain cases it may be possible to submit other documentary evidence. The term "broker" generally includes all

persons who, in the ordinary course of a trade or business, stand ready to effect sales made by others, as well as brokers and dealers registered as such under the laws of the United States or a state. These requirements generally will apply to a United States office of a broker, and the information reporting requirements generally will apply to a foreign office of a United States broker, as well as to a foreign office of a foreign broker if the broker is (i) a controlled foreign corporation within the meaning of Section 957(a) of the Internal Revenue Code, (ii) a foreign person 50% or more of whose gross income from all sources for the 3-year period ending with the close of its taxable year preceding the payment (or for such part of the period that the foreign broker has been in existence) was effectively connected with the conduct of a trade or business within the United States or (iii) under the New Regulations (applicable with respect to payments made after 1999), a foreign partnership if it is engaged in a trade or business in the United States or if 50% or more of its income or capital interests are held by U.S. Persons.

Generally, any amounts withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or credit against such beneficial owner's federal income tax.

**UNDERWRITERS**

Under the terms and subject to the conditions contained in an Underwriting Agreement, dated the date hereof (the “Underwriting Agreement”), the underwriters named below (the “Underwriters”) have severally agreed to purchase, and TVA has agreed to sell to them, severally, the respective principal amount of the Bonds set forth opposite their names below:

<u>Name</u>	<u>Principal Amount of Bonds</u>
Morgan Stanley & Co. Incorporated	\$ 74,680,000
A.G. Edwards & Sons, Inc. ....	74,680,000
First Tennessee Bank National Association .....	74,680,000
Edward D. Jones & Co., L.P. ....	74,680,000
Prudential Securities Incorporated ..	74,680,000
BT Alex. Brown Incorporated .....	5,000,000
Bear, Stearns & Co. Inc. ....	5,000,000
CIBC Oppenheimer Corp. ....	5,000,000
Credit Suisse First Boston Corporation .....	5,000,000
Donaldson, Lufkin & Jenrette Securities Corporation .....	5,000,000
Goldman, Sachs & Co. ....	5,000,000
Lehman Brothers Inc. ....	5,000,000
SBC Warburg Dillon Read Inc. ...	5,000,000
Schroder & Co. Inc. ....	5,000,000
Advest, Inc. ....	1,200,000
Artemis Capital Group, Inc. ....	1,200,000
Arthurs, Lestrang & Company Incorporated .....	1,200,000
Robert W. Baird & Co. Incorporated .....	1,200,000
BancAmerica Robertson Stephens ..	1,200,000
Blount Parrish & Company, Inc. ...	1,200,000
William Blair & Company, L.L.C.	1,200,000
Blaylock & Partners, L.P. ....	1,200,000
J.C. Bradford & Co. ....	1,200,000
JW Charles Securities, Inc. ....	1,200,000
Commerzbank Capital Markets Corporation .....	1,200,000
Compass Bank .....	1,200,000
Cowen & Company .....	1,200,000
Craigie Incorporated .....	1,200,000
Crowell, Weedon & Co. ....	1,200,000
Dain Rauscher Wessels .....	1,200,000
Davenport & Company LLC .....	1,200,000
D.A. Davidson & Co. Incorporated	1,200,000
Doley Securities, Inc. ....	1,200,000
Doft & Co., Inc. ....	1,200,000

<u>Name</u>	<u>Principal Amount of Bonds</u>
EVEREN Securities, Inc. ....	1,200,000
Fahnestock & Co. Inc. ....	1,200,000
Ferris, Baker Watts, Incorporated ..	1,200,000
Fidelity Capital Markets, A Division of National Financial Services Corporation .....	1,200,000
First Albany Corporation .....	1,200,000
First of Michigan Corporation .....	1,200,000
Gibraltar Securities Co. ....	1,200,000
Gruntal & Co., L.L.C. ....	1,200,000
Interstate/Johnson Lane Corporation .....	1,200,000
Janney Montgomery Scott Inc. ....	1,200,000
J.J.B. Hilliard, W.L. Lyons, Inc. ...	1,200,000
Josephthal & Co. Inc. ....	1,200,000
Kirkpatrick, Pettis, Smith, Polian Inc. ....	1,200,000
La Salle National Bank .....	1,200,000
Legg Mason Wood Walker, Incorporated .....	1,200,000
McDonald & Company Securities, Inc. ....	1,200,000
McGinn, Smith & Co., Inc. ....	1,200,000
Mesirow Financial, Inc. ....	1,200,000
H.J. Meyers & Co., Inc. ....	1,200,000
Miller, Johnson & Kuehn, Incorporated .....	1,200,000
The Ohio Company .....	1,200,000
Olde Discount Corporation .....	1,200,000
Pacific Crest Securities Inc. ....	1,200,000
Parker/Hunter Incorporated .....	1,200,000
Piper Jaffray Inc. ....	1,200,000
Pryor, McClendon, Counts & Co., Inc. ....	1,200,000
Ragen MacKenzie Incorporated ...	1,200,000
Raymond James & Associates, Inc.	1,200,000
Redwood Securities Group, Inc. ...	1,200,000
The Robinson-Humphrey Company, LLC .....	1,200,000
Roney Capital Markets A Division of First Chicago Capital Markets, Inc. ....	1,200,000
Charles Schwab & Co., Inc. ....	1,200,000
Scott & Stringfellow, Inc. ....	1,200,000
Muriel Siebert & Co., Inc. ....	1,200,000
Southwest Securities, Inc. ....	1,200,000
Stephens Inc. ....	1,200,000
Sterne, Agee & Leach, Inc. ....	1,200,000
Stifel, Nicolaus & Company, Incorporated .....	1,200,000

<u>Name</u>	<u>Principal Amount of Bonds</u>
Suntrust Equitable Securities Corporation . . . . .	1,200,000
Sutro & Co. Incorporated . . . . .	1,200,000
TD Securities (USA) Inc. . . . .	1,200,000
Tucker Anthony Incorporated . . . . .	1,200,000
U.S. Clearing Corp. . . . .	1,200,000
Utendahl Capital Partners, L.P. . . . .	1,200,000
Van Kasper & Company . . . . .	1,200,000
Wedbush Morgan Securities . . . . .	1,200,000
Wheat First Securities, Inc. . . . .	1,200,000
The Williams Capital Group, L.P. . . . .	1,200,000
Total . . . . .	<u>\$500,000,000</u>

The Underwriting Agreement provides that the Underwriters' obligation to pay for and accept delivery of the Bonds is subject to approval of certain matters by its legal counsel and to certain other conditions. The Underwriters must buy all of the Bonds if they buy any.

TVA has granted the Underwriters an option exercisable for three Business Days after the date of this Offering Circular to purchase up to \$100,000,000 aggregate principal amount of additional PARRS to cover over-allotments, if any, at the initial Price to Public (less the Underwriting Discount and Commissions), as set forth on the cover page of this Offering Circular. If the Underwriters exercise their over-allotment option, the Underwriters have severally agreed, subject to certain conditions, to purchase approximately the same percentage thereof that the principal amount of PARRS to be purchased by each of them, as shown in the foregoing table, bears to the \$500,000,000 principal amount of PARRS offered hereby.

The Underwriters have advised TVA that they will initially offer the Bonds to the public at the price set forth on the cover page of this Offering Circular, and to certain dealers at the same price, less a concession not exceeding 2.00% of the principal amount. The Underwriters may allow and such dealers may reallow a discount not in excess of 1.40% of the principal amount of the Bonds to

certain other dealers. After the initial public offering, the Underwriters may change the public offering price, concession and discount.

The Bonds have been approved for listing, subject to notice of issuance, on the New York Stock Exchange. Trading of the Bonds on the New York Stock Exchange is expected to commence within a 30-day period after the initial delivery thereof. In order to meet one of the requirements for listing the Bonds on the New York Stock Exchange, the Underwriters have undertaken to sell the Bonds to a minimum of 400 beneficial owners. TVA has been advised by the Underwriters that they presently intend to make a market in the Bonds, as permitted by applicable laws and regulations. The Underwriters are not obligated, however, to make a market in the Bonds, and any such market making may be discontinued at any time at the sole discretion of the Underwriters. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the Bonds.

In order to facilitate the offering of Bonds, the Underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the Bonds. Specifically, the Underwriters may over-allot in connection with the offering, creating a short position in the Bonds for their own account. In addition, to cover over-allotments or to stabilize the price of Bonds, the Underwriters may bid for and purchase Bonds in the open market. Any of these activities may stabilize or maintain the market price of the Bonds above independent market levels. The Underwriters are not required to engage in these activities and may end these activities at any time.

TVA has agreed to indemnify the Underwriters against certain civil liabilities or to contribute to the payments the Underwriters may be required to make respecting those liabilities.

From time to time, some of the Underwriters perform services for TVA in the normal course of business.

**VALIDITY OF BONDS**

Edward S. Christenbury, Esq., General Counsel of TVA, will pass on the validity of the Bonds for TVA. Orrick, Herrington & Sutcliffe LLP, 666 Fifth Avenue, New York, New York 10103 will pass on the validity of the Bonds for the Underwriters.

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All statements in this Offering Circular involving opinions, regardless of whether expressly so identified, are opinions only and not factual representations. This Offering Circular is not a contract or agreement with the purchaser of any of the Bonds.

TENNESSEE VALLEY AUTHORITY

By:                   /s/  DAVID N. SMITH                    
David N. Smith  
*Chief Financial Officer*

Dated June 2, 1998

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**SUMMARY ELECTION FORM**  
**(To be completed by the Financial Institution)**  
**TENNESSEE VALLEY AUTHORITY**  
**POWER BONDS 1998 SERIES D DUE JUNE 1, 2028**  
**(PUTABLE AUTOMATIC RATE RESET SECURITIES)**  
**CUSIP NUMBER 880591 300**

*Capitalized terms used and not defined in  
this Summary Election Form shall have the meanings defined  
in the Offering Circular for the Bonds.*

To: Tennessee Valley Authority

The financial institution named below (the "Financial Institution"), on behalf of each of the beneficial owners named below (the "Beneficial Owners"), hereby exercises the option for repayment of the aggregate principal amount of Bonds designated below. To be valid, this Summary Election Form must be received by TVA at the office specified in the instructions for completing this Summary Election Form (together with the Option to Elect Repayment Form for each Beneficial Owner) *no earlier than* the relevant date on which TVA sends a notice of reset of the Coupon Rate (the "Reset Notification Date") and *no later than* the May 22 (or the prior Business Day if such date is not a Business Day) following the Reset Notification Date. This election shall have no effect with respect to (i) any Bonds for which an Option to Elect Repayment Form is not properly completed and delivered to TVA or (ii) any Bonds which are not timely wired as required in the instructions accompanying this Summary Election Form.

(1) \_\_\_\_\_  
Name of Financial Institution Requesting Repayment

(2) \_\_\_\_\_  
Aggregate Principal Amount of Bonds to be Repaid

(3) \_\_\_\_\_  
Date

(4) Financial Institution Representative: (5) Wire instructions for payment of principal  
(interest will be paid separately):

Name:  
Phone Number:  
Fax Number:  
Mailing Address (No P.O. Boxes):

Bank Name:  
ABA Number:  
Account Name:  
Account Number:  
Reference (optional):

(6) Name of Beneficial Owner;	Principal Amount of Bonds to be Repaid:
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

(Continue on separate sheet if necessary.)

Election Number\* (to be completed by TVA): \_\_\_\_\_

\* Upon receipt of this Summary Election Form, TVA will assign an Election Number for the Bonds referred to above and return this Summary Election Form by facsimile to the party specified on line (4) above no later than two Business Days after receipt.

**TVA is an agency and instrumentality of the United States Government. The making of any false or fraudulent statement or representation to TVA is a violation of federal criminal law punishable by fine, imprisonment or both.**

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**OPTION TO ELECT REPAYMENT FORM  
(To be completed by the Financial Institution)**

**TENNESSEE VALLEY AUTHORITY  
POWER BONDS 1998 SERIES D DUE JUNE 1, 2028  
(PUTABLE AUTOMATIC RATE RESET SECURITIES)  
CUSIP NUMBER 880591 300**

*Capitalized terms used and not defined in  
this election form shall have the meanings defined  
in the Offering Circular for the Bonds.*

To: Tennessee Valley Authority

The undersigned financial institution (the "Financial Institution") represents that (1) it has received a valid request for repayment from the beneficial owner listed below (the "Beneficial Owner") of Tennessee Valley Authority Power Bonds 1998 Series D Due June 1, 2028 (Putable Automatic Rate Reset Securities) (the "Bonds" — sometimes called "PARRS") and is currently authorized by the Beneficial Owner to put the Bonds listed below to TVA; and (2) the Beneficial Owner currently owns Bonds in the principal amount listed below, and the Financial Institution currently holds such Bonds through its account or through its agents with a Federal Reserve Bank member.

The Financial Institution agrees to wire the Bonds specified below to TVA's account entitled: "TVA General NYC ABA 021038860" on June 1 of the year of election (or the next succeeding Business Day, if such date is not a Business Day) between 11:00 a.m. and 1:00 p.m. New York City time free of charge and bearing the Election Number assigned by TVA as a reference. The Financial Institution also agrees that (1) it shall follow the instructions accompanying this form; (2) it shall maintain records in accordance with reasonable industry practice and applicable law with respect to the request and authorization from the Beneficial Owner described in the preceding paragraph for a period of three years from the date of election listed below and shall allow TVA to inspect such records upon request; and (3) the Financial Institution shall indemnify and hold harmless TVA against and from any and all claims, liabilities, costs, losses, expenses, suits and damages resulting from any misrepresentation in this election form or other improper action by the Financial Institution in connection with the request for repayment.\*

- (1) \_\_\_\_\_  
Name of Beneficial Owner Requesting Repayment
- (2) \_\_\_\_\_  
Name of Financial Institution Requesting Repayment
- (3) \_\_\_\_\_  
Signature of Representative of Financial Institution Requesting Repayment  
(Must Be Notarized)
- (4) \_\_\_\_\_  
Principal Amount to be Repaid
- (5) \_\_\_\_\_  
Date of Election

\* TVA may, in its sole discretion, impose any additional authentication requirements on any Financial Institution that fails to meet the record-keeping requirements set forth above.

**TVA is an agency and instrumentality of the United States Government. The making of any false or fraudulent statement or representation to TVA is a violation of federal criminal law punishable by fine, imprisonment or both.**

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**INSTRUCTIONS FOR EXERCISING THE REPAYMENT OPTION AND  
COMPLETING THE SUMMARY ELECTION FORM AND THE  
OPTION TO ELECT REPAYMENT FORM FOR  
TENNESSEE VALLEY AUTHORITY  
POWER BONDS 1998 SERIES D DUE JUNE 1, 2028  
(PUTABLE AUTOMATIC RATE RESET SECURITIES)  
CUSIP NUMBER 880591 300**

*Capitalized terms used and not defined in  
these Instructions shall have the meanings defined  
in the Offering Circular for the Bonds.*

**General Instructions for exercising the Repayment Option:**

The Financial Institution must:

1. Deliver a completed Summary Election Form, together with an original copy of the completed Option to Elect Repayment Form for each beneficial owner listed on such Summary Election Form, to:

Tennessee Valley Authority  
ATTN: Vice President and Treasurer  
400 West Summit Hill Dr.  
Knoxville, Tennessee 37902

FACSIMILE TRANSMISSIONS WILL NOT BE ACCEPTED. To be valid, a properly completed Summary Election Form must be received by TVA at the above specified office *no earlier than* the relevant Reset Notification Date and *no later than* May 22 (or the prior Business Day, if such date is not a Business Day) following the Reset Notification Date.

Upon receipt of a Summary Election Form, TVA will assign an Election Number for the Bonds referred to therein and return the Summary Election Form by facsimile to the representative of the Financial Institution specified therein no later than two Business Days after receipt. *If a copy of the Summary Election Form, with the assigned Election Number, is not received by May 27, contact TVA at (423) 632-3366.*

2. Arrange for the Holders of the Bonds on the Federal Reserve Banks' book-entry system to wire the aggregate principal amount of the Bonds to be repaid to TVA's account entitled "TVA General NYC ABA 021038860", free of charge, between 11:00 a.m. and 1:00 p.m. New York City time on June 1 of the year of election (or the next succeeding Business Day, if such date is not a Business Day). If there is a delay in repayment of Bonds due to the fact that (1) TVA cannot verify the receipt of Bonds by the close of business on the Return Date or (2) the transfer of Bonds to TVA is rejected by the Federal Reserve Banks, TVA will not pay interest on such Bonds on or after the requested Return Date. THE ELECTION NUMBER MUST ACCOMPANY THE DELIVERY.

**Instructions for Completing the Summary Election Form:**

1. Indicate name of Financial Institution completing the Summary Election Form on line (1).
2. Indicate the aggregate principal amount of Bonds of all beneficial owners covered by the Summary Election Form on line (2).
3. Indicate the date the Summary Election Form was completed on line (3).
4. Indicate the name, mailing address (no P.O. boxes, please), telephone number and facsimile transmission number of the person to whom confirmation of these elections may be sent on line (4).
5. Indicate the wire instructions for payment of principal on line (5).
6. Indicate the name of each beneficial owner requesting repayment and the principal amount of Bonds of each such beneficial owner to be repaid on line (6).

**Instructions for Completing the Option to Elect Repayment Forms:**

1. Indicate the name of the beneficial owner requesting repayment on line (1).
2. Indicate the name of the Financial Institution completing the Option to Elect Repayment Form on line (2).
3. Affix authorized signature of the Financial Institution's representative on line (3). *The signature must be notarized.*
4. Indicate the principal amount of Bonds to be repaid on line (4).
5. Indicate the date the Option to Elect Repayment Form was completed on line (5).

*For assistance with the Summary Election Form  
or the Option to Elect Repayment Forms or any questions relating thereto,  
please telephone TVA at (423) 632-3366.*

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## INFORMATION STATEMENT

# TENNESSEE VALLEY AUTHORITY

A Wholly Owned Corporate Agency  
and Instrumentality of the

## UNITED STATES OF AMERICA

The Tennessee Valley Authority (“TVA” or the “Corporation”) presents this Information Statement (“Statement”) for the information of potential purchasers of its Power Bonds (the “New Power Bonds”), including its First Installment Series Bonds (the “Installment Bonds” — sometimes called “FISBS”), its Discount Notes and such other evidences of indebtedness (“Other Indebtedness”) it may issue pursuant to the Act (as defined below). New Power Bonds are to be issued pursuant to authority vested in TVA by the Tennessee Valley Authority Act of 1933, as amended (the “Act”), and the Basic Tennessee Valley Authority Power Bond Resolution adopted by the Board of Directors of TVA (the “Board”) on October 6, 1960, as amended on September 28, 1976, October 17, 1989, and March 25, 1992 (the “Basic Resolution”). Discount Notes and Other Indebtedness are issued pursuant to the Act and their respective authorizing resolutions.

TVA may from time to time offer New Power Bonds and Other Indebtedness and may offer on a continuous basis Discount Notes for sale by direct placements or through selected investment dealers, dealer banks, underwriters, or underwriting syndicates as TVA deems appropriate. Information concerning particular offerings of New Power Bonds, Discount Notes or Other Indebtedness will be described in an appropriate offering circular and in any supplement thereto. This Statement, and any supplement hereto, should be read in conjunction with the offering circular and any supplement thereto for the particular New Power Bonds, Discount Notes or Other Indebtedness being offered.

This Statement will be updated by supplements or replaced from time to time to reflect annual financial results of the Corporation and as otherwise determined appropriate by the Corporation. Any provisions herein modified or superseded shall not be deemed, except as so modified, to constitute a part of this Statement. Additional copies of this Statement may be obtained upon written request directed to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902, Attention: Vice President and Treasurer, or by calling (423) 632-3366.

No salesperson, dealer or other person has been authorized to give any information or to make any representations not contained herein or in a specific offering circular or supplement approved by TVA, and, if given or made, such information or representation must not be relied upon as having been authorized by TVA. This Statement and any offering circular or supplement do not constitute an offer to sell or a solicitation of any offer to buy any of the New Power Bonds, Discount Notes or Other Indebtedness offered thereby in any jurisdiction to any person to whom it is unlawful to make such offer in such jurisdiction. The delivery of this Statement and any offering circular or supplement at any time does not imply that the information given herein or therein is correct at any time subsequent to its respective date.

THE NEW POWER BONDS, DISCOUNT NOTES, AND OTHER INDEBTEDNESS OF TVA WILL NOT BE OBLIGATIONS OF, NOR WILL PAYMENT OF PRINCIPAL THEREOF OR ANY INTEREST THEREON BE GUARANTEED BY, THE UNITED STATES OF AMERICA. PRINCIPAL AND INTEREST, IF ANY, WILL BE PAYABLE SOLELY FROM TVA’S NET POWER PROCEEDS AS HEREIN DEFINED. THE NEW POWER BONDS, DISCOUNT NOTES, AND OTHER INDEBTEDNESS ARE NOT REQUIRED TO BE REGISTERED UNDER THE SECURITIES ACT OF 1933. ACCORDINGLY, NO REGISTRATION STATEMENT HAS BEEN, AND NONE WILL BE, FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. TVA IS NOT SUBJECT TO THE PERIODIC REPORTING REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934.

This Statement describes the business and operations of TVA as of its date and the financial condition of TVA as of the date of the financial statements included herein. Recipients of this Statement should retain it for future reference until such time as a subsequent Statement is made available by TVA, but delivery or retention of this Statement after the date hereof shall not create any implication that the information provided herein is correct at any time after the date hereof, and TVA assumes no duty to update this Statement after the date hereof, except as described above.

**The date of this Information Statement is February 27, 1998.**

## FORWARD-LOOKING STATEMENTS

This Statement contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions or assumptions or otherwise relating to future events or performance may be forward-looking. Some examples include statements regarding TVA's projections of future power and energy requirements, future costs related to environmental compliance, and targets for TVA's future competitive position. Although TVA believes that these statements are accurate, TVA does not guarantee their accuracy. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. Such factors include, among other things, new laws and regulations, especially those related to the deregulation of electric utilities, the status of TVA as a government agency, and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial environment; performance of TVA's generating facilities; fuel prices; the demand for electricity; weather conditions; changes in accounting standards; and unforeseeable adverse events.

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## THE TENNESSEE VALLEY AUTHORITY

TVA is one of the largest electric power systems in the United States, having produced nearly 153 billion kilowatt-hours (“kWh”) of electricity in fiscal 1997. TVA is a wholly owned corporate agency and instrumentality of the United States established by the Act with the objective of developing the resources of the Tennessee Valley region.

TVA’s activities fall into two types of programs — the power program and the nonpower programs. Financial accounts for the two types of activities are kept separately. Substantially all of TVA’s revenues and assets are attributable to the power program, which is required to be self-supporting from the revenues it produces and capital it raises through its power program borrowings. TVA is authorized by the Act to issue Power Bonds, Discount Notes, and Other Indebtedness (collectively, “Evidences of Indebtedness”) in an amount not exceeding \$30 billion outstanding at any one time, the proceeds of which may be used only for the power program. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness”. Historically, most of the funding for TVA’s nonpower programs has been provided by congressional appropriations. Additional funds have been obtained from revenues and user fees from the nonpower programs. For fiscal years 1997 and 1998 Congress appropriated \$106 million and \$70 million, respectively, for the nonpower programs. The appropriations act for fiscal 1998 anticipates no appropriations for TVA’s nonpower programs for fiscal 1999 and thereafter and provides that essential stewardship activities are to be funded from other sources, which may include certain power revenues. For a discussion of recent legislation relating to TVA’s power and nonpower programs, see “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Recent Legislation”.

In the Act, Congress has reserved the right to alter, amend or repeal the Act, but has provided that no amendment or repeal shall operate to impair the obligation of any contract made by TVA in the exercise of any power conferred by the Act. For a discussion of recent legislation relating to the TVA Act, see “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Recent Legislation”.

TVA is administered by the Board, which is composed of three persons appointed by the President and confirmed by the Senate. Appointments are for nine-year staggered terms with one term expiring with each three-year interval. The Board has sole authority for determining the rates which TVA charges for power. The Act requires the Corporation to charge rates for power which, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes; debt service on outstanding Evidences of Indebtedness, including provision and maintenance of reserve funds and other funds established in connection therewith; and annual payments to the U.S. Treasury (the “Treasury”) in repayment of and as a return on the government’s appropriation investment in TVA power facilities. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness”. Such appropriation investment totaled \$588 million as of September 30, 1997. See “Certain Provisions of the Tennessee Valley Authority Act” — “Payments to the Treasury”.

TVA is required annually to file with the President and with the Congress a financial statement and a complete report as to the business of the Corporation. The Comptroller General of the United States is authorized to periodically audit the transactions of TVA.

Under certain conditions, TVA may borrow from the Treasury up to \$150 million for a period of one year or less. Any issuance by TVA of Evidences of Indebtedness with a term of one year or longer is subject to the approval of the Secretary of the Treasury as to the issue date and maximum interest rate. The borrowing authority of TVA is treated as budget authority by the Office of Management and Budget for purposes of the budget of the United States.

Income on Evidences of Indebtedness issued by TVA is subject to various federal tax consequences. Under the Act, Evidences of Indebtedness are exempt both as to principal and interest from all taxation now or hereafter imposed by any state or local taxing authority except estate, inheritance and gift taxes. This exemption might not extend to franchise or other non-property taxes in lieu thereof imposed on corporations or to gain or loss realized upon the sale or exchange of an Evidence of Indebtedness, notwithstanding that such gain might in some cases be treated as interest income for United States federal income tax purposes.

## SELECTED FINANCIAL DATA

The following selected financial data of TVA's power program for the fiscal years 1993 through 1997 have been derived from TVA's audited financial statements. These data should be read in conjunction with the audited financial statements and notes thereto (the "Financial Statements") presented herein.

### Condensed Statements of Income (dollars in millions)

	Fiscal Year Ended September 30				
	1997	1996	1995	1994	1993
Operating Revenues .....	\$ 5,552	\$ 5,693	\$ 5,375	\$ 5,401	\$ 5,276
Operating Expenses .....	3,698	3,656	3,448	3,461	3,269
Operating Income .....	1,854	2,037	1,927	1,940	2,007
Other Income and Expense, Net .....	157	(10)	(91)	(59)	23
Income Before Interest Expense .....	2,011	2,027	1,836	1,881	2,030
Interest Expense .....	2,084	2,083	2,024	1,853	1,777
Allowance for Funds Used During Construction .....	(81)	(117)	(198)	(123)	(58)
Net Interest Expense .....	2,003	1,966	1,826	1,730	1,719
Net Income .....	<u>\$ 8</u>	<u>\$ 61</u>	<u>\$ 10</u>	<u>\$ 151</u>	<u>\$ 311</u>
Ratio of Earnings to Fixed Charges(1) .....	1.00	1.03	1.01	1.08	1.18

### Condensed Balance Sheet (in millions)

	September 30				
	1997	1996	1995	1994	1993
<b>Assets</b>					
Current Assets .....	\$ 1,399	\$ 1,306	\$ 1,088	\$ 1,025	\$ 1,434
Property, Plant, and Equipment .....	29,298	29,521	29,301	28,071	27,888
Investment Funds .....	561	440	260	150	—
Deferred Charges and Other Assets .....	2,426	2,762	2,644	2,596	1,601
<b>TOTAL ASSETS .....</b>	<u><b>\$33,684</b></u>	<u><b>\$34,029</b></u>	<u><b>\$33,293</b></u>	<u><b>\$31,842</b></u>	<u><b>\$30,923</b></u>
<b>Liabilities and Proprietary Capital</b>					
Current Liabilities .....	\$ 3,853	\$ 5,101	\$ 5,416	\$ 4,591	\$ 4,942
Other Liabilities .....	1,704	1,580	1,264	963	1,034
Long-Term Debt .....	24,152	23,320	22,583	22,206	20,954
Proprietary Capital .....	3,975	4,028	4,030	4,082	3,993
<b>TOTAL LIABILITIES AND PROPRIETARY CAPITAL .....</b>	<u><b>\$33,684</b></u>	<u><b>\$34,029</b></u>	<u><b>\$33,293</b></u>	<u><b>\$31,842</b></u>	<u><b>\$30,923</b></u>

(1) Ratio of Earnings to Fixed Charges (unaudited) is calculated by dividing Net Income plus Interest Expense by Interest Expense.

**COMPARATIVE FIVE-YEAR DATA**

**Statistical and Financial Summaries**

	For the years ended September 30,				
	1997	1996	1995	1994	1993
<b>Sales (millions of kilowatt-hours (“kWh”))</b>					
Municipalities and cooperatives .....	114,771	117,035	110,245	108,073	105,566
Industries directly served .....	17,359	16,599	16,684	15,792	16,196
Federal agencies .....	7,567	6,966	7,226	4,407	2,382
<b>Total sales</b> .....	<u>139,697</u>	<u>140,600</u>	<u>134,155</u>	<u>128,272</u>	<u>124,144</u>
<b>Operating revenues (millions of dollars)</b>					
Electric					
Municipalities and cooperatives .....	\$ 4,811	\$ 4,980	\$ 4,654	\$ 4,582	\$ 4,479
Industries directly served .....	464	452	460	452	472
Federal agencies .....	179	172	179	296	254
Other .....	98	89	82	71	71
<b>Total revenues</b> .....	<u>\$ 5,552</u>	<u>\$ 5,693</u>	<u>\$ 5,375</u>	<u>\$ 5,401</u>	<u>\$ 5,276</u>
<b>Revenue per kilowatt-hour (cents) (a)</b> .....	3.90	3.99	3.94	4.03	4.06
<b>Net winter dependable generating capacity (megawatts)</b>					
Hydro (b) .....	5,384	5,298	5,225	5,242	4,885
Fossil .....	15,014	15,012	15,032	15,032	15,088
Nuclear units in service .....	5,625	5,545	3,342	3,342	3,365
Combustion turbine .....	2,394	2,268	2,232	2,264	2,284
<b>Total capacity</b> .....	<u>28,417</u>	<u>28,123</u>	<u>25,831</u>	<u>25,880</u>	<u>25,622</u>
<b>System peak load (megawatts) — summer</b> .....	26,661	25,376	25,496	23,398	23,878
<b>System peak load (megawatts) — winter</b> .....	26,670	25,995	24,676	24,723	21,666
<b>Percent gross generation by fuel source</b>					
Fossil .....	61%	65%	71%	72%	77%
Hydro .....	11%	11%	12%	14%	13%
Nuclear .....	28%	24%	17%	14%	10%
<b>Fuel cost per kilowatt-hour (cents)</b>					
Fossil .....	1.23	1.23	1.26	1.34	1.27
Nuclear(c) .....	.58	.56	.61	1.10	1.09
Aggregate fuel cost per kWh net thermal generation .....	1.04	1.06	1.14	1.31	1.25
<b>Fuel data</b>					
Net thermal generation (millions of kWh) .....	135,735	131,898	118,097	110,643	109,968
Billion Btu .....	1,381,837	1,338,157	1,197,295	1,120,868	1,105,395
Fuel expense (millions of dollars) .....	1,406	1,395	1,348	1,450	1,375
Cost per million Btu (cents) .....	101.73	104.22	112.61	129.40	124.42
Net heat rate, fossil only (Btu's per kWh) .....	10,180	10,145	10,138	10,131	10,052

(a) Excludes Department of Energy settlement payment of \$160 million for the years 1993 and 1994.

(b) Includes 405 megawatts of dependable capacity from the Corps of Engineers projects on the Cumberland River system.

(c) TVA changed its method of expensing the interest component of nuclear fuel expense in 1995.

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

### Results of Operations

#### *Operating Environment*

Net income for fiscal 1997 amounted to \$8 million, down from \$61 million for fiscal 1996. The reduction in earnings resulted from lower operating income attributable principally to mild weather experienced within TVA's service area during the winter and summer months of fiscal 1997, partially offset by other income related to certain investment earnings.

Net income for fiscal 1996 was \$61 million compared with \$10 million for fiscal 1995. This improvement was primarily driven by sales growth and increased operating efficiencies.

#### *Operating Revenues*

Operating revenues were \$5,552 million in fiscal 1997 compared with \$5,693 million in fiscal 1996 and \$5,375 million in fiscal 1995. The \$141 million decrease in fiscal 1997 as compared to fiscal 1996 was primarily due to a decrease in energy sales to municipalities and cooperatives as a result of the cool summer and warm winter during fiscal 1997. The TVA service area experienced 17 percent lower heating degree days and 11 percent lower cooling degree days during fiscal 1997 compared with fiscal 1996. Accordingly, total kWh sales decreased 0.9 billion kWh, from 140.6 billion in fiscal 1996 to 139.7 billion in fiscal 1997.

The \$318 million increase in operating revenues from fiscal 1995 to fiscal 1996 was primarily due to an increase in kWh sales of approximately six billion kWh (4.5 percent), from 134 billion in fiscal 1995 to over 140 billion in fiscal 1996, combined with an increase in the revenue per kWh of approximately 0.05 cents (1.3 percent), from 3.94 cents in fiscal 1995 to 3.99 cents in fiscal 1996. The increase in kWh sales primarily resulted from overall growth within the municipalities and cooperatives segment and more extreme weather conditions in fiscal 1996.

#### *Operating Expenses*

Operating expenses increased \$42 million, or 1.2 percent, from \$3,656 million in fiscal 1996 to \$3,698 million in fiscal 1997. The operation of the Watts Bar Unit One and Browns Ferry Unit Three nuclear units for the entire fiscal year of 1997 resulted in higher depreciation and operating expenses in fiscal 1997 as compared with fiscal 1996. These expenses, however, were partially offset by lower net fuel and purchased power expense in fiscal 1997 compared with fiscal 1996 as a result of greater generation of lower-cost nuclear power and the decrease in total power sales for fiscal 1997.

Total operating expenses increased \$208 million in fiscal 1996 versus fiscal 1995, or 6.0 percent, from \$3,448 million to \$3,656 million. The increase resulted primarily from increased generation during fiscal 1996 and the introduction of the two nuclear units to the power system. While operating and maintenance costs increased \$168 million, and depreciation and amortization expenses increased \$201 million, net fuel and purchased power expense declined \$165 million in fiscal 1996 compared with fiscal 1995 due to favorable fuel prices and greater off-system power sales.

#### *Other Income and Expenses*

TVA had net other income of \$157 million in fiscal 1997 compared with net other expense of \$10 million in fiscal 1996 and \$91 million in fiscal 1995. The fiscal 1997 net other income consisted primarily of net investment earnings of the decommissioning trust funds of \$138 million. The fiscal 1995 net expense was primarily composed of a \$136 million charge for a voluntary early-out package offered employees, partially offset by the recognition of an \$81 million deferred gain from a fiscal 1993 sale of investments.

### *Interest Expense*

Gross interest expense remained essentially unchanged at \$2,084 million in fiscal 1997 compared with \$2,083 million in fiscal 1996. Total outstanding indebtedness net of unamortized discounts and other adjustments as of September 30, 1997, was \$26.9 billion, with an average interest rate of 7.56 percent, compared with \$27.3 billion, with an average interest rate of 7.60 percent as of September 30, 1996. The allowance for funds used during construction decreased from \$117 million in fiscal 1996 to \$81 million in fiscal 1997 as a result of the decline in overall construction spending.

Gross interest expense for fiscal 1996 increased \$59 million from \$2,024 million in fiscal 1995 to \$2,083 million in fiscal 1996. This increase resulted from an increase in total outstanding debt from \$26.7 billion as of September 30, 1995, to \$27.3 billion as of September 30, 1996. In addition, allowance for funds used during construction declined \$81 million from \$198 million in fiscal 1995 to \$117 million in fiscal 1996 due to the reduction of the overall level of capital spending in fiscal 1996.

## **Liquidity and Capital Resources**

### *Capital Structure*

Through fiscal 1959, the U.S. Government made appropriation investments of nearly \$1,365 million in TVA's power program. In 1959, TVA received its current congressional approval to issue bonds to finance its growing power program. Since that time, TVA's power program has been required to be self-supporting from revenues it produces and capital it raises through its power program borrowings. Because TVA is wholly owned by the U.S. Government, TVA does not issue equity securities. As a result, TVA raises its capital requirements through the internal generation of funds or through borrowings subject to a congressionally mandated \$30 billion limit. In fiscal 1997, TVA reduced its total outstanding debt by approximately \$348 million. This is the first time since 1961 that TVA has ended a fiscal year with a net reduction in outstanding debt. See "Competition" for a discussion of TVA's plans to reduce its debt in the future.

Like stockholders in investor-owned companies, the U.S. Government expects to earn a return on its investment. The rate of return on this investment, plus a repayment of the initial investment, is specified by law. Total repayments and return on investment by TVA to the U.S. Treasury exceed \$3 billion.

### *Capital Expenditures*

Cash required by TVA for capital expenditures totaled \$641 million, \$990 million and \$1.7 billion for fiscal 1997, 1996 and 1995, respectively. The reductions reflect the decline in construction spending resulting from the return of Browns Ferry Unit Three to commercial operation in January 1996, the commencement of commercial operation at Watts Bar Unit One in May 1996 and the Board's decision not to complete or restart certain other nuclear units. See "Nuclear Power Program" — "Status of Certain Nuclear Units". TVA's current forecast for capital expenditures, including capitalized interest, totals \$733 million for fiscal 1998, which it expects to fund from internally generated funds.

### *Financing Activities*

Long-term debt and cash from operations are used to finance capital expenditures. Short-term debt and cash from operations are used to manage daily cash needs. In fiscal 1997 TVA issued \$3.1 billion in long-term bonds, the proceeds of which were used to refinance existing debt.

In October and December 1997, TVA issued in the public market \$250 million in Power Bonds (due 1999) and \$750 million in Power Bonds (due 2017), respectively, to retire existing debt.

In January 1998, TVA issued in the public market \$250 million in Power Bonds (due 2018) and \$1,000 million in Power Bonds (due 2038) to retire existing debt.

Subsequent to September 30, 1997, TVA monetized the call provisions on approximately \$2 billion of its Power Bonds. The premiums received by TVA have been deferred and are being amortized over the term of the agreements.

### *Cash Flows*

Net cash provided by operations for fiscal 1997, 1996 and 1995 was \$1,066 million, \$910 million, and \$802 million, respectively. This positive trend reflects continued improvements in TVA's operations during the three-year period.

Net cash used in investing activities for fiscal 1997, 1996 and 1995 was \$580 million, \$1,254 million and \$1,871 million, respectively. These reductions reflect the decline in construction spending from \$1,868 million in fiscal 1995 to \$722 million in fiscal 1997.

Net cash (used in)/provided by financing activities for fiscal 1997, 1996 and 1995 was (\$425) million, \$530 million and \$1,119 million, respectively. The cash used in financing activities during fiscal 1997 reflects the repayment of total outstanding debt of approximately \$348 million.

### **Accounting for the Effects of Regulation**

TVA accounts for the financial effects of regulation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 71, *Accounting for the Effects of Certain Types of Regulation*. As a result, TVA records certain regulatory assets and liabilities that would not be recorded under generally accepted accounting principles for non-regulated entities.

TVA has approximately \$1.9 billion of regulatory assets (see Note 1 of the accompanying Financial Statements — "Other deferred charges" and "Debt issue and reacquisition costs") along with approximately \$6.3 billion of deferred nuclear plants as of September 30, 1997. In the event that competition in the utility industry changes the application of SFAS No. 71, TVA would be required to evaluate such regulatory assets under the provisions of SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of*. Statement 121 establishes requirements for evaluating and measuring asset impairments and provides that regulatory assets that are no longer probable of recovery through future revenues be charged to earnings. Such an event may have an adverse effect on future results of operations from the write-off of regulatory assets. However, TVA intends to seek full recovery of any regulatory assets that may result from TVA's transition to doing business in the competitive market.

### **Year 2000 Costs**

TVA is evaluating the potential impact of the "Year 2000" problem on its operations. The Year 2000 problem, which is common to most companies, concerns the inability of information systems, such as computer software programs, to process date sensitive information related to the Year 2000 and beyond. TVA has established an enterprise-wide team to develop a plan and strategy, organize resources, assess the impact, and develop solutions. While it is not possible, at present, to give an accurate estimate of the cost of this work, TVA is allocating sufficient resources to address the Year 2000 problem and does not expect that such costs will be material to TVA's operations.

### **THE AREA SUPPLIED BY TVA**

TVA supplies power in most of Tennessee, northern Alabama, northeastern Mississippi, and southwestern Kentucky, and in small portions of Georgia, North Carolina and Virginia. The population of the area served by TVA is over 7 million. Subject to certain minor exceptions, TVA may not without specific authorization by act of Congress enter into contracts which would have the effect of making it or its distributors a source of power supply outside the area for which TVA or its distributors were the primary source of power supply on July 1, 1957.

TVA is primarily a wholesaler of power. Its customers are composed of three major groups: (1) distributors, consisting of municipal and cooperative systems; (2) industries which have large or unusual loads; and (3) federal agencies. In addition, TVA has entered into exchange power arrangements with most of the surrounding electric systems.

## RATES, CUSTOMERS AND MARKET

The Act delegates to the Board sole responsibility for establishing the rates which TVA charges and authorizes it to include in power contracts such terms and conditions as in its judgment may be necessary or desirable for carrying out the purposes of the Act. The Act requires the Corporation to charge rates for power which, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes; debt service on outstanding Evidences of Indebtedness, including provision and maintenance of reserve funds and other funds established in connection therewith; and annual payments to the Treasury in repayment of and as a return on the Government's appropriation investment in TVA power facilities. See "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Rate Covenant" and "Recent Legislation". Rates set by the Board are not subject to review or approval by any state or federal regulatory body. See "Competition".

A summary of power program operating revenues by customer type for each of the last five fiscal years ended September 30 is shown in the Comparative Five-Year Data, presented on page 3.

### **Municipal and Cooperative Distributors**

TVA has long-term wholesale power contracts with 159 municipal and cooperative distributors. Such contracts are for terms of 20 years and require distributors to purchase substantially all of their electric power and energy requirements from TVA. Most distributors purchase power under a contract that requires 10 years' notice to terminate the contract and further provides that on each annual anniversary of the contract (beginning with the tenth anniversary) one additional year is automatically added to the term. Six distributors' power contract term arrangements require 15 years' notice to terminate the contract. On each annual anniversary of these contracts (beginning with the fifth anniversary) one additional year is automatically added to the term. As part of the arrangement, TVA agreed that these term arrangements are deemed to provide for adequate recovery by TVA of any investment in generation, transformation, or transmission facilities for service to the distributor. Municipal and cooperative distributors accounted for approximately 87 percent of total power revenues in fiscal 1997. See "Competition".

A number of TVA distributors, including some with the largest loads, have been expressing interest in revising the wholesale power contracts to allow them more options with respect to contract term and other matters. TVA has indicated its willingness to work with distributors to accommodate their desire for more flexibility. In this regard, the TVA Board recently approved offering distributors the option of moving from 10 or 15-year termination notice periods to a 5-year termination notice period. Such contract amendments are being conditioned upon such notice not being given during the first five years after the effective date of the revision. TVA is also agreeing that these term arrangements and existing 10 years' notice contracts are deemed to provide for adequate recovery by TVA of any investment in generation, transformation, or transmission facilities for service to the distributor. For a discussion of events which may affect TVA's relationships with its distributors, see "Competition".

TVA's wholesale power contracts contain standard provisions specifying the wholesale rates, resale rates and terms and conditions under which the power is to be distributed. Under the contracts, TVA, on a quarterly basis, may determine and make adjustments in the wholesale rate schedule with corresponding adjustments in resale rate schedules necessary to enable TVA to meet all requirements of the Act and the tests and provisions of its bond resolutions. In addition, the contracts provide for agreement between the parties on general or major changes in both the wholesale and resale rate schedules and permit TVA, if agreement is not reached, to make changes in such schedules to carry out the objectives of the Act, to meet financial requirements and tests, and to comply with the provisions of its bond resolutions.

The resale rates under which the distributors serve ultimate consumers are stipulated in the power contracts between the distributors and TVA and are revised from time to time to reflect changes in costs, including changes in the wholesale cost of power. They are designed to promote the Act's objective of providing an adequate supply of power at the lowest feasible rates.

## **Industries and Federal Agencies Served Directly**

Contracts with industries served directly by TVA normally are for terms of 10 years but are subject to termination by TVA or the customer upon a minimum notice period that varies according to the customer's contract demand and the period of time service has been provided at that location. Industries directly served accounted for approximately 8 percent of power revenues in fiscal 1997. The power sold directly to industries is delivered under contracts at rates established by TVA. Such rates are the same as those charged by distributors to large industries (those with demand greater than 25,000 kilowatts ("kW")) they serve. Power is sold to federal agencies under the same contract terms and rates as directly served industries.

## **COMPETITION**

The electric utility industry has become increasingly competitive in the past decade. Competition is expected to intensify in the future as a result of federally encouraged deregulation of utilities affecting the wholesale power markets and various provisions of the Energy Policy Act of 1992 ("Energy Act"). Chief among the provisions of this act which will further intensify the competitive environment are amendments (1) to the Federal Power Act that give the Federal Energy Regulatory Commission ("FERC") greater authority to order electric utilities with transmission lines to wheel (transmit) power over their systems for electric power generating entities; and (2) to the Public Utility Holding Company Act of 1935 that allow the creation of certain kinds of power generating entities without the entities or their parent corporations being made subject to regulation by the Securities and Exchange Commission under that act.

Nevertheless, a special provision in the Energy Act (the "anti-cherry picking provision") prevents the wheeling authority of FERC from being used to provide TVA-served municipal and cooperative distributors with an alternative source of power supply. That provision excludes from the wheeling authority the wheeling of electric energy that will be consumed within the area that may be served by TVA and the distributors (except for Bristol, Virginia).

Several important regulatory rulings were issued during 1996 that will continue to have a significant impact on TVA. In April 1996, FERC issued Order Nos. 888 and 889. Order No. 888 requires FERC-regulated utilities that own, control, or operate transmission lines to file nondiscriminatory open-access tariffs that offer others certain basic types of transmission service. Order No. 889 requires FERC-regulated utilities to participate in an electronic information system known as the Open Access Same-time Information System ("OASIS"), which allows for the electronic communication of information about transmission systems and services to all potential customers at the same time. This rule also requires FERC-regulated utilities to functionally separate their wholesale power marketing and transmission operations. FERC also issued a Notice of Proposed Rulemaking ("NOPR") to obtain comments on a system for reserving capacity on utilities' own and others' transmission lines.

In response to these rulings, TVA has taken steps to voluntarily comply with FERC orders. Specifically, TVA has adopted changes (effective January 1, 1997) to its existing guidelines, originally adopted by the TVA Board in 1994, which offer transmission service patterned after the open-access tariff but consistent with the TVA Act and the Energy Act. TVA posts available transmission capacity and conducts transmission business through an OASIS on the Internet. TVA has implemented a Code of Conduct based on FERC's standards contained in Order No. 889. Actions under this Code of Conduct include separating TVA's operations for transmission requests, scheduling, and transmission system security from TVA's wholesale off-system sales activities.

Although other power suppliers, under certain circumstances, may sell power in the area where TVA power is distributed, there are statutory provisions restricting TVA from expanding the area in which it is a source of power supply. It is important that TVA market power at rates competitive with other suppliers in the region. TVA believes that its ten years of stable rates during the period fiscal 1988 through fiscal 1997 have assisted distributors of TVA power in competing for new commercial and industrial loads.

In 1997 at least seven bills had been introduced in the current Congress that would mandate or promote competition in electric service at the retail level. These bills, like ones introduced during the last Congress,

would also result in other major changes in the electric power industry that would significantly impact both privately owned companies and publicly owned electric power suppliers like TVA and the distributors of TVA power. The amount of government regulation, particularly for the latter, would greatly increase. In spite of their purpose to increase competition, some of these bills, as presently drafted, would not permit TVA and the distributors of TVA power to compete for customers outside the area for which TVA may be a source of power supply but would allow others to compete for customers of TVA and the distributors of TVA power. The Senate has not held formal hearings on these bills, but two days of hearings were held in the House in October 1997. Hearings on various topics of competition and electric industry restructuring have also been held in the House and Senate. TVA anticipates that in the event any retail choice legislation is enacted, such legislation would enable TVA and the distributors of TVA power to take part, reciprocally, in retail competition outside the area for which they can now be a source of electric power supply. The introduction of additional bills is expected during 1998, and this legislation is expected to receive serious congressional consideration. Although some key members of Congress have expressed an intention to complete action on retail competition legislation in 1998, final enactment remains uncertain.

Retail competition legislation raises serious issues for TVA, as it does for the rest of the electric utility industry. Among the issues which could have the greatest impact on the TVA system are: (1) the right to continue recovery of the costs of assets which would no longer be economical under full and open market competition; (2) whether TVA and its distributors will be able to sell power outside the TVA service area; (3) whether Congress will attempt to shorten the terms of TVA's present wholesale power contracts with its distributors; and (4) whether TVA rates will be regulated by FERC.

Three bills have been introduced in this Congress that would require the disposition of certain federally-owned hydroelectric system assets. None of these bills is applicable to TVA. Other such bills, which may include TVA, may be introduced. A similar proposal was not enacted during the past Congress. In TVA's opinion, enactment of such legislation is unlikely.

In today's competitive environment, some of the municipal and cooperative distributors may consider alternative wholesale supply arrangements upon expiration or termination of their power contracts with TVA. In February 1997 the city council of Bristol, Virginia ("Bristol") approved a recommendation from the Bristol Virginia Utilities Board that Bristol accept an offer from Cinergy to supply its power in the future. In April 1997 Cinergy requested that TVA provide transmission service to enable Cinergy to provide electricity to Bristol. TVA agreed to provide that service consistent with FERC's open-access transmission orders and contingent upon stranded investment cost recovery determined in accordance with applicable law. In June 1997 Cinergy initiated a FERC proceeding to require TVA to provide transmission service upon terms more favorable to Cinergy. Among the terms being challenged is TVA's demand for payment of stranded investment costs. On November 25, 1997, FERC issued an order referring the matter to an administrative law judge for an evidentiary hearing on TVA's stranded cost claim. TVA and Cinergy attempted to negotiate the terms and conditions under which TVA would provide transmission service for the supply of power to Bristol. In addition to the stranded cost issue, the parties could not agree on three operational issues. All of these issues have been submitted to FERC for resolution. On December 31, 1997, the power contract between TVA and Bristol ended, and Bristol ceased being a TVA distributor. TVA is providing transmission service to Cinergy under an interim arrangement pending resolution of the outstanding issues.

TVA's management continues to develop plans and strategies it believes will help position TVA to successfully compete in a deregulated electricity market both within the Tennessee Valley and nationwide. In July 1997 Chief Financial Officer David Smith released the TVA Ten Year Business Outlook which sets targets for a 50 percent reduction in debt and a 15 percent reduction in the total cost of power by 2007. This plan recommended a price increase for fiscal year 1998 that would result in a 5.5 percent increase in TVA's power revenues, the first such increase in ten years. In August 1997, the TVA Board approved an increase in rates designed to provide such additional power revenues, and on October 1, 1997, TVA implemented the rate increase. The Ten Year Business Outlook also calls for TVA initiatives to reduce fuel, labor, and supply costs, with a proposed reduction of approximately 700 employees in TVA's power program workforce. In addition, the plan recommended offering the opportunity to TVA's distributor customers to change their power contracts after five years from a rolling ten-year term to a rolling five-year term. The Board subsequently

approved making such arrangements available to the municipal and cooperative customers served by TVA. See “Rates, Customers and Markets” — “Municipal and Cooperative Distributors”. The plan has been built on assumptions that TVA believes to be reasonable, based upon today’s knowledge and predictions for the future. However, future events may upset these assumptions and lead to plan modifications.

In January 1998, TVA and the Tennessee Valley Public Power Association (the “TVPPA”), which represents the interests of distributors of TVA power, issued a joint statement indicating their consensus regarding legislative positions on the restructuring of the electric utility industry. The statement recommends, among other things, that in the event customer choice legislation is enacted at the federal level: (1) the anti-cherry picking provision of the Energy Act and the territorial limitations which restrict the area in which TVA and its distributors may be a source of power (the “fence”) be removed, provided that (a) the distributors’ contracts are modified to shorten terms and termination notice and to allow distributors to purchase partial requirements from TVA, (b) the issue of stranded investment is addressed, and (c) TVA is required to grant access to its transmission system at reasonable charges to permit power to be transmitted to or on behalf of the distributors; (2) any recovery of TVA’s stranded investment costs be subject to FERC approval, not be allowed prior to termination of a contract, and not be allowed after October 1, 2007 unless TVA and the distributor otherwise agree; (3) TVA’s rights to serve new retail customers be subject to certain conditions and restrictions benefiting the distributors; (4) TVA generally be required to offer long-term, all-requirements power to distributors at wholesale rates no less favorable than that offered to new wholesale customers; (5) TVA continue to have the statutory authority to set certain terms and conditions in its all-requirements wholesale power contracts with distributors so as to facilitate the TVA Act’s mandate that TVA power be distributed at the lowest feasible rates; and (6) TVA have no authority to approve retail rates or other conditions of retail service except under certain limited circumstances.

Representatives of three of the largest distributors of TVA power, the municipal power systems of Knoxville, Memphis, and Nashville, Tennessee, have also expressed positions on issues concerning restructuring of the electric utility industry, some of which differ from the positions set forth in the joint statement issued by TVA and TVPPA.

TVA anticipates that discussions with distributors regarding a wide range of issues involving the restructuring of the electric utility industry, including the issues noted above, will continue throughout the national restructuring process.

TVA has begun under the auspices of the Department of Energy (“DOE”) a regional process to gather views from a wide variety of stakeholder groups as to the role the TVA power system should play in the electric utility industry after nationwide competition has begun.

In August 1995, the General Accounting Office (“GAO”) issued a report which, among other things, focused on TVA’s level of debt, rates, competitive position and deferred nuclear assets. The report raised the issue of whether TVA would be able to recover all the costs of its deferred nuclear assets and the financial and competitive impact this would have. While GAO is authorized to assist the Congress by evaluating government programs and activities and may make recommendations in this regard, it has no authority to order or direct that any action be taken. The report relating to TVA did not make any specific recommendations. TVA furnished to GAO a detailed response as to why the report is flawed in its analysis. GAO included TVA’s response in the report appendix.

A September 1997 report by GAO on the recurring and potential future costs to the federal government of its electricity-related programs concluded with respect to TVA that (1) the federal government’s initial appropriation investment in TVA and debt obligations held by the Federal Financing Bank result in no net cost to the federal government; (2) as long as TVA’s power program remains in a protected position similar to a traditional regulated utility, the risk of loss to the federal government is remote; and (3) if TVA is required to compete with other electric utilities at a time when wholesale prices are expected to fall, it is reasonably possible that losses to the federal government would occur if the government decided to voluntarily take any actions to prevent default on TVA’s debt service requirements, even though TVA’s debt is not guaranteed by the federal government. TVA does not agree with GAO’s assessment of the risk of loss to the federal government. TVA’s comments on the assessment are included in Volume 2 of the GAO report.

In November 1997 the Congressional Budget Office (the "CBO") released a study discussing the federal government's role in supplying electricity and possible options for changing that role. Among other things, the study found that the government could save money over the long term by selling many of the facilities it now uses to supply electric power but that the government may want to stay in the electric power business for other reasons. With regard to TVA, the CBO estimated that, depending on the market value at which TVA could be sold, the government could currently lose up to \$5.6 billion or gain up to \$2.5 billion by divesting itself of TVA. The study also cites what it terms "financial challenges" that TVA now faces and will face in the near future that could affect its earnings potential and ability to cover its capital obligations. TVA expresses no opinion on the accuracy of the CBO's study or on the likelihood of any change in the government owned status of TVA.

In June 1997 Representative Bob Clement introduced a bill in the House of Representatives to create the "TVA 2000 Regional Commission". Under the bill, a twelve-member Commission (appointed by the President and by House and Senate leaders) representing a diversity of Tennessee Valley interests would complete a study and submit its report by the end of 1998. The Commission would conduct a comprehensive legal and factual study of the navigational, flood control, economic development, recreational, and economic impacts of the future structure, competitiveness and economic viability of TVA.

### **POWER AND ENERGY REQUIREMENTS**

TVA prepares annual forecasts of future power and energy requirements as part of its planning and budgeting process. TVA's forecast procedure involves producing a range of load forecasts for the explicit purpose of bounding the range of uncertainty associated with load growth. The load forecasts are produced probabilistically. TVA believes that the high load forecast has a 90 percent probability that actual load will be less than forecast, that the medium load forecast has a 50 percent probability that actual load will be less than forecast, and that the low load forecast has a 10 percent probability that actual load will be less than forecast. TVA's current load forecast through fiscal year 2000 reflects an average annual load growth rate of 5.0 percent, 2.5 percent, and 0.5 percent for the high, medium, and low load forecasts, respectively. TVA's total system energy requirements through fiscal year 2000 reflect an average annual growth rate of 5.1 percent, 2.4 percent, and (0.3) percent for the high, medium, and low load forecasts, respectively. Numerous factors could cause actual results to differ materially from TVA's forecasts.

Various provisions in the Energy Act make changes in a wide range of laws affecting energy use and development in the United States. In addition to various other features, some of which are discussed herein, this act establishes a statutory framework for how TVA plans and selects methods for meeting future energy needs.

TVA may enter into electricity futures contracts for the sole purpose of limiting or otherwise hedging TVA's economic risks directly associated with electric power generation, purchases, and sales. The Chicago Board of Trade has proposed designating the TVA power transmission system as a hub for electricity futures contracts. This proposal is subject to review by the Commodity Futures Trading Commission.

### **POWER SYSTEM**

TVA's power generating facilities at September 30, 1997, included 29 hydroelectric plants, 11 coal-fired plants, 3 nuclear plants, 1 pumped storage hydroelectric plant and 4 combustion turbine plants. Power is delivered to TVA customers over a transmission system of approximately 16,600 miles of lines, including 2,400 miles of extra-high-voltage (500,000 volt) transmission lines. The system interconnects with neighboring power systems at numerous points, and TVA has various types of interchange arrangements with these systems. The extent and types of interchange transactions depend upon the characteristics of the systems' loads, the management policies of the systems and other factors. Interchange arrangements are an essential part of TVA's efforts to minimize investment in electrical facilities, increase the reliability of service, effect operating economies and minimize the cost of electric energy.

In March 1997 a suit was filed in the United States District Court in Birmingham, Alabama, by four individuals challenging TVA's sale of power to Trico Steel Company, L.L.C. ("Trico"). Plaintiffs, who

claimed to be employees of Trico’s competitors, claimed that the TVA Act does not permit TVA to sell power to a limited liability company such as Trico; that the pricing provisions of TVA’s power supply contract with Trico violated various sections of the TVA Act; and that the TVA Board’s actions with respect to the Trico contract were unconstitutional because a provision of the TVA Act violates the separation of powers doctrine. Plaintiffs did not ask for monetary damages but sought to enjoin TVA from selling power to Trico and from issuing any additional power bonds until the alleged problems were corrected. TVA filed a motion asking the court to dismiss the complaint on several legal grounds. The court, on September 24, 1997, granted TVA’s motion and dismissed the lawsuit. The court held that the fixing of TVA’s rates is not subject to judicial review and that plaintiffs did not have standing to maintain the lawsuit since they had not suffered the requisite injury. The court did not reach the other issues in the case. The plaintiffs have appealed the decision.

During the fiscal year ended September 30, 1997, 61 percent of the power generated by the TVA coordinated system was by fossil fired plants, 28 percent by nuclear, and 11 percent by hydro. Coal consumption during this time was 39.8 million tons. Coal is purchased under contracts ranging from a single delivery to deliveries over several years. TVA coal inventory levels vary from plant to plant based upon a simulated inventory model. As of September 30, 1997, TVA had approximately 21 days’ coal supply in inventory at full burn. See “Nuclear Power Program” — “Nuclear Fuel” for a discussion of TVA’s nuclear fuel supplies. Management believes the sources and availability of fuel materials essential to its business should be adequate for the foreseeable future.

TVA’s power system is one of the largest in the United States in capacity and in energy production. Its size permitted the construction of large facilities which resulted in lower unit costs. Most of TVA’s dams were completed years ago when construction costs were far below present-day levels. Because most of the dams are multipurpose, their cost is shared by navigation, flood control, recreation and local economic development, as well as by power; thus, each purpose is served at a substantially lower cost than if the dams had been built for a single purpose.

**Generating Resources**

The following table summarizes the winter net dependable capacity (“NDC”) in megawatts (“MW”) on this coordinated system as of September 30, 1997:

	<u>Generating Units</u>	<u>Winter NDC MW(1)</u>
TVA Hydro Plants .....	109	3,129
TAPOCO Hydro Plants .....		318(2)
Corps of Engineers Hydro Plants.....		405(3)
TVA Pumped Storage Facility.....	4	<u>1,532</u>
Total Hydro .....		5,384
Fossil .....	59	15,014
Nuclear .....	5	5,625
Combustion Turbine .....	48	<u>2,394</u>
Total NDC .....		<u>28,417</u>

- (1) NDC as stated is the net power output which can be obtained for a period adequate to satisfy the daily load patterns under expected conditions of operation with equipment in an average state of maintenance. For planning purposes, TVA currently estimates summer dependable total hydro capacity of approximately 5,615 MW; coal-fired capacity of approximately 14,679 MW; nuclear power capacity of approximately 5,479 MW; and combustion turbine capacity of approximately 2,045 MW, for a total summer NDC of approximately 27,818 MW.
- (2) Four hydro plants owned by TAPOCO, Inc., a subsidiary of the Aluminum Company of America (“Alcoa”), are operated as part of the TVA power system. Under contractual arrangements with TAPOCO, electric power generated at these facilities is supplied to TVA. In return, TVA supplies electric power for Alcoa’s aluminum plant operations located in Tennessee.

- (3) The Corps of Engineers' plants on the Cumberland River system have a total installed capacity of 853 MW, of which 405 MW of NDC is available to TVA under a marketing agreement with the Southeastern Power Administration.

Under arrangements among TVA, the Corps of Engineers (the "CORPS") and the Southeastern Power Administration ("SEPA"), 8 hydro plants of the CORPS comprising the Cumberland River system are operated in coordination with the TVA system. These arrangements further provide for capacity (405 MW) and energy from the Cumberland River system to be supplied to TVA by SEPA at the points of generation, and the price paid for the power to be based on the operating and maintenance expenses and amortization of the power facilities. A portion of the output of the Cumberland River system is also made available to SEPA's customers outside the TVA region. The agreement with SEPA covering these arrangements for power from the Cumberland River system can be terminated upon three years' notice.

TVA has contracted with Choctaw Generation, Inc. to purchase and take delivery of up to 440 MW of power over a 30-year term from a lignite power plant to be constructed in Mississippi, contingent upon satisfactory completion of all necessary environmental reviews. Commercial operation of the plant is currently scheduled for January 2001. The owner of the facility has construction and operating risks, and if the owner fails to deliver the required energy, the owner will be responsible for securing replacement power for TVA at the contractually agreed price.

### **Integrated Resource Plan**

In December 1995, the Board approved TVA's Integrated Resource Plan ("IRP") which presents TVA's strategy for meeting future customer energy demands. The IRP identifies a 25-year least-cost energy resource strategy for TVA's power system. TVA's IRP strategy relies on a portfolio of energy resource options that made up the best strategies evaluated for the TVA power system. These strategies performed well across all of the IRP evaluation criteria including debt, rates, costs, reliability, and environmental impacts and regulations. These strategies are designed to enable TVA to respond to future demands in a manner that maintains flexibility and enhances its competitive position. Included in the portfolio are customer service options such as energy conservation and load management; supply side options, including power purchased from other producers; and investigation and use of renewable energy.

Since the final IRP was issued in December 1995, TVA has undertaken the following actions identified in the IRP.

1. Purchased 2,000 MW of options of future peak and base-load capacity to meet future power needs in the Tennessee Valley region.

2. Issued an Environmental Impact Statement evaluating the conversion of Bellefonte Nuclear Plant to a fossil fuel-fired plant. A feasibility study performed by an outside team of technical and financial experts concluded that one of the most economical fossil conversion strategies was to complete Bellefonte as a natural gas-fired combined-cycle plant. In addition, TVA submitted a proposal to DOE to complete Bellefonte as a nuclear plant and to operate it to produce tritium for DOE in addition to electricity. TVA also proposed providing irradiation services to produce tritium at Unit One of the Watts Bar Nuclear Plant. Further action will depend on DOE's evaluation of and response to the TVA proposals and other potential options to produce tritium. See "Nuclear Power Program" — "Status of Certain Nuclear Units".

3. Implemented or began pilot programs for the following energy service programs:

- Residential demand-side management programs such as a heat pump retrofit program, a new homes program, an energy self-audit and student-audit program, and a low income demonstration program.
- An energy service company pilot designed to encourage the efficient use of electricity in the commercial and industrial sectors.
- Beneficial electrification programs designed to encourage efficient heating and air conditioning in residential and commercial establishments, commercial cooking, residential security lighting, and industrial electrotechnologies.

- Load management activities which include water heater control, storage water heaters, and real time pricing.

4. Continued research into several renewable energy technologies such as wind, biomass, and landfill methane.

TVA continues to review and update its resource plans. To date, several internal options have been approved including upgrades to combustion turbine units, upgrades to Raccoon Mountain Pumped Storage Plant, and fossil plant improvements. Discussions with suppliers of peaking power are underway to determine if other options should be pursued.

## NUCLEAR POWER PROGRAM

### Overview

TVA has five operating nuclear units at three locations: Sequoyah Units One and Two, Browns Ferry Units Two and Three and Watts Bar Unit One. Construction activities at three additional units have been suspended and one licensed unit remains in an inoperative status. See detailed discussions on all operating and inoperative nuclear units in the sections below and Note 2 of the accompanying Financial Statements.

### Sequoyah

Sequoyah is a two-unit plant located approximately 7.5 miles northeast of the city limits of Chattanooga, Tennessee, with pressurized water reactors supplied by Westinghouse Electric Corporation. Each unit is rated at 1,147 MW net electrical output. TVA received an Operating License for Unit One in 1980, and the unit began commercial operation in 1981. TVA received an Operating License for Unit Two in 1981, and the unit began commercial operation in 1982. The Operating Licenses expire 40 years after issuance. The plant was designed and built and is operated by TVA. TVA voluntarily shut down both units in 1985 in response to technical and operational concerns.

Both Sequoyah units returned to commercial operation in 1988 and were removed from the NRC's list of plants that require close monitoring in 1989. Sequoyah Units One and Two have recorded an 82.5 average percent equivalent availability for the three years ending September 1997. (The "equivalent availability" is the ratio of the energy a unit could have generated, if called on, to the energy the unit would have produced if it had run at full load over the entire period, expressed as a percentage).

### Browns Ferry

Browns Ferry is a three-unit plant located approximately 10 miles southwest of Athens, Alabama, with boiling water reactors supplied by General Electric Company. Each unit is rated at 1,065 MW net electrical output. The plant was designed and built and is operated by TVA. TVA received Operating Licenses for Units One, Two, and Three in 1973, 1974 and 1976, respectively. They began commercial operation in 1974, 1975 and 1977, respectively. The Operating Licenses for these units expire 40 years after issuance. Units One, Two and Three were voluntarily shut down by TVA in 1985 in response to technical and operational concerns.

Browns Ferry Unit Two was returned to commercial operation in 1991 and was removed from the NRC's list of plants requiring continued close monitoring in 1992. Browns Ferry Unit Two has recorded an 86.8 average percent equivalent availability factor for the three years ending September 1997.

Browns Ferry Unit Three was restarted in November 1995 and returned to commercial operation in January 1996. In June 1996 the NRC removed Browns Ferry Unit Three from the list of plants warranting close monitoring. Browns Ferry Unit Three recorded a 90.9 percent equivalent availability factor from restart through September 30, 1997.

Browns Ferry Unit One has been idled since March 1985. Major modifications would be required to bring the plant to current standards. At September 30, 1997 the undepreciated cost of Browns Ferry Unit One was \$80 million. In 1994 preliminary cost estimates based on IRP information indicated that cost associated with

returning Unit One to service would have been between \$1.2 and \$3.2 billion. See “Status of Certain Nuclear Units” for discussion of the status of Browns Ferry Unit One.

### **Watts Bar**

Watts Bar is a two-unit power plant located approximately 50 miles northeast of Chattanooga, Tennessee, with pressurized water reactors supplied by Westinghouse Electric Corporation. Unit One is rated at 1,154 MW net electrical output. The plant was designed and has been built to its present level of completion by TVA. The Construction Permit for Unit Two expires in December 1999.

Although physical construction of Watts Bar Unit One was substantially complete in 1985, efforts to obtain an Operating License were delayed due to numerous safety concerns. Overall plant design was reverified and extensive modifications were made. The NRC granted TVA a license to operate Unit One at up to five percent of rated power in November 1995 and at full power in February 1996. Watts Bar Unit One successfully completed all power ascension testing activities and commenced full power commercial operation in May 1996. The Operating License for Unit One expires 40 years after issuance. Since beginning commercial operation, the plant has operated at an 82.1 percent equivalent availability factor through September 30, 1997.

In 1988, TVA suspended construction activities at Watts Bar Unit Two because of a reduction in the forecasted load growth. Total investment in Unit Two at September 30, 1997, was \$1.7 billion, including capitalized interest. In 1994 preliminary cost estimates based on IRP information indicated that the cost associated with completing Unit Two would have been between \$1.1 and \$2.9 billion. See “Status of Certain Nuclear Units” for discussion of the status of Unit Two.

### **Bellefonte**

Bellefonte is a two-unit power plant located approximately 59 miles southwest of Chattanooga with pressurized water reactors supplied by Babcock & Wilcox Company rated at 1,212 MW net electrical output each. The plant was designed and has been built to its present level of completion by TVA. Construction Permits were obtained from the NRC for both units in December 1974.

TVA deferred construction activities on Bellefonte Unit Two because of a reduction in forecasted load growth in October 1985. Construction activity was deferred on Unit One in July 1988. In March 1993, TVA notified the NRC of its plans to resume completion activities at Bellefonte, but no construction activities have occurred since 1988. Construction Permits for Unit One and Unit Two have been extended by the NRC to 2001 and 2004, respectively.

As of September 30, 1997, TVA had \$4.6 billion, including capitalized interest, invested in these units. See “Status of Certain Nuclear Units” for discussion of Bellefonte’s current status. In 1994 preliminary cost estimates based on IRP information indicated that cost associated with completing the Bellefonte units would have been between \$1.3 and \$3.5 billion for Unit One and \$900 million and \$2.4 billion for Unit Two.

### **Status of Certain Nuclear Units**

Preliminary cost estimates, utilizing the IRP (see “Power System” — “Integrated Resource Plan”), showed that completing the units at Bellefonte and Watts Bar Unit Two may not be economically feasible. As a result, the Board in December 1994 announced a major change in policy declaring that TVA will not, by itself, complete Bellefonte Units One and Two and Watts Bar Unit Two as nuclear units. In addition, the Board decided that Browns Ferry Unit One should continue in its inoperative status.

TVA’s IRP identified as a viable option the conversion of the Bellefonte facility to a combined-cycle plant utilizing natural gas or gasified coal. In 1997 an independent team of technical and financial experts completed a feasibility study to evaluate options for the conversion of Bellefonte Nuclear Plant to a fossil fuel-fired plant. The feasibility study indicates that one of the most economical fossil conversion strategies is to complete Bellefonte as a natural gas-fired combined-cycle plant. TVA also issued an Environmental Impact Statement (“EIS”) assessing the environmental impacts of various fossil conversion options. The EIS

identified the natural gas-fired combined-cycle plant alternative as the preferred option. In addition, TVA submitted a proposal to DOE to complete Bellefonte as a nuclear plant and to operate it to produce tritium for DOE in addition to electricity. TVA also proposed providing irradiation services to produce tritium at Unit One of the Watts Bar Nuclear Plant. Further action will depend on DOE's evaluation of and response to the TVA proposal and DOE's other potential options to produce tritium.

At September 30, 1997, TVA's total investment in Bellefonte Units One and Two, Watts Bar Unit Two and Browns Ferry Unit One was \$7.0 billion. The future decisions on these units will ultimately impact the method of cost recovery, and the TVA Board has determined that it will establish rate adjustments and operating policies to ensure full recovery of the cost of these units and compliance with the requirements of the TVA Act.

Because of extensive regulatory requirements and the resulting delays which are often very lengthy, estimates of the cost to complete nuclear plants have typically been unreliable. No assurance can be given that TVA's cost estimates would not be changed significantly if a decision is made to complete or operate any of the inoperative units.

### **Nuclear Fuel**

TVA owns all nuclear fuel held for its nuclear units (operating and deferred). The net book value of such fuel was \$840 million as of September 30, 1997. See Note 2 of the accompanying Financial Statements. TVA currently has sufficient inventory to last until late 1998.

TVA's investment in the fuel being used in the Sequoyah, Watts Bar and Browns Ferry units is being amortized and accounted for as a fuel expense. The Bellefonte initial cores have been defabricated and uranium from these cores has been used in the Sequoyah and Browns Ferry units with the net book value assigned accordingly.

### **Nuclear Waste**

#### *Spent Nuclear Fuel*

The Nuclear Waste Policy Act of 1982 (the "NWP") provides that the federal government has the responsibility for the permanent disposal of spent nuclear fuel but charges each nuclear power system with the responsibility for the cost of such permanent disposal. The NWP requires each nuclear power system to enter into a disposal contract with DOE for such material. The contract requires each nuclear power system to pay a fee which is currently one mill per kWh for the net electricity generated by each of its reactors and sold. Although it is uncertain when DOE will be able to begin accepting spent nuclear fuel, TVA believes its spent fuel efforts will ensure that sufficient cost-effective at-reactor storage is available to meet all of TVA's spent fuel storage requirements until DOE is prepared to accept TVA's spent fuel.

TVA presently has the capability to store its spent fuel at Sequoyah through the year 2002, at Browns Ferry Units One and Two through the year 2011, and at Browns Ferry Unit Three through the year 2000. Based on a one unit operation, Watts Bar storage capability will be sufficient until 2018. Plans are in place to extend storage capacity at Browns Ferry Unit Three until 2006. TVA plans to extend storage capability through life-of-plant if necessary by using higher density racks in its existing storage pools or dry storage casks. Additional storage capacity increases will require NRC approval. However, all of the above methods of extending storage capability have been licensed by the NRC at other facilities.

#### *Low-Level Radioactive Waste*

Disposal costs for low-level radioactive waste that result from normal operation of nuclear units have increased significantly in recent years. Pursuant to the Low-Level Radioactive Waste Policy Act, each state is responsible for disposal of low-level waste generated in that state. States may form regional compacts to jointly fulfill their responsibilities. The States of Tennessee and Alabama (where TVA nuclear plants are located) have joined with other southeastern states to form the Southeast Compact Commission for Low-Level

Radioactive Waste Management. This commission regulates the siting of new disposal facilities and the disposal of low-level waste within the southeastern states.

Until July 1995, the low-level waste generators located in the Southeastern states were required to dispose of their waste at the Barnwell, South Carolina disposal facility. South Carolina has withdrawn from the Southeast Compact Commission in order to open the Barnwell facility to all states except North Carolina. The states participating in the Southeast Compact Commission have selected North Carolina as the host state to select, license, and construct a new disposal site. TVA plans to continue to use the Barnwell facility for low-level radioactive waste disposal until the North Carolina facility is opened. Should either or both of the disposal facilities close unexpectedly, low-level radioactive waste will be stored in on-site facilities at the TVA nuclear plants. These facilities are sized to handle any anticipated storage needs for the foreseeable life of the plants.

### **Nuclear Insurance**

The indemnification and limitation of liability plan afforded the United States nuclear industry by the Price-Anderson Act was extended for an additional 15 years in 1988, with certain provisions of the Price-Anderson Act now due to expire on August 1, 2002. The 1988 amendments and the 1993 inflation adjustment to the Price-Anderson Act substantially increased the limit of liability from an accident at an NRC-licensed reactor, and this amount is now approximately \$8.7 billion (\$79 million for each of the NRC-licensed reactors in the United States), composed of primary and secondary layers of financial protection. For further information about this nuclear liability insurance and its deferred premium see Note 10 of the accompanying Financial Statements. TVA, in accordance with industry practice, maintains certain liability insurance coverage for workers at the nuclear sites.

NRC regulations require nuclear power plant licensees to obtain, and TVA has acquired, onsite property damage insurance coverage of \$1.06 billion per nuclear site. Some of the nuclear property insurance may require the payment of retrospective premiums of up to approximately \$32.0 million (retrospective premium amount as of November 1997) in the event that losses by another insured party or TVA exceed available funds. In accordance with NRC regulations, the proceeds of nuclear property insurance are used first to ensure that the reactor is in safe and stable condition and that it can be maintained in a condition that prevents significant risk to the public. Next, the proceeds go for decontamination or, if necessary, decommissioning the reactor. Any excess proceeds insure against casualties to property.

### **Decommissioning**

In prior years, the excess of the annual decommissioning provision over earnings from any investments designated for funding decommissioning costs has been charged to depreciation expense. Investments were made in amounts sufficient to fully fund all estimated decommissioning costs. Effective for fiscal 1998, TVA changed its method of accounting for decommissioning costs and related liabilities. TVA's current accounting policy recognizes, as incurred, all obligations related to closure or removal of its nuclear units. The liability for closure is measured at the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk free rate of interest. The corresponding charge to recognize the additional obligation was effected through the creation of a regulatory asset. TVA further modified its method of accounting for decommissioning costs such that earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset, and interest expense on the decommissioning liability are deferred in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation." The book value of TVA's decommissioning fund investments was \$553 million at September 30, 1997. See Notes 1 and 10 of the accompanying Financial Statements.

## **ENVIRONMENTAL MATTERS**

TVA's activities are subject to various federal, state, and local environmental statutes and regulations. Major areas of regulation affecting TVA's activities include air pollution control, water pollution control, and management and disposal of solid and hazardous wastes. Because TVA is a federal agency, it is subject only to

those state and local environmental requirements for which Congress has clearly waived federal agency immunity. Respecting the major environmental areas (air, water and waste), limited waivers have been enacted by Congress. TVA's activities may also be subject to other narrower environmental requirements or to environmental requirements which affect only federal activities.

TVA has incurred and continues to incur substantial capital expenditures and operating expenses to comply with environmental requirements. See Note 10 of the accompanying Financial Statements. Because of the continually changing nature of these requirements, the total amount of these costs is not now determinable. It is anticipated that environmental requirements will become more stringent and that compliance costs will increase, perhaps by substantial amounts.

### **Air Pollution**

Under the Clean Air Act, the United States Environmental Protection Agency (the "EPA") has promulgated national ambient air quality standards for certain air pollutants, including sulfur dioxide, particulate matter and nitrogen oxide. Coal-fired generating units are major sources of these pollutants. TVA also operates other smaller sources. The States of Alabama and Tennessee and the Commonwealth of Kentucky have promulgated implementation plans which regulate sources within their boundaries, including TVA sources, in order to achieve and maintain the national ambient standards. TVA has installed control equipment and employs control strategies to comply with applicable state-established emission limitations. TVA estimates that it spent about \$1.4 billion in capital costs on air pollution control activities prior to the 1990 Clean Air Act Amendments.

The acid rain control provisions of the 1990 Amendments to the Clean Air Act establish a number of new requirements for utilities. These requirements are being implemented by EPA and states in two phases. TVA's Phase I affected units were brought into compliance at a capital cost of approximately \$750 million (exclusive of interest expenses). TVA's current Phase 2 compliance strategy is expected to result in capital costs of approximately \$550 million.

Several EPA developments may affect the air pollution control requirements that are applicable to TVA's fossil plants. States and EPA are considering how the long-range transportation of both nitrogen oxide, which contributes to the formation of ozone, and ozone may contribute to violations of the ozone ambient air quality standard in downwind states. Eight northeastern states have petitioned EPA to order upwind states — including Alabama, Kentucky, and Tennessee — to reduce their nitrogen oxide emissions. Also, EPA has proposed that nitrogen oxide emissions be reduced in 22 eastern states including Alabama, Kentucky, and Tennessee. Most of these reductions would come from utility units. EPA has also made the ozone ambient standard and the particulate matter standard more stringent along with proposed rules to reduce regional haze. These actions may lead to additional reductions of utility nitrogen oxide and sulfur dioxide emissions beyond those required by the acid rain provisions of the 1990 amendments. The costs for such additional reductions are unknown at this time but could exceed \$2.5 billion.

The ozone ambient standard was exceeded in the Memphis, Tennessee area in the summer of 1995, and this triggered the Memphis-Shelby County ozone maintenance-contingency plan. Under this contingency plan, sources of nitrogen oxide within Shelby County can be required to further reduce emissions. TVA has agreed to reduce Allen Fossil Plant's nitrogen oxide emissions to help address this problem. The costs of doing this will not be substantial.

Under DOE's Climate Challenge Program, TVA entered into an agreement with DOE in 1993 to reduce greenhouse gas emissions (e.g., carbon dioxide) by 22.7 million tons by the year 2000. The costs of this voluntary effort have not been substantial. Efforts are being made internationally to obtain binding commitments from countries to reduce their greenhouse gas emissions. Negotiations were completed in December 1997 on a United Nations framework convention on climate change. Under this convention, some industrialized nations, including the United States, will have to reduce their greenhouse gas emissions. If this treaty is approved by the United States, utilities would likely be required to reduce their greenhouse gas emissions, and the cost to TVA could be substantial.

## **Water Pollution**

Under the Clean Water Act, every point source which discharges pollutants into waters of the United States must obtain a National Pollutant Discharge Elimination System (“NPDES”) permit specifying the allowable quantity and characteristics of the pollutants discharged. TVA’s various point sources have received NPDES permits, including all of its major generating units. Compliance with NPDES requirements has necessitated substantial expenditures and may require additional, substantial expenditures in the future as NPDES permits come up for renewal and applicable requirements are made more stringent.

The Clean Water Act allows the permitting authority to establish thermal limits less stringent than the water quality criteria if the discharger can demonstrate that the alternate limit will assure protection and propagation of a balanced, indigenous aquatic population. TVA has now been issued alternate limits at several of its facilities, and it is meeting these limits. EPA has underway a rulemaking that would address the design of water intakes. The rulemaking is not expected to be completed for several years but could require changes to be made at TVA facilities. The cost of such changes is uncertain.

## **Solid and Hazardous Waste Management**

Under the Resource Conservation and Recovery Act (“RCRA”), the storage, transportation, and disposal of hazardous wastes are regulated by EPA and the states. RCRA also allows EPA and the states to regulate solid wastes, and the states have detailed permitting programs for this. TVA has detailed procedures in place designed to ensure compliance with all applicable requirements for the management of hazardous wastes. In addition, TVA has instituted an approved supplier list for hazardous waste disposal contractors under which such contractors’ financial status, compliance history, and physical facilities and operations can be reviewed before they are allowed to treat or dispose of any of the hazardous wastes generated by TVA facilities. TVA does not itself operate any hazardous waste disposal or treatment facilities but does operate two permitted hazardous waste storage facilities in Muscle Shoals, Alabama. TVA has obtained or is in the process of obtaining solid waste disposal permits for the solid waste disposal areas (e.g. fly ash, scrubber sludge, demolition materials and asbestos) it operates at some of its plant sites. TVA’s costs in this area have not been substantial, but applicable requirements are constantly changing and are expected to become more stringent.

Under the Comprehensive Environmental Response, Compensation, and Liability Act (“CERCLA”), the release and cleanup of hazardous substances are regulated. Certain persons who are associated with the release of hazardous substances to the environment can be held responsible for their cleanup, regardless of when the substances were released or when the specific person may have been associated with the substance. This liability under CERCLA is generally viewed as joint and several. TVA, in a manner similar to other industries and power systems, has generated or used hazardous substances over the years. In connection with these activities, TVA has been identified as a potentially responsible party with respect to three non-TVA sites at which TVA hazardous substances were disposed and which have not yet been resolved. In addition, TVA is currently investigating two other sites at which TVA is either an owner or a partial owner and for which TVA may have cleanup responsibilities by virtue of its control of the property. TVA’s potential liabilities for its share of cleanup costs at these sites are uncertain but in total should be less than \$10 million.

## **Miscellaneous**

Polychlorinated biphenyls (“PCBs”) have been widely used as insulating fluids in electric equipment (e.g., transformers and capacitors). Use of such equipment and the cleanup of released PCBs are regulated by EPA under the Toxic Substances Control Act. The TVA power system uses thousands of pieces of equipment which contain some level of PCBs. Most of this equipment can continue to be operated under EPA’s PCB regulations for the remainder of its useful lives, but TVA is phasing out much of this equipment as a matter of policy. The cost of phasing out the remainder of this equipment should not exceed \$40 million (equipment replacement and disposal costs) but cannot be accurately determined at this time. TVA has in place detailed procedures to conform its operations to EPA’s PCB regulations, and it has not incurred substantial costs in this area.

Many of TVA’s facilities were constructed at a time when asbestos was the insulation of choice by industry. Asbestos materials now require special handling and disposal when they are removed. Although not required, TVA is removing or encapsulating asbestos as appropriate.

There is public concern about whether there are adverse health effects from exposure to electric and magnetic fields (“EMF”). There are many sources of EMF, including electric transmission lines. Recent research, including a report from a National Academy of Sciences organization (the “NAS”), has confirmed that there is no conclusive evidence that EMF causes adverse health effects. A report by the National Cancer Institute on the scientific evidence has now confirmed the NAS conclusions. However, research in this area continues. Substantial costs could be incurred by electric systems, including TVA, if EMF levels from transmission lines have to be reduced, but this appears unlikely at this time.

As a federal agency, TVA is required to consider the potential environmental effects of major federal actions affecting the quality of the human environment under the National Environmental Policy Act (the “NEPA”) and implementing regulations and to make these evaluations available to the public. TVA has incorporated the NEPA review process into its decision making process. NEPA-related costs are incurred continuously but not in substantial amounts.

### INSURANCE

TVA does not generally carry property damage or public liability insurance except as may be required or appropriate with respect to nuclear facilities and except to the extent it may do so as part of an owner-controlled insurance program it has implemented for some large contracts requiring on-site labor. Liability for service-connected injuries to employees is governed by the Federal Employees’ Compensation Act. See “Nuclear Power Program” — “Nuclear Insurance” herein and Note 10 of the accompanying Financial Statements for additional information with respect to insurance.

### MANAGEMENT

TVA is administered by a board of directors composed of three persons appointed by the President and confirmed by the Senate. The Board and selected officers, their ages, their years of employment with TVA and principal occupations for recent years are as follows:

<u>Name and Title</u>	<u>Age</u>	<u>Year Commenced Employment</u>	<u>Year Term Expires</u>
Craven Crowell . . . . . Chairman	54	1993	2002
Johnny H. Hayes . . . . . Director	57	1993	2005
William H. Kennoy . . . . . Director	61	1991	1999
Joseph W. Dickey . . . . . Chief Operating Officer & Executive Vice President, Fossil and Hydro Power Group	53	1991	
Oswald J. Zeringue . . . . . Chief Nuclear Officer & Executive Vice President	52	1989	
David N. Smith . . . . . Chief Financial Officer & Executive Vice President, Financial Services	54	1995	
Norman A. Zigrossi . . . . . Chief Administrative Officer & Executive Vice President, Business Services	62	1986	
Edward S. Christenbury . . . . . General Counsel and Secretary	56	1987	

Mr. Crowell was appointed to the Board in July 1993. Prior to his current position, he served as Chief of Staff for Jim Sasser, Tennessee's then senior U.S. Senator (1989-1993), as Vice President of TVA's Office of Governmental & Public Affairs (1988-1989), and as TVA's Director of Information (1980-1988).

Mr. Hayes was initially appointed to the Board in July 1993 to fill the remainder of a Board term which expired in May 1996. Subsequently he received a recess appointment to the Board and was then appointed for a full term (until 2005). Prior to his current position, he served as the State of Tennessee's Commissioner of Economic and Community Development (1992-1993) and as Tennessee's Commissioner of Employment Security (1991-1992).

Mr. Kenney was appointed to the Board in April 1991. Prior to his current position, he served as President of Kenney Engineers for twenty-five years.

Mr. Dickey was named Chief Operating Officer in February 1994 and additionally was named Executive Vice President in October 1996. Prior to his current position, he served as TVA's Senior Vice President, Fossil and Hydro Power (1991-1994), as Vice President of Power Resources (Florida Power & Light Co.) (1988-1991), and as Vice President, Nuclear Energy (Florida Power & Light Co.) (1985-1988).

Mr. Zeringue was named Chief Nuclear Officer & Executive Vice President in 1997. Prior to his current position, he served as Senior Vice President, Nuclear Operations (1993-1997), as Browns Ferry Site Vice President (1989-1993), and as Plant Manager of Palo Verde Nuclear Station, Arizona Public Service Company (1987-1989).

Mr. Smith was named Chief Financial Officer in January 1995 and additionally was named Executive Vice President, Financial Services, in October 1996. Prior to his current position, he served as Executive Director of Odyssey Financial (1993-1994), as Vice President of Finance of LTV Corporation (1991-1993), and as Assistant Treasurer and Director of Corporate Finance of LTV Corporation (1986-1991).

Mr. Zigrossi was named Chief Administrative Officer in February 1994 and additionally was named Executive Vice President, Business Services, in October 1996. Prior to his current position, he served as TVA's President, Resource Group (1992-1994) and as TVA's Inspector General (1986-1992).

Mr. Christenbury assumed the position of General Counsel of TVA in January 1987. Prior to his current position, he served as an Assistant General Counsel at the NRC (1980-1987).

## EMPLOYEES

On December 31, 1997, TVA had about 14,200 employees, of which approximately 5,200 were trades and labor employees. Neither the federal labor laws covering most private sector employers, nor those covering most federal agencies are applicable to TVA; however, the Board has a longstanding policy of recognizing and dealing with recognized representatives of its employees. TVA employees are prohibited by federal law from engaging in strikes against TVA. In 1992, TVA entered into separate long-term agreements with the Tennessee Valley Trades and Labor Council ("Council"), the Salary Policy Employee Panel ("Panel"), and the International Brotherhood of Teamsters ("Teamsters"). One agreement recognized the Panel for collective bargaining purposes for 20 years. The other recognizes the Council and Teamsters for collective bargaining purposes for 15 years. About 77 percent of TVA's employees are in these bargaining units. TVA's labor agreements typically provide for negotiation of most provisions except monetary matters about every three years; wage and salary and benefit negotiations or adjustments generally occur annually. Unresolved disputes over rates of pay for trades and labor employees are resolved by binding decisions of the Secretary of Labor, while pay and monetary benefits disputes for other represented employees are resolved through binding arbitration. TVA's hourly construction, modification and supplemental maintenance work is now performed by contractors primarily under project labor agreements negotiated by TVA and the Council. Permanent craft operating and regular maintenance work continues to be performed by annual TVA employees represented by the Council for operating and maintenance employees, and by the Teamsters for materials handling work.

During mid-1997, negotiations between TVA and the Council (which is comprised of six unions representing annual trades and labor employees, including those working inside the power plants) were

delayed for about three months because of lawsuits filed by some Council unions, but there are now no legal restrictions on continuance of negotiations. The parties reopened negotiation sessions but have since reached an impasse. The collective bargaining agreement with the Council has no specific expiration date; however, it contains provisions for possible expiration of major parts of the agreement upon six months' notice, which notice TVA gave the Council in June 1997. With the expiration of parts of the agreement on December 31, 1997, TVA exercised its right to give a 90-day notice to reopen the remainder of the agreement with the Council, and potentially to cancel the agreement. In October, TVA concluded negotiations with the Teamsters for a new agreement.

The agreements with the Panel (which had been comprised of five unions representing white collar employees) also had no expiration date but provided for possible expiration of major parts of the agreement in 1999, upon 12 months' notice. However, in September 1997, two unions formerly belonging to the Panel, which together represent about 64 percent of the employees represented by Panel-affiliated unions, notified TVA and the Panel that they had disaffiliated from the Panel. After the Panel failed to provide TVA assurances that it could fulfill its contractual obligation to speak for all Panel unions, TVA informed the Panel that because it was in material breach of the TVA-Panel agreement, it was no longer appropriate for TVA to continue bargaining with the Panel. TVA, however, informed each of the five affected unions that it would recognize and separately bargain with each for their existing separate bargaining unit and that it was willing to extend to each of them, on an interim basis, the terms of the former TVA-Panel agreement, to the extent applicable to individual unions. To date, the two unions which notified the Panel of their disaffiliation have agreed to interim agreements, and each of these unions has concluded negotiations for a new separate agreement with TVA. Another former Panel union has accepted TVA's offer of an interim agreement through April 30, 1998, and agreed to negotiate for a new separate agreement, without prejudice to either party's position regarding the current validity of the TVA-Panel agreement. Those negotiations have concluded without agreement, but that union is polling its membership regarding TVA's last offer. A fourth Panel union has yet to accept TVA's offer of an interim agreement. (The bargaining unit for the remaining union has been merged into one of the other former Panel unions with whom TVA has reached agreement.)

Salaries of regular TVA employees are limited by a federal pay cap (Executive Level IV, currently \$118,400). This had led in the past to difficulties in the recruitment and retention of top management talent, and continues to be an issue which TVA must face in its recruitment and retention efforts. The impact of the pay cap has been alleviated somewhat by the increases in TVA's pay cap since January 1990 from \$80,700 to \$118,400. TVA has also addressed this issue by developing and implementing supplementary compensation arrangements, which have substantially reduced the impact of the pay cap. In TVA's opinion, the implementation of these arrangements is within TVA's legal authority. The GAO has expressed the opinion that some of these arrangements are not within TVA's legal authority. However, GAO has no authority to issue binding legal opinions on this matter or to stop any TVA payments. Congress is aware of TVA's supplemental compensation arrangements and has not taken any action that would undermine TVA's position that the arrangements are within its legal authority. Recently, TVA's executive compensation arrangements have come under increasing scrutiny from some members of Congress. It is possible that this scrutiny could result in legislative proposals to limit TVA's authority in this area. TVA has recently contracted with a national compensation management firm to determine whether TVA's executive compensation arrangements are appropriate to attract and retain the caliber of executive talent required to manage TVA's power system.

In October 1995, the President issued an Executive Order requiring Government corporations, including TVA, to submit information to the Office of Management and Budget ("OMB") on bonuses paid to its senior executives. Those bonuses and the information supporting them were last reported to OMB in December 1997 and were also publicly disseminated. OMB approval of TVA's bonuses is not required.

## **CERTAIN PROVISIONS OF THE TENNESSEE VALLEY AUTHORITY ACT**

The following summarizes certain provisions of the Act.

### **Payments in Lieu of Taxes**

TVA is not subject to federal income taxes or to taxation by states or their subdivisions. However, the Act requires TVA to make payments in lieu of taxes to states and counties in which the power operations of the Corporation are conducted. The basic amount is 5 percent of gross revenues from the sale of power to other than federal agencies during the preceding year, with the provision for minimum payments under certain circumstances.

### **Payments to the Treasury**

The Act requires TVA to make certain payments into the Treasury each year from Net Power Proceeds in excess of those required for debt service as a return on and reduction of the Appropriation Investment. Net Power Proceeds are defined as the remainder of TVA's Gross Power Revenues after deducting the cost of operating, maintaining and administering its power properties (including multiple-purpose properties in the proportion that multiple-purpose costs are allocated to power) and payments to states and counties in lieu of taxes, but before deducting depreciation accruals or other charges representing the amortization of capital expenditures, plus the net proceeds of the sale or other disposition of any power facility or interest therein.

### **Acquisition of Real Estate**

The Act empowers TVA to acquire real estate in the name of the United States of America by purchase or by exercise of the right of eminent domain, "and thereupon all such real estate shall be entrusted to the Corporation as the agent of the United States to accomplish the purposes of [the] Act". Since nearly all of TVA's properties, including powerhouses and transmission line rights-of-way, constitute real estate, title to which is held in the name of the United States and entrusted to TVA as agent of the United States, all references in this Statement to "TVA properties" and the like, and to the amounts invested therein, should be read and construed in the light of this provision of the Act.

## **THE BASIC RESOLUTION; POWER BONDS, DISCOUNT NOTES AND OTHER INDEBTEDNESS**

TVA's Power Bonds are issued pursuant to Section 15d of the Act and pursuant to the Basic Resolution. At December 31, 1997, TVA had outstanding U.S. \$23.1 billion and DM 1.5 billion (issued in September 1996) principal amount of Power Bonds. Power Bonds may be issued only to provide capital for TVA's power program (including refunding any Evidences of Indebtedness issued for like purposes) and only as authorized by law at the time of issuance. Power Bonds are payable as to both principal and interest solely from Net Power Proceeds but may, at the option of TVA, be paid from the proceeds of refunding obligations or other funds legally available for such payment. Power Bonds are not obligations of, or guaranteed by, the United States of America. Net Power Proceeds for fiscal 1997, 1996, and 1995 were \$2.9 billion, \$2.9 billion and \$2.6 billion, respectively. Power Bonds of each series must be further authorized by Supplemental Resolution.

TVA intends from time to time to issue New Power Bonds with maturities and on terms determined in light of market conditions at the time of sale. The New Power Bonds may be sold to dealers or underwriters, who may resell the New Power Bonds in public offerings or otherwise. In addition, New Power Bonds may be sold by TVA directly or through other entities.

Except for FISBS described below, the specific aggregate principal amount, maturity, interest rate or method for determining such rate, interest payment dates, if any, purchase price to be paid to TVA, any terms for redemption or other special terms, form and denomination of New Power Bonds, information as to any stock exchange listing, and the names of any dealers, underwriters or agents, together with a description of any amendments or supplements to the Basic Resolution in connection with the sale of New Power Bonds being

offered at a particular time, will be set forth in an offering circular, and any appropriate supplement thereto, together with the terms of such New Power Bonds.

New Power Bonds include TVA's FISBS that may be issued from time to time in installments with maturities of from one year to fifty years. TVA intends to offer FISBS for sale on a continuous basis to members of a group of securities dealers selected by TVA, who will resell such FISBS. The aggregate principal amount of all such Installment Bonds will not exceed \$4 billion at any one time outstanding and the maximum effective rate payable on any such Installment Bonds will not exceed 10 percent.

Information relating to FISBS will be set forth in an Installment Bonds offering circular and any appropriate amendment or supplement thereto. At the time of each sale TVA will determine if the FISBS then being sold will be subject to redemption prior to the maturity date and will establish the purchase price, principal amount, interest rate or interest rate formula, maturity date, and certain other terms of such sale.

TVA's Discount Notes are also issued pursuant to Section 15d of the Act and in accord with Section 2.5 of the Basic Resolution. As of December 31, 1997, TVA had outstanding approximately \$2.6 billion in Discount Notes. The Discount Notes are payable solely from Net Power Proceeds (but may, at the option of TVA, be paid from the proceeds of refunding obligations or other funds legally available for such payment) and are not obligations of, or guaranteed by, the United States of America.

TVA intends to offer Discount Notes for sale on a continuous basis to a group of securities dealers selected by TVA, who will resell such notes. Discount Notes will be issued in such form and upon such terms and conditions as deemed appropriate by TVA. Certain information respecting Discount Notes will be set forth in a Discount Notes offering circular and any appropriate supplement thereto.

TVA from time to time may issue Other Indebtedness, in addition to New Power Bonds and Discount Notes, to assist in financing its Power Program. Other Indebtedness, such as Quarterly Income Debt Securities ("QIDS"), are issued pursuant to Section 15d of the Act and under appropriate authorizing resolutions. At December 31, 1997, TVA had outstanding \$1.1 billion principal amount of QIDS.

Subordinated debt securities, such as QIDS, may be issued from time to time by TVA with maturities and on terms determined in light of market conditions at the time of sale. These subordinated debt securities may be sold to dealers or underwriters, who may resell them in public offerings or otherwise. In addition, the subordinated debt securities may be sold by TVA directly or through other entities. TVA subordinated debt securities will be payable as to both principal and interest solely from Net Power Proceeds (but may, at the option of TVA, be paid from the proceeds of refunding obligations or other funds legally available for such payment) and will not be obligations of, or guaranteed by, the United States of America.

The specific aggregate principal amount, maturity, interest rate or method for determining such rate, interest payment dates, if any, purchase price to be paid to TVA, any terms for redemption or other special terms, form and denomination of Other Indebtedness, information as to any stock exchange listing, and the names of any dealers, underwriters or agents, will be set forth in an offering circular, and any appropriate supplement thereto, together with the terms of such Other Indebtedness.

The following summary of certain provisions of the Basic Resolution does not purport to be complete and is qualified in its entirety by reference to the full text of the Basic Resolution. See also "Recent Legislation".

### **Application of Net Power Proceeds**

Section 2.3 of the Basic Resolution provides as follows:

Net Power Proceeds shall be applied, and the Corporation hereby specifically pledges them for application, first to payments due as interest on Bonds, on Bond Anticipation Obligations, and on any Evidences of Indebtedness issued pursuant to Section 2.5 which rank on a parity with Bonds as to interest; to payments of the principal due on Bonds for the payment of which other provisions have not

been made; and to meeting requirements of sinking funds or other analogous funds under any Supplemental Resolutions. The remaining Net Power Proceeds shall be used only for:

(a) Required interest payments on any Evidences of Indebtedness issued pursuant to Section 2.5 which do not rank on a parity with Bonds as to interest.

(b) Required payments of or on account of principal of any Evidences of Indebtedness other than Bonds.

(c) Minimum payments into the United States Treasury required by the Act in repayment of and as a return on the Appropriation Investment.

(d) Investment in Power Assets, additional reductions of the Corporation's capital obligations, and other lawful purposes related to the Power Program; provided, however, that payments into the United States Treasury in any fiscal year in reduction of the Appropriation Investment in addition to the minimum amounts required for such purpose by the Act may be made only if there is a net reduction during such year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes, and only to such extent that the percentage of aggregate reduction in the Appropriation Investment during such year does not exceed the percentage of net reduction during the year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes.

Section 2.4 of the Basic Resolution provides as follows:

The Corporation, having first adopted a Supplemental Resolution authorizing the issuance of a series of Bonds and pending such issuance, may issue Bond Anticipation Obligations and renewals thereof (including Interim Obligations to the Secretary of the Treasury) to be paid from the proceeds of such series of Bonds when issued or from other funds that may be available for that purpose.

Section 2.5 of the Basic Resolution provides as follows:

To assist in financing its Power Program the Corporation may issue Evidences of Indebtedness other than Bonds and Bond Anticipation Obligations, which may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 hereof, but no such other Evidences of Indebtedness shall rank on a parity with or ahead of the Bonds as to payments on account of the principal thereof or rank ahead of the Bonds as to payments on account of the interest thereon.

See "Amendments to the Basic Resolution to Become Effective in the Future" for a discussion of amendments that will affect the above provisions of Sections 2.3 and 2.5 of the Basic Resolution. See "Recent Legislation" for a discussion of legislation relating to appropriations for TVA's nonpower programs and the funding of such programs, including the use of power revenues.

### **Rate Covenant**

Section 3.2 of the Basic Resolution provides as follows:

The Corporation shall fix, maintain, and collect rates for power sufficient to meet in each fiscal year the requirements of that portion of the present subsection (f) of section 15d of the Act which reads as follows:

The Corporation shall charge rates for power which will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to States and counties in lieu of taxes; debt service on outstanding bonds, including provision and maintenance of reserve funds and other funds established in connection therewith; payments to the Treasury as a return on the appropriation investment pursuant to subsection (e) hereof; payment to the Treasury of the repayment sums specified in subsection (e) hereof; and such additional margin as the Board may consider desirable for investment in power system assets, retirement of outstanding bonds in advance of maturity, additional reduction of appropriation investment, and other purposes connected with the Corporation's power business, having due

regard for the primary objectives of the Act, including the objective that power shall be sold at rates as low as are feasible.

For purposes of this Resolution, “debt service on outstanding bonds,” as used in the above provision of the Act, shall mean for any fiscal year the sum of all amounts required to be (a) paid during such fiscal year as interest on Evidences of Indebtedness, (b) accumulated in such fiscal year in any sinking or other analogous fund provided for in connection with any Evidences of Indebtedness, and (c) paid in such fiscal year on account of the principal of any Evidences of Indebtedness for the payment of which funds will not be available from sinking or other analogous funds, from the proceeds of refunding issues, or from other sources; provided, however, that for purposes of clause (c) of this definition Bond Anticipation Obligations and renewals thereof shall be deemed to mature in the proportions and at the times provided for paying or setting aside funds for the payment of the principal of the authorized Bonds in anticipation of the issuance of which such Bond Anticipation Obligations were issued.

The rates for power fixed by the Corporation shall also be sufficient so that they would cover all requirements of the above-quoted provision of subsection (f) of section 15d of the Act if, in such requirements, there were substituted for “debt service on outstanding bonds” for any fiscal year the amount which if applied annually for 35 years would retire, with interest at the rates applicable thereto, the originally issued amounts of all series of Bonds and other Evidences of Indebtedness, any part of which was outstanding on October 1 of such year.

#### **Covenant for Protection of Bondholders’ Investment**

Under the Act and Section 3.3 of the Basic Resolution, TVA must, in each successive 5-year period beginning October 1, 1960, use either for the reduction of its capital obligations (including Evidences of Indebtedness and the Appropriation Investment) or for investment in Power Assets an amount of Net Power Proceeds at least equal to the sum of (1) depreciation accruals and other charges representing the amortization of capital expenditures and (2) the net proceeds from any disposition of power facilities.

#### **Depreciation**

The Basic Resolution requires TVA to accrue, in accordance with a recognized method, annual amounts for depreciation of its power properties (except land and other nondepreciable property) which will amortize their original cost less anticipated net salvage value within their expected useful lives. TVA has provided allowances for depreciation of its power properties (except land and other nondepreciable property) on a straight-line basis during their expected useful lives.

#### **Issuance of Additional Bonds and Other Evidences of Indebtedness**

The Act presently limits the issuance of Evidences of Indebtedness by TVA to a total of \$30 billion outstanding at any one time to assist in financing TVA’s power program (and for refunding). At December 31, 1997, TVA had approximately U.S.\$26.8 billion and DM 1.5 billion (issued in September 1996) of Evidences of Indebtedness outstanding. The Basic Resolution permits the issuance of Power Bonds only to provide capital for TVA’s power program, including the refunding of any Evidences of Indebtedness issued for that purpose.

Power Bonds, the terms and conditions of which may not be inconsistent with the Basic Resolution, must also be authorized by Supplemental Resolution.

The issuance of Power Bonds is limited as follows by the Basic Resolution:

Each Supplemental Resolution authorizing the issuance of Power Bonds must contain a finding by the Board that after the Power Bonds authorized thereby have been issued, Gross Power Revenues will be adequate to meet the requirements of the Basic Resolution with respect to rates and the application of depreciation accruals. These requirements are described under “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Rate Covenant” and — “Covenant for Protection of Bondholders’ Investment”.

The amount of Power Bonds outstanding may not be increased unless net power income (after interest expense and depreciation charges but before payments as a return on or in reduction of the appropriation investment) for the latest five fiscal years has aggregated at least \$200 million. Moreover, that minimum requirement is increased by \$15 million for each ¼ percent (or major fraction thereof) by which the average for those five years of the October 1 average interest rate payable by the United States Treasury upon its total marketable public obligations exceeds ¾ percent. See Section 3.4 of the Basic Resolution and “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Amendments to the Basic Resolution to Become Effective in the Future”.

Pending the issuance of Power Bonds authorized by a Supplemental Resolution, Bond Anticipation Obligations and renewals thereof (including Interim Obligations to the Secretary of the Treasury) may be issued, to be paid from the proceeds of such Power Bonds when issued or from other funds that may be available for that purpose.

Evidences of Indebtedness (such as Discount Notes) other than Power Bonds and Bond Anticipation Obligations may also be issued to assist in financing TVA’s power program. They may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 of the Basic Resolution. They may not rank on a parity with or ahead of the Power Bonds as to principal or ahead of them as to interest. See “Amendments to the Basic Resolution to Become Effective in the Future”.

### **Mortgaging and Disposal of Power Properties**

TVA may not mortgage any part of its power properties and may not dispose of all or any substantial portion of such properties unless provision is made for a continuance of the interest, principal and sinking fund payments due and to become due on all outstanding Evidences of Indebtedness, or for the retirement of such Evidences of Indebtedness.

### **Modifications of Resolutions and Outstanding Bonds**

The Basic Resolution provides for amendments to it, to any Supplemental Resolution, and to any outstanding Power Bonds. In summary, amendments of the respective rights and obligations of TVA and the bondholders may be made with the written consent of the holders of at least 66⅔ percent in principal amount of the outstanding Power Bonds to which the amendment applies; but changes in the maturity, principal amount, redemption premium, or rate of interest or maturity of any interest installment, with respect to any Power Bond, or in the above percentage for any such consent, cannot be made without the consent of the holder of such Power Bonds.

In addition, TVA may amend the Basic Resolution or any Supplemental Resolution without the consent of the bondholders in order (1) to close the Basic Resolution against the issuance of additional Power Bonds or to restrict such issuance by imposing additional conditions or restrictions; (2) to add other covenants and agreements to be observed by TVA or to eliminate any right, power or privilege conferred upon TVA by the Basic Resolution; (3) to modify any provisions to release TVA from any of its obligations, covenants, agreements, limitations, conditions or restrictions, provided that such modification or release shall not become effective with respect to any Power Bonds issued prior to the adoption of such amendment; (4) to correct any defect, ambiguity or inconsistency in, or to make provisions in regard to matters or questions arising under, the Basic Resolution or any Supplemental Resolution, so long as such amendments are not contrary to, or inconsistent with, the Basic Resolution or such Supplemental Resolution; or (5) to make any other modification or amendment which the Board by resolution determines will not materially and adversely affect the interests of holders of the Power Bonds.

### **Events of Default**

Any of the following shall be deemed an Event of Default under the Basic Resolution: (i) default in the payment of the principal or redemption price of any Power Bond when due and payable at maturity, by call for redemption, or otherwise; (ii) default in the payment of any installment of interest on any Power Bond when due and payable for more than 30 days; or (iii) failure of TVA to duly perform any other covenant, condition

or agreement contained in the Power Bonds or in the Basic Resolution or any Supplemental Resolution for 90 days after written notice specifying such failure has been given to TVA by the holders of at least 5 percent in aggregate principal amount of the then outstanding Power Bonds.

Upon any such Event of Default, the holders of the Power Bonds may proceed to protect and enforce their respective rights, subject to the restrictions described below. The holders of at least 5 percent in aggregate principal amount of Power Bonds then outstanding shall, subject to certain restrictions, have the right and power to institute a proceeding (i) to enforce TVA's covenants and agreements, (ii) to enjoin any acts in violation of the rights of holders of Power Bonds, and (iii) to protect and enforce the rights of holders of Power Bonds. Power Bonds do not provide for acceleration upon an Event of Default.

Such holders have no right to bring any such action or proceeding against TVA unless they have given TVA written notice of an Event of Default, and TVA has had a reasonable opportunity to take appropriate corrective action with respect thereto and has failed or refused to do so.

Holders of a majority in aggregate principal amount of the outstanding Power Bonds have the right to direct the time, method and place of conducting any proceeding for any remedy available and may waive any default and its consequences, except a default in the payment of the principal of, premium, if any, or interest on any Power Bonds.

#### **Amendments to the Basic Resolution to Become Effective in the Future**

On March 25, 1992, TVA adopted a resolution amending the Basic Resolution, entitled "Fourth Amendatory Resolution to Basic Tennessee Valley Authority Power Bond Resolution" (the "Fourth Amendatory Resolution"). The amendments to the Basic Resolution made by the Fourth Amendatory Resolution will become effective only at such time as either (a) all Power Bonds issued prior to the date of adoption of the Fourth Amendatory Resolution cease to be outstanding (which will occur not later than November 15, 2029) or (b) the holders of at least 66 $\frac{2}{3}$  percent of the principal amount of all then outstanding Power Bonds issued prior to the adoption of the Fourth Amendatory Resolution consent in writing to such amendments. At such times as the amendments become effective, they shall apply to all Power Bonds. The holders of Power Bonds offered after March 25, 1992, shall be deemed to have given their consent to the effect that, at any time after the conditions set forth in (a) or (b) above have been met, the amendments to the Basic Resolution made by the Fourth Amendatory Resolution will become effective in the manner provided. No further vote or consent of the holders of Power Bonds offered after March 25, 1992, is required to permit such amendments to the Basic Resolution to become effective.

The Fourth Amendatory Resolution, when effective in accordance with its terms and the terms of the Basic Resolution as described above, will (1) delete from the Basic Resolution the limitation on issuance of Power Bonds set forth in Section 3.4 thereof and (2) amend the Basic Resolution to permit issuance of other Evidences of Indebtedness under Section 2.5 thereof that rank on a parity with Power Bonds as to principal and interest.

Section 3.4 of the Basic Resolution presently restricts TVA's ability to issue Power Bonds unless net power income (after interest expense and depreciation charges but before payments as a return on or in reduction of the Appropriation Investment) for the latest five fiscal years has aggregated at least \$200 million. That amount is increased by \$15 million for each  $\frac{1}{4}$  percent (or major fraction thereof) by which the average for those five years of the October 1 average interest rates payable by the United States Treasury upon its total marketable public obligations exceeds  $\frac{3}{4}$  percent. Upon the effectiveness of the Fourth Amendatory Resolution (which eliminates Section 3.4) Sections 3.5 through 3.10 will be renumbered as appropriate.

The foregoing is a brief summary of certain provisions of the Fourth Amendatory Resolution. This summary is not to be considered a full statement of the terms of the Fourth Amendatory Resolution and, accordingly, is qualified by reference to the Fourth Amendatory Resolution. Copies in reasonable quantity of the Fourth Amendatory Resolution may be obtained upon written request directed to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902, Attention: Vice President and Treasurer, or by calling (423) 632-3366.

## Recent Legislation

In October 1997, Congress enacted the Energy and Water Development Appropriations Act, 1998, Pub. L. No. 105-62, 111 Stat. 1320, 1338 (1997). The paragraph captioned “TENNESSEE VALLEY AUTHORITY” in Title IV of this act (such paragraph being hereinafter referred to as the “Appropriations Act paragraph”) (1) appropriates \$70 million for TVA’s nonpower programs in fiscal year 1998; (2) anticipates no further appropriations to TVA thereafter; and (3) requires TVA, beginning with October 1, 1998, to fund nonpower programs that constitute “essential stewardship activities” with revenues derived from one or more of various sources, including power revenues, notwithstanding provisions of the TVA Act and power bond covenants to the contrary. TVA has not yet made determinations as to funding its nonpower activities after September 30, 1998.

The Appropriations Act paragraph states;

For the purpose of carrying out the provisions of the Tennessee Valley Authority Act of 1933, as amended (16 U.S.C. ch. 12A), including hire, maintenance, and operation of aircraft, and purchase and hire of passenger motor vehicles, \$70,000,000, to remain available until expended, of which \$6,900,000 shall be available for operation, maintenance, surveillance, and improvement of Land Between the Lakes; and for essential stewardship activities for which appropriations were provided to the Tennessee Valley Authority in Public Law 104-206, such sums as are necessary in fiscal year 1999 and thereafter, to be derived only from one or more of the following sources: nonpower fund balances and collections; investment returns of the nonpower program; applied programmatic savings in the power and nonpower programs; savings from the suspension of bonuses and awards; savings from reductions in memberships and contributions; increases in collections resulting from nonpower activities, including user fees; or increases in charges to private and public utilities both investor and cooperatively owned, as well as to direct load customers: *Provided*, That such funds are available to fund the stewardship activities under this paragraph, notwithstanding sections 11, 14, 15, 29, or other provisions of the Tennessee Valley Authority Act, as amended, or provisions of the TVA power bond covenants: *Provided further*, That the savings from, and revenue adjustments to, the TVA budget in fiscal year 1999 and thereafter shall be sufficient to fund the aforementioned stewardship activities such that the net spending authority and resulting outlays for these activities shall not exceed \$0 in fiscal year 1999 and thereafter.

However, the Clinton administration’s proposed budget for fiscal year 1999 includes \$76.8 million for TVA’s nonpower programs. TVA cannot predict whether Congress will approve this amount or otherwise appropriate funds for TVA’s nonpower programs in fiscal year 1999 or thereafter.

In 1997 three other bills were introduced in Congress which, beginning with fiscal years 1998 to 2001, would eliminate the provision in the TVA Act permanently authorizing appropriations for TVA. TVA does not anticipate enactment of any of these three bills.

## Stripping

Certain series of the Corporation’s New Power Bonds (the “Eligible New Power Bonds”) may be separated (“stripped”) into their Interest and Principal Components (as hereinafter defined) and maintained as such on the book-entry records of the Federal Reserve Banks. The components of each Eligible New Power Bond are: each future interest payment due on or prior to the first date on which the Eligible New Power Bond is subject to redemption at the option of the Corporation (each an “Interest Component”); and the principal payment plus any interest payments after the first date on which the Eligible New Power Bond is subject to redemption at the option of the Corporation (the “Principal Component”). Each Interest Component and the Principal Component will receive an identifying designation and CUSIP number. A request for separation of an Eligible New Power Bond into its Interest and Principal Components must be made to the Federal Reserve Bank of New York (“FRBNY”). Currently the FRBNY does not charge a fee for stripping Eligible New Power Bonds. For an Eligible New Power Bond to be stripped into its Interest and Principal Components as described above, the principal amount of the Eligible New Power Bond must be in an amount that, based on the stated interest rate of the Eligible New Power Bonds, will produce a semi-annual interest payment of \$1,000 or multiples thereof. The minimum principal amounts required to strip an Eligible New Power Bond at

various interest rates, as well as the interest payments corresponding to those minimum principal amounts, may be obtained by calling the Corporation's Vice President and Treasurer at (423) 632-3366, and the minimum principal amount required to strip an Eligible New Power Bond will be disclosed in a related offering circular except for Installment Bonds. Interest and Principal Components will be obligations of TVA payable solely from TVA's Net Power Proceeds.

Once a New Power Bond has been stripped into its Interest and Principal Components, the Interest and Principal Components may be maintained and transferred on the book-entry system of the Federal Reserve Banks in integral multiples of \$1,000. Payments on the Interest and Principal Components will be made on the applicable payment dates on the related New Power Bonds by crediting holders' accounts at the FRBNY. At the request of a holder and on the holder's payment of a fee (currently the FRBNY's fee applicable to on-line book-entry securities transfers), the FRBNY will restore ("reconstitute") the unmatured Interest and Principal Components of a stripped New Power Bond to their fully constituted form. Holders wishing to reconstitute the unmatured Interest and Principal Components of a stripped New Power Bond to their fully constituted form must (i) produce all outstanding Interest and Principal Components for a stripped New Power Bond and (ii) comply with all applicable requirements of the FRBNY governing the stripping and reconstitution of securities.

The offering price of the Interest and Principal Components could be at substantial discounts from their face amounts and, as a result, these components may be subject to greater interest rate volatility than the fully constituted New Power Bonds or other obligations bearing current interest. There also may be a less liquid secondary market for such Interest and Principal Components as compared to the secondary market for the fully constituted New Power Bonds.

The Interest and Principal Components of Eligible New Power Bonds could be subject to restrictions or requirements with respect to the legality of investment therein which do not apply to New Power Bonds held in their fully constituted form. Thus, each person or entity is advised to consult with its own counsel with respect to the legality of investment in Interest and Principal Components.



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**TENNESSEE VALLEY AUTHORITY**  
**FINANCIAL STATEMENTS**  
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**TENNESSEE VALLEY AUTHORITY**

**BALANCE SHEETS**

**At September 30, 1997 and 1996**

	Power program		All programs	
	1997	1996	1997	1996
	(in millions)			
<b>ASSETS</b>				
<b>Current Assets</b>				
Cash and cash equivalents .....	\$ 299	\$ 238	\$ 374	\$ 318
Accounts receivable .....	701	680	707	689
Inventories at average cost and other				
Fuel .....	112	110	112	110
Other .....	287	278	287	278
Total current assets .....	1,399	1,306	1,480	1,395
<b>Property, Plant and Equipment</b>				
Completed plant .....	28,528	27,955	29,632	29,069
Less accumulated depreciation .....	(7,178)	(6,553)	(7,469)	(6,854)
Net completed plant .....	21,350	21,402	22,163	22,215
Construction in progress .....	605	744	622	764
Deferred nuclear generating units .....	6,303	6,293	6,303	6,293
Nuclear fuel and capital leases .....	1,040	1,082	1,040	1,082
Total property, plant and equipment .....	29,298	29,521	30,128	30,354
<b>Investment Funds</b> .....	561	440	561	440
<b>Deferred Charges and Other Assets</b>				
Loans and other long-term receivables .....	121	319	170	375
Debt issue and reacquisition costs .....	1,096	1,162	1,096	1,162
Other deferred charges .....	1,209	1,281	1,209	1,281
Total deferred charges and other assets .....	2,426	2,762	2,475	2,818
<b>Total assets</b> .....	<b>\$33,684</b>	<b>\$34,029</b>	<b>\$34,644</b>	<b>\$35,007</b>
<b>LIABILITIES AND PROPRIETARY CAPITAL</b>				
<b>Current Liabilities</b>				
Accounts payable .....	\$ 468	\$ 392	\$ 487	\$ 417
Accrued liabilities .....	161	187	172	196
Accrued interest .....	499	498	499	498
Discount notes .....	2,151	1,774	2,151	1,774
Current maturities of long-term debt .....	574	2,250	574	2,250
Total current liabilities .....	3,853	5,101	3,883	5,135
<b>Other Liabilities</b> .....	1,704	1,580	1,704	1,580
<b>Long-term Debt</b>				
Public bonds — senior .....	20,354	19,403	20,354	19,403
Federal Financing Bank — senior	3,200	3,200	3,200	3,200
Public bonds — subordinated .....	1,100	1,100	1,100	1,100
Unamortized discount and other adjustments .....	(502)	(383)	(502)	(383)
Total long-term debt .....	24,152	23,320	24,152	23,320
<b>Proprietary Capital</b>				
Appropriation investment .....	588	608	4,887	4,800
Retained earnings reinvested in power program .....	3,387	3,420	3,387	3,420
Accumulated net expense of nonpower programs .....	—	—	(3,369)	(3,248)
Total proprietary capital .....	3,975	4,028	4,905	4,972
<b>Total liabilities and proprietary capital</b> .....	<b>\$33,684</b>	<b>\$34,029</b>	<b>\$34,644</b>	<b>\$35,007</b>

The accompanying notes are an integral part of these financial statements.

**TENNESSEE VALLEY AUTHORITY**  
**STATEMENTS OF INCOME — POWER PROGRAM**  
**For the Years Ended September 30, 1997, 1996 and 1995**

	<b>1997</b>	<b>1996</b>	<b>1995</b>
	(in millions)		
<b>Operating Revenues</b>			
Sales of electricity			
Municipalities and cooperatives .....	\$4,811	\$4,980	\$4,654
Industries directly served .....	464	452	460
Federal agencies .....	179	172	179
Other .....	98	89	82
Total operating revenues .....	5,552	5,693	5,375
<b>Operating Expenses</b>			
Fuel and purchased power, net .....	1,211	1,278	1,443
Operating and maintenance .....	1,201	1,218	1,050
Depreciation and amortization .....	1,014	904	703
Tax-equivalents .....	272	256	252
Total operating expenses .....	3,698	3,656	3,448
<b>Operating income</b> .....	1,854	2,037	1,927
<b>Other Income (Expense), Net</b> .....	157	(10)	(91)
Income before interest expense .....	2,011	2,027	1,836
<b>Interest Expense</b>			
Interest on debt .....	1,993	1,965	1,908
Amortization of debt discount, issue, and reacquisition costs, net .....	91	118	116
Allowance for funds used during construction .....	(81)	(117)	(198)
Net interest expense .....	2,003	1,966	1,826
<b>Net Income</b> .....	\$ 8	\$ 61	\$ 10

The accompanying notes are an integral part of these financial statements.

**TENNESSEE VALLEY AUTHORITY**  
**STATEMENTS OF CASH FLOWS**  
**For the Years Ended September 30, 1997, 1996, and 1995**

	Power program			All programs		
	1997	1996	1995	1997	1996	1995
	(in millions)					
<b>Cash Flows From Operating Activities</b>						
Net power income . . . . .	\$ 8	\$ 61	\$ 10	\$ 8	\$ 61	\$ 10
Net expense of nonpower programs	—	—	—	(121)	(127)	(182)
Items not requiring (providing) cash						
Depreciation and amortization . .	1,066	924	715	1,080	938	728
Allowance for funds used during construction . . . . .	(81)	(117)	(198)	(81)	(117)	(198)
Nuclear fuel amortization . . . . .	196	156	112	196	156	112
Other, net . . . . .	(151)	162	72	(151)	164	142
Changes in current assets and liabilities						
Accounts receivable . . . . .	(24)	(1)	(5)	(21)	7	22
Inventories and other . . . . .	(19)	(22)	(8)	(19)	(22)	(8)
Accounts payable and accrued liabilities . . . . .	56	(246)	74	52	(250)	(36)
Accrued interest . . . . .	1	43	31	1	43	31
Other . . . . .	14	(50)	(1)	14	(50)	(2)
Net cash provided by operating activities . . . . .	1,066	910	802	958	803	619
<b>Cash Flows From Investing Activities</b>						
Construction expenditures . . . . .	(722)	(1,107)	(1,868)	(733)	(1,121)	(1,880)
Allowance for funds used during construction . . . . .	81	117	198	81	117	198
Nuclear fuel . . . . .	(159)	(76)	(77)	(159)	(76)	(77)
Proceeds from sale of investments . . . . .	513	(162)	(100)	513	(162)	(100)
Purchases of investments . . . . .	(483)	—	—	(483)	—	—
Proceeds from sale of loans receivable . . . . .	211	—	—	211	—	—
Other, net . . . . .	(21)	(26)	(24)	(13)	(13)	(39)
Net cash used in investing activities . . . . .	(580)	(1,254)	(1,871)	(583)	(1,255)	(1,898)
<b>Cash Flows From Financing Activities</b>						
Long-term debt						
Issues . . . . .	3,100	4,400	3,500	3,100	4,400	3,500
Redemptions . . . . .	(3,829)	(2,706)	(2,503)	(3,829)	(2,706)	(2,503)
Short-term borrowings, net . . . . .	377	(1,057)	222	377	(1,057)	222
Borrowing expenses, net . . . . .	(12)	(44)	(38)	(12)	(44)	(38)
Congressional appropriations . . . .	—	—	—	106	109	139
Payments to U.S. Treasury . . . . .	(61)	(63)	(62)	(61)	(63)	(62)
Net cash (used in) provided by financing activities . . . . .	(425)	530	1,119	(319)	639	1,258
Net change in cash and cash equivalents . . . . .	61	186	50	56	187	(21)
Cash at beginning of period . . . . .	238	52	2	318	131	152
<b>Cash at end of period . . . . .</b>	<b>\$ 299</b>	<b>\$ 238</b>	<b>\$ 52</b>	<b>\$ 374</b>	<b>\$ 318</b>	<b>\$ 131</b>

The accompanying notes are an integral part of these financial statements.

**TENNESSEE VALLEY AUTHORITY**

**STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL — POWER PROGRAM**

	For the years ended September 30,		
	1997	1996	1995
	(in millions)		
Retained earnings reinvested at beginning of period . . . . .	\$3,420	\$3,402	\$3,434
Net income . . . . .	8	61	10
Return on appropriation investment . . . . .	(41)	(43)	(42)
<b>Retained earnings reinvested at end of period . . . . .</b>	<b>3,387</b>	<b>3,420</b>	<b>3,402</b>
Appropriation investment at beginning of period . . . . .	608	628	648
Return of appropriation investment . . . . .	(20)	(20)	(20)
Appropriation investment at end of period . . . . .	588	608	628
<b>Proprietary capital at end of period . . . . .</b>	<b><u>\$3,975</u></b>	<b><u>\$4,028</u></b>	<b><u>\$4,030</u></b>

**STATEMENTS OF NET EXPENSE — NONPOWER PROGRAMS**

	For the years ended September 30,		
	1997	1996	1995
	(in millions)		
Water and Land Stewardship . . . . .	\$ 78	\$ 75	\$ 63
Land Between The Lakes . . . . .	7	7	6
Economic Development . . . . .	22	25	23
Environmental Research Center . . . . .	14	20	21
Columbia Dam . . . . .	—	—	69
<b>Net expense . . . . .</b>	<b><u>\$121</u></b>	<b><u>\$127</u></b>	<b><u>\$182</u></b>

**STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL — NONPOWER PROGRAMS**

	For the years ended September 30,		
	1997	1996	1995
	(in millions)		
Proprietary capital at beginning of period . . . . .	\$944	\$ 964	\$1,007
Congressional appropriations . . . . .	106	109	139
Net expense . . . . .	(121)	(127)	(182)
Other, net . . . . .	1	(2)	—
<b>Proprietary capital at end of period . . . . .</b>	<b><u>\$930</u></b>	<b><u>\$ 944</u></b>	<b><u>\$ 964</u></b>

The accompanying notes are an integral part of these financial statements.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**General**

TVA is a wholly-owned corporate agency and instrumentality of the United States. It was established by the TVA Act with the objective of developing the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense by providing: (1) an ample supply of power within the region, (2) navigable channels and flood control for the Tennessee River System, and (3) agricultural and industrial development and improved forestry in the region. TVA carries out these regional and national responsibilities in a service area that centers on Tennessee and parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina and Virginia.

TVA's programs are divided into two types of activities — the power program and the non-power programs. Substantially all TVA revenues and assets are attributable to the power program. The power program is separate and distinct from the non-power programs and is required to be self-supporting from power revenues and funds borrowed from public markets. The power program receives no congressional appropriations and is required to make annual payments to the U.S. Treasury in repayment of, and as a return on, the government's appropriation investment in TVA power facilities. Most of the funding for TVA's non-power programs has been provided by congressional appropriations. Certain nonpower activities are also funded by various revenues and user fees. Financial accounts for the power and non-power programs are kept separately.

Power rates are established by the TVA Board of Directors as authorized by the TVA Act. The TVA Act requires TVA to charge rates for power that, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance and administration of its power system; payments to states in lieu of taxes; and debt service on outstanding indebtedness.

**Fiscal year**

Unless otherwise indicated, years (1997, 1996, etc.) refer to TVA's fiscal years ended September 30.

**Revenue recognition**

Revenues from power sales are recorded as service is rendered to customers. TVA accrues estimated unbilled revenues for power sales provided to customers for the period of time from the end of the billing cycle to month-end.

**Property, plant, and equipment, and depreciation**

Additions to plant are recorded at cost, which includes direct and indirect costs such as general engineering, a portion of corporate overhead and an allowance for funds used during construction. The cost of current repairs and minor replacements is charged to operating expense. The TVA Act requires TVA's Board of Directors to allocate the cost of completed multi-purpose projects between the power and nonpower programs, subject to the approval of the President of the United States. The original cost of property retired, together with removal costs less salvage value, is charged to accumulated depreciation. Depreciation is generally computed on a straight-line basis over the estimated service lives of the various classes of assets. Depreciation expense expressed as a percentage of the average annual depreciable completed plant was 3.21 percent for 1997 and 1996 and 3.35 percent for 1995.

**Decommissioning costs**

During 1997 the excess of decommissioning investment earnings over the annual decommissioning provision was recorded as other income. Of the total investment earnings of \$151 million, \$13 million was recorded as an offset to the decommissioning provision, with the \$138 million excess recorded as other income. During

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

1996 the annual decommissioning provision of \$30 million exceeded the earnings from decommissioning fund investments of \$17 million and the \$13 million excess was charged to depreciation expense. During 1995, investment earnings approximated decommissioning expense and no decommissioning charges were made to depreciation expense.

**Allowance for funds used during construction**

The practice of capitalizing an allowance for funds used during construction is followed in the power program. The allowance is applicable to construction in progress excluding deferred nuclear generating units. In 1995, TVA changed its assumptions used in determining the interest rate used to calculate the allowance for funds used during construction. The change was made to more accurately reflect the nature of the indebtedness issued to fund construction. The effect of the change for 1995 was to increase the amount of interest capitalized by approximately \$56 million.

**Loans and other long-term receivables**

In June 1997, TVA entered into a five-year agreement with a bank pursuant to which TVA agreed to sell certain receivables relating to TVA's consumer energy-conservation programs. As of September 30, 1997, a \$211-million pool had been sold for proceeds equal to its carrying amount. In accordance with Statement of Financial Accounting Standards (SFAS) No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, the transaction has been reflected as a reduction of loans and other long-term receivables. Under the terms of the agreement, TVA has retained substantially the same risk of credit loss as if the receivables had not been sold and, accordingly, an appropriate liability account has been retained.

**Other deferred charges**

Deferred charges primarily include prepaid pension costs and regulatory assets capitalized under the provisions of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. At September 30, 1997, other deferred charges included total unamortized regulatory assets of \$950 million — of which \$468 million represents a capitalized interest component of nuclear fuel; \$411 million represents a transition obligation related to the adoption of SFAS No. 112, *Employers Accounting for Postemployment Benefits*; and \$71 million represents TVA's portion of the costs for decommissioning the Department of Energy's nuclear waste disposal facility. At September 30, 1996, the unamortized balances of these three regulatory assets were \$595 million, \$446 million and \$81 million, respectively, for a total of \$1,122 million. These regulatory assets are being amortized over periods ranging from eight to 15 years, generally on a straight-line basis.

**Investment funds**

Investment funds consist primarily of a portfolio of investments in trusts designated for funding nuclear decommissioning requirements (see note 10). These funds, at September 30, 1997, were invested in portfolios generally designed to earn returns in line with overall equity market performance.

**Debt issue and reacquisition costs**

Issue and reacquisition expenses, call premiums and other related costs are deferred and amortized (accrued), respectively, on a straight-line basis over the term of the related outstanding securities.

TVA has also incurred premiums related to certain advanced refundings. In accordance with regulatory practices, TVA has deferred these premiums and is amortizing them to expense ratably through the maturity dates of the new debt issues. The unamortized balances of such regulatory assets at September 30, 1997 and 1996, were \$983 million and \$1,042 million, respectively.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**Tax-equivalents**

The TVA Act requires TVA to make payments to states and local governments in which the power operations of the corporation are conducted. The basic amount is 5 percent of gross revenues from the sale of power to other than federal agencies during the preceding year, with the provision for minimum payments under certain circumstances. Cash paid for tax-equivalents for 1997, 1996 and 1995 have been \$272 million, \$256 million and \$252 million, respectively.

**Interest and capital costs**

During 1997, 1996 and 1995, cash paid for interest on outstanding indebtedness (net of amount capitalized) was \$1,911 million, \$1,805 million and \$1,678 million, respectively. In addition to paying interest on outstanding indebtedness, the TVA Act requires TVA to make annual payments to the U.S. Treasury. The annual Treasury payments represent a repayment of the original appropriation investment, along with a return on the appropriation investment. TVA paid \$20 million each year for 1997, 1996 and 1995 as a repayment of the appropriation investment. TVA paid \$41 million to the U.S. Treasury in 1997 as a return on the appropriation investment, while paying \$43 million in 1996 and \$42 million in 1995.

**Risk-management activities**

TVA is exposed to market risk from changes in interest rates and currency exchange rates. To manage volatility relating to these exposures, TVA has entered into various derivative transactions, principally interest rate swap agreements and foreign currency swap contracts. TVA is exposed to credit losses in the event of nonperformance by counterparties on the risk-management instruments. TVA monitors such risk and does not believe that there is a significant risk of nonperformance by any of the parties of these instruments.

**Statements of cash flows**

Cash and cash equivalents include the cash available in commercial bank accounts and U.S. Treasury accounts, as well as short-term securities held for the primary purpose of general liquidity. Such securities mature within three months from the date of acquisition.

**Research and development costs**

Expenditures related to research and development costs of new or existing products and processes are expensed as incurred. The amounts charged against income were \$44 million in 1997, \$45 million in 1996 and \$43 million in 1995.

**Insurance**

TVA is primarily self-insured for property loss, workers' compensation, general liability and automotive liability. TVA is also self-insured for health care claims for eligible active and retired employees. Consulting actuaries assist TVA in determining its liability for self-insured claims. TVA maintains nuclear liability insurance with an outside party (see note 10).

**Management estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**2. NUCLEAR POWER PROGRAM**

The nuclear power program at September 30, 1997, consisted of nine units — five operating, three deferred, and one inoperative — at four locations, with investments in property, plant and equipment as follows and in the status indicated:

	<u>Operating units</u>	<u>Installed capacity (megawatts)</u>	<u>Completed plant, net</u>	<u>Construction in progress</u>	<u>Deferred</u>	<u>Fuel investment</u>
			(in millions)			
Browns Ferry .....	2	2,304	\$ 3,508	\$ 44	\$ —	\$289
Sequoyah .....	2	2,442	2,055	77	—	146
Watts Bar .....	1	1,270	6,674	34	1,716	108
Bellefonte .....	—	—	—	—	4,587	—
Raw materials .....	—	—	—	—	—	297
Total .....	<u>5</u>	<u>6,016</u>	<u>\$12,237</u>	<u>\$155</u>	<u>\$6,303</u>	<u>\$840</u>

Browns Ferry 3, taken off-line in March 1985 for plant modifications and regulatory improvements, was returned to service in 1996. Browns Ferry 1, also taken off-line in 1985 for modifications and improvements, will continue to remain in an inoperative status until its ultimate disposition is determined. For financial reporting purposes, the undepreciated cost of Browns Ferry 1 of \$80 million is included in net completed plant and is being depreciated as part of the recoverable cost of the plant over the remaining license period.

Watts Bar 1 began operating commercially during 1996. In 1988, TVA suspended construction activities on Watts Bar 2 and the unit is currently in lay-up. Bellefonte 1 and 2 were deferred in 1988 and 1985, respectively. Estimated 1998 expenditures for the three deferred units total \$9 million and are limited to lay-up, maintenance and ensuring that options remain viable.

In 1993, TVA began an integrated resource planning process to determine TVA's strategy for meeting future customer energy demands. As part of this long-term energy strategy, TVA re-evaluated the need for finishing Bellefonte 1 and 2 and Watts Bar 2 as nuclear units. In December 1994, TVA determined it will not, by itself, complete Bellefonte 1 and 2 and Watts Bar 2 as nuclear units. In the Integrated Resource Plan (IRP), TVA determined that it would study the potential for converting the Bellefonte Nuclear Plant to a combined cycle plant utilizing natural gas or gasified coal as the primary fuel and/or joint venturing with a partner for completion. The feasibility of converting Bellefonte to such an alternative fuel will require in-depth engineering and financial analyses; and accordingly, TVA is utilizing a team of technical and financial experts. The IRP also concluded that Watts Bar 2 should remain in deferred status until completion of the Bellefonte study. The impact on TVA's financial position of completing, converting or joint venturing these units will be determined upon completion of the Bellefonte study. The future decisions on these units will ultimately impact the method of cost recovery, and the TVA Board has determined that it will, at that time, establish rate adjustments and operating policies to ensure full recovery of the cost of these units and compliance with the requirements of the TVA Act. For financial reporting purposes, the cost of the three units is presented as deferred nuclear generating units.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**3. COMPLETED PLANT**

Completed plant consists of the following at September 30:

<u>Power program</u>	<u>1997</u>			<u>1996</u>		
	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net</u>	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net</u>
	(in millions)					
Fossil plants . . . . .	\$ 7,427	\$2,954	\$ 4,473	\$ 7,320	\$2,790	\$ 4,530
Nuclear plants . . . . .	14,514	2,277	12,237	14,370	1,835	12,535
Transmission . . . . .	3,144	982	2,162	2,911	943	1,968
Hydro plants . . . . .	1,382	471	911	1,273	454	819
Other . . . . .	2,061	494	1,567	2,081	531	1,550
Total power . . . . .	<u>\$28,528</u>	<u>\$7,178</u>	<u>\$21,350</u>	<u>\$27,955</u>	<u>\$6,553</u>	<u>\$21,402</u>

**4. LEASES**

Certain property, plant and equipment are leased under agreements with terms ranging from one to 30 years. Most of the agreements include purchase options or renewal options that cover substantially all the economic lives of the properties. Obligations under capital lease agreements in effect as September 30 were:

<u>Fiscal year</u>	<u>General plant capital leases</u> (in millions)
1998 . . . . .	\$ 36
1999 . . . . .	36
2000 . . . . .	36
2001 . . . . .	36
2002 . . . . .	36
Thereafter . . . . .	<u>301</u>
Total future minimum lease payments . . . . .	481
Less interest element . . . . .	<u>(280)</u>
Present value of future minimum lease payments . . . . .	<u>\$ 201</u>

**5. APPROPRIATION INVESTMENT — POWER PROGRAM**

The TVA Act requires TVA to make annual payments to the U.S. Treasury from net power proceeds. The payments required by the TVA Act may be deferred under certain circumstance for not more than two years. The return is based on the appropriation investment as of the beginning of the year and the computed average interest rate payable by the U.S. Treasury on its total marketable public obligations as of the same date (6.71 percent at September 30, 1997).

**6. DEBT**

**Borrowing authority**

The TVA Act authorizes TVA to issue bonds, notes and other evidences of indebtedness up to a total of \$30 billion outstanding at any one time. TVA must meet certain cash flow and earnings tests that are contained in the TVA Act and the Basic TVA Power Bond Resolution. Debt service on these obligations, which is payable solely from TVA's net power proceeds, has precedence over the payment to the U.S. Treasury described in note 5.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**Debt outstanding**

Debt outstanding at September 30, 1997 and 1996 (excluding defeased debt of \$950 million at September 30, 1996, which is not considered by TVA to be debt that is subject to the \$30 billion bond limit), consisted of the following:

	<b>1997</b>	<b>1996</b>
	(in millions)	
<b>Short-term debt</b>		
Held by the public .....		
Discount notes (net of discount) .....	\$ 2,151	\$ 1,774
Current maturities of long-term debt — 5.07% to 5.98% .....	574	2,250
Total short-term debt .....	2,725	4,024
 <b>Long-term debt</b>		
Held by the public — senior		
Maturing in 1998 .....	—	1,453
Maturing in 1999 — 5.88% to 6.58% .....	2,450	750
Maturing in 2000 — 8.375% .....	1,000	1,000
Maturing in 2001 — 6.00% to 6.50% .....	1,800	1,250
Maturing in years 2002 through 2045 — 6.125% to 8.625% .....	15,104	14,950
Held by Federal Financing Bank — senior		
Maturing in 2003 through 2016 — 8.535% to 11.695% .....	3,200	3,200
Held by the public — subordinated		
Maturing in 2045 through 2046 — 7.50% to 8.00% .....	1,100	1,100
Total long-term debt .....	24,654	23,703
Unamortized discount and other adjustments .....	(502)	(383)
Net long-term debt .....	24,152	23,320
<b>Total debt</b> .....	<b>\$26,877</b>	<b>\$27,344</b>

**Short-term debt**

The weighted average rates applicable to short-term debt outstanding in the public market as of September 30, 1997 and 1996, were 5.56 percent and 5.38 percent, respectively. During 1997, 1996 and 1995, the maximum outstanding balance of short-term borrowings held by the public was (in millions) \$3,962, \$3,537 and \$3,503 respectively, and the average amounts (and weighted average interest rates) of such borrowings were approximately (in millions), \$2,743 (5.47 percent), \$2,692 (5.50 percent) and \$2,743 (5.83 percent), respectively.

**Put and call options**

Bond issues of \$12.8 billion held by the public are redeemable in whole or in part, at TVA's option, on call dates ranging from the present to April 2012 at call prices ranging from 100 percent to 106.7 percent of the principal amount. Additionally, TVA has bond issues of \$2.1 billion held by the public that are redeemable in whole or in part at the option of the respective bondholders. One bond issue totaling \$500 million, which matures in July 2045, is redeemable in 2001 by the bondholders. A second issue totaling \$121.3 million, which matures in April 2036, is redeemable in 1998 or 2006 at the option of the bondholders and a third issue totaling \$1.5 billion, which matures in April 2036, is redeemable in 1999 or 2006 at the option of the bondholders. All of these issues are reported in the debt schedule with maturity dates corresponding to the earliest redeemable dates.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

Subsequent to September 30, 1997, TVA monetized the call provisions on approximately \$1 billion of public bond issues. The premium received by TVA has been deferred and is being amortized over the term of the agreements.

**Bond discount and premium**

Discounts and premiums on power borrowings are deferred and amortized (accrued), respectively, as components of interest expense on a straight-line basis over the term of the related outstanding securities.

**Foreign currency transaction and interest rate swap**

During 1996, TVA entered into a currency swap contract as a hedge for a foreign currency denominated debt transaction where TVA issued 1.5 billion Deutschemark bonds, the cash flows of which were swapped for those of a U.S. dollar obligation of \$1 billion. Any gain (loss) on the debt instrument due to the foreign currency transaction is offset by a loss (gain) on the swap contract. At September 30, 1997 and 1996 the currency transaction resulted in gains of \$131 million and \$16 million, respectively, which are included in the account "unamortized discount and other adjustments." The offsetting loss on the swap contract is recorded as a deferred liability. If any loss/gain were to be incurred as a result of the early termination of the swap contract, any resulting charge (income) would be amortized over the remaining life of the bond as a component of interest expense.

Additionally, TVA entered into a 10-year fixed rate interest swap agreement with a notional amount of \$300 million. Such agreement was entered into to hedge TVA's inflation exposure related to its inflation-indexed accruing principal bonds.

**7. FAIR VALUE OF FINANCIAL INSTRUMENTS**

TVA uses the methods and assumptions described below to estimate the fair values of each significant class of financial instrument.

**Cash and cash equivalents, and short-term debt**

The carrying amount approximates fair value because of the short-term maturity of these instruments.

**Investment funds**

At September 30, 1997, these investments were classified as trading securities and carried at their fair value.

**Loans and other long-term receivables**

Fair values for these homogenous categories of loans and receivables are estimated by determining the present value of future cash flows using the current rates at which similar loans are presently made to borrowers with similar credit ratings and for the same remaining maturities.

**Bonds**

Fair value of long-term debt traded in the public market is determined by multiplying the par value of the bonds by the quoted market price (asked price) nearest the balance sheet date. The fair value of other long-term debt and long-term debt held by the Federal Financing Bank is estimated by determining the present value of future cash flows using rates of financial instruments with quoted market prices of similar characteristics and the same remaining maturities.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

The estimated values of TVA's financial instruments at September 30 are as follows:

	1997		1996	
	Carrying amount	Fair amount	Carrying amount	Fair amount
	(in millions)			
Cash and cash equivalents .....	\$ 374	\$ 374	\$ 318	\$ 318
Investment funds .....	561	561	440	440
Loans and other long-term receivables .....	170	160	375	365
Short-term debt .....	2,151	2,151	1,774	1,774
Long-term debt, including current maturities .....	25,228	26,127	25,953	26,562

The fair market value of the financial instruments held at September 30, 1997 may not be representative of the actual gains or losses that will be recorded when these instruments mature or if they are called or presented for early redemption.

**8. BENEFIT PLANS**

**Pension plan**

TVA has a defined benefit plan for most full-time employees that provides two benefit structures, the Original Benefit Structure and the Cash Balance Benefit Structure. The plan assets are primarily stocks and bonds. TVA contributes to the plan such amounts as are agreed upon between TVA and the TVA Retirement System board of directors, which in no event would be less than the amount necessary on an actuarial basis to provide assets sufficient to meet obligations for benefits. The pension benefit for participants in the Original Benefit Structure is based on the member's years of creditable service, average base pay for the highest three consecutive years and the pension rate for the member's age and years of service, less a Social Security offset.

The Cash Balance Benefit Structure was implemented January 1, 1996. The pension benefit for participants in the Cash Balance Benefit Structure is based on credits accumulated in the member's account and member's age. A member's account receives credits each pay period equal to 6 percent of his or her straight-time earnings. The account also increases at an interest rate equal to the change in the Consumer Price Index plus

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

3 percent, which amounted to 5.82 percent for both 1997 and 1996. The components of pension expense for the years ended September 30 were:

	<b>1997</b>	<b>1996</b>	<b>1995</b>
	(in millions)		
<b>Pension expense:</b>			
Service cost . . . . .	\$ 70	\$ 72	\$ 62
Interest cost on projected benefit obligation . . . . .	308	309	304
Actual return on assets . . . . .	(1,334)	(616)	(816)
Net amortization and deferral . . . . .	899	217	450
<b>Net pension (income) expense . . . . .</b>	<b>\$ (57)</b>	<b>\$ (18)</b>	<b>\$ —</b>
<b>Funded status:</b>			
Actuarial present value of benefit obligations:			
Vested benefit obligation . . . . .	\$(3,770)	\$(3,506)	\$(3,256)
Nonvested benefits . . . . .	(48)	(50)	(113)
Accumulated benefit obligation . . . . .	(3,818)	(3,556)	(3,369)
Effects of projected future compensation . . . . .	(391)	(401)	(323)
Projected benefit obligation . . . . .	(4,209)	(3,957)	(3,692)
Plan assets at fair value . . . . .	5,962	4,851	4,375
Excess of plan assets over projected benefit obligation . . . . .	1,753	894	683
Unrecognized net gain . . . . .	(1,536)	(770)	(627)
Unrecognized net obligation being amortized over 15 years beginning October 1, 1987 . . . . .	—	2	2
<b>Prepaid pension cost . . . . .</b>	<b>\$ 217</b>	<b>\$ 126</b>	<b>\$ 58</b>

The discount rate used to determine the actuarial present value of the projected benefit obligation was 8.0 percent in 1997 and 1996 and 7.5 percent in 1995. The assumed annual rates of increase in future compensation levels for 1997, 1996, and 1995 ranged from 3.3 to 8.3 percent. The expected long-term rate of return on plan assets was 11 percent for 1997, 1996 and 1995.

**Other postretirement benefits**

TVA sponsors an unfunded defined benefit postretirement plan that provides for contributions toward the cost of retirees' medical coverage. The plan covers employees who, at retirement, are age 60 and older (or who are age 50 and have at least five years of service). TVA's contributions are a flat dollar amount based upon the participants' age and years of service and certain payments toward the plan costs.

The annual assumed cost trend for covered benefits is 10.5 percent in 1997, decreasing by one-half percent per year reaching 5.0 percent in 2008 and thereafter. For 1996 and 1995, an annual trend rate of 11.0 percent and 11.5 percent, respectively, was assumed. The effect of the change in assumptions on a cost basis was not significant. Increasing the assumed health-care cost trend rates by 1 percent would increase the accumulated postretirement benefit obligation (APBO) as of September 30, 1997, by \$15 million and the aggregated service and interest cost components of net periodic postretirement benefit cost for 1997 by \$3 million.

The weighted average discount rate used in determining the APBO was 8.0 percent for 1997 and 1996, and 7.5 percent for 1995. Any net unrecognized gain or loss resulting from experience different from that assumed or

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

from changes in assumptions, in excess of 10 percent of the APBO, is amortized over the average remaining service period of active plan participants. The following sets forth the plan's funded status at September 30:

	<u>1997</u>	<u>1996</u>	<u>1995</u>
	(in millions)		
<b>Accumulated postretirement benefit obligation (APBO)</b>			
Retirees . . . . .	\$220	\$230	\$214
Fully eligible active plan participants . . . . .	2	4	1
Other active plan participants . . . . .	126	187	116
<b>APBO</b> . . . . .	348	421	331
Unrecognized net (loss) gain . . . . .	—	(95)	(15)
<b>Accrued postretirement benefit cost</b> . . . . .	<u>\$348</u>	<u>\$326</u>	<u>\$316</u>
<b>Net periodic postretirement benefit cost</b>			
Service cost . . . . .	\$ 13	\$ 8	\$ 7
Interest cost . . . . .	32	24	26
Amortization of loss . . . . .	4	—	—
<b>Net periodic postretirement benefit cost</b> . . . . .	<u>\$ 49</u>	<u>\$ 32</u>	<u>\$ 33</u>

**Other postemployment benefits**

Statement of Financial Accounting Standards No. 112, *Employers Accounting for Postemployment Benefits* (SFAS No. 112), applies to postemployment benefits, including workers' compensation provided to former or inactive employees, their beneficiaries and covered dependents after employment but before retirement. Adoption of SFAS No. 112 in 1995 changed TVA's method of accounting from recognizing costs as benefits are paid to accruing the expected costs of providing these benefits. This resulted in recognition of an original transition obligation of approximately \$280 million. During 1996, TVA made adjustments to certain assumptions utilized in the determination of the obligation at September 30, 1996, which resulted in an increase in the original transition obligation of approximately \$194 million. In connection with the adoption of SFAS No. 112, and related approval by its Board of Directors, TVA recorded the transition obligation as a regulatory asset. The regulatory asset is being amortized over approximately 15 years, whereby the annual expense will approximate the expense that would be recorded on an as-paid basis.

**Early-out and accelerated severance packages**

In 1997, 1996 and 1995 TVA provided both voluntary and involuntary severance packages, which affected an aggregate of approximately 4,900 employees. During this period, severance costs totaled approximately \$196 million and consisted primarily of severance pay (\$150 million) and other retirement and postretirement benefits (\$46 million). Also during 1997 TVA recognized a related pension curtailment gain of \$27 million. The aggregate costs of the severance packages have been charged to the power program primarily as other expense during 1997, 1996 and 1995 in the amounts of \$11 million, \$35 million and \$136 million, respectively, and the non-power program as non-power expense during 1997 and 1996 in the amounts of \$8 million and \$6 million, respectively.

**9. MAJOR CUSTOMERS**

One municipal customer accounts for approximately 9 percent of total power sales and four other municipal customers account for an additional aggregate 19 percent of total power sales. These five municipal customers purchase power from TVA under long-term contracts for terms of 20 years, which require 10-years notice to terminate.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**10. CONSTRUCTION EXPENDITURES AND COMMITMENTS AND CONTINGENCIES**

**Construction expenditures**

Construction expenditures, including capitalized interest, are estimated to be approximately \$732 million for 1998 and \$659 million for 1999. These estimates are revised periodically to reflect changes in economic conditions and other factors considered in their determination.

**Purchase commitments**

TVA has entered into approximately \$2.3 billion in long-term commitments ranging in terms of up to eight years for the purchase of coal.

**Contingencies**

***Nuclear insurance.*** The Price-Anderson Act sets forth an indemnification and limitation of liability plan for the U.S. nuclear industry. All Nuclear Regulatory Commission (NRC) licensees, including TVA, maintain nuclear liability insurance in the amount of \$200 million for each plant with an operating license. The second level of financial protection required is the industry's retrospective assessment plan, using deferred premium charges. The maximum amount of the deferred premium for each nuclear incident is approximately \$79 million per reactor, but not more than \$10 million per reactor may be charged in any one year for each incident. TVA could be required to pay a maximum of \$474 million per nuclear incident on the basis of its six licensed units, but it would have to pay no more than \$60 million per incident in any one year.

In accordance with NRC regulations, TVA carries property and decontamination insurance of \$1.06 billion at each licensed nuclear plant for the cost of stabilizing or shutting down a reactor after an accident. Some of this insurance may require the payment of retrospective premiums of up to a maximum of approximately \$34 million.

***Clean Air legislation.*** The Clean Air Act Amendments of 1990 require fossil-fuel fired generation units to reduce their sulfur dioxide and nitrogen oxide emissions in two phases in order to control acid rain. The Phase I compliance period commenced on January 1, 1995, for sulfur dioxide and January 1, 1996, for nitrogen oxide, while the Phase II compliance period commences on January 1, 2000. Based on the level of emissions, 26 of TVA's 59 operating coal-fired units are classified as Phase I units, with the remaining units being Phase II units. Compliance with these requirements has resulted in substantial expenditures for the reduction of emissions at TVA's coal-fired generating plants.

TVA's compliance strategy to reduce sulfur dioxide emissions includes the use of scrubbers at six fossil units and the use of lower-sulfur coal at the remaining 53 fossil units. TVA has completed all planned scrubbers and is on schedule to complete the change-over to lower-sulfur coal.

Nitrogen oxide reductions are required for 19 of TVA's Phase I units. These reductions were achieved through the installation of low-nitrogen-oxide burners at 13 units. TVA is in compliance with all Phase I requirements and is currently installing nitrogen oxide reduction equipment to bring TVA's remaining units in compliance with Phase II nitrogen oxide emission requirements.

Expenditures related to the Clean Air projects during 1997 and 1996 were approximately \$40 million and \$80 million, respectively. TVA has already completed the actions necessary to achieve Phase I compliance for both sulfur dioxide and nitrogen oxide emissions, and TVA is proceeding to take actions to comply with Phase II requirements that become effective in the year 2000 or after. The total cost of compliance cannot reasonably be determined at this time because of the uncertainties surrounding final Environmental Protection Agency regulations, resultant compliance strategy, potential for development of new emission control technologies and future amendments to the legislation.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**Hazardous substances.** The release and cleanup of hazardous substances are regulated under the Comprehensive Environmental Response, Compensation, and Liability Act. In a manner similar to other industries and power systems, TVA has generated or used hazardous substances over the years. TVA has been identified as a potentially responsible party with respect to three off-site disposal areas. TVA's liability at these sites has not yet been determined. In addition, TVA is currently investigating two other sites that TVA either owns or partially owns. TVA may have cleanup responsibilities at those sites by virtue of its control of the property. TVA's potential liabilities for its share of cleanup costs at these sites are uncertain but are not expected to be substantial.

**Pending litigation.** TVA is a party to various civil lawsuits and claims that have arisen in the ordinary course of its business. Although the outcome of pending litigation cannot be predicted with any certainty, it is the opinion of TVA counsel that the ultimate outcome should not have a material adverse effect on TVA's financial position or results of operations.

**Decommissioning costs.** Provision for decommissioning costs of nuclear generating units is based on the estimated cost to dismantle and decontaminate the facilities to meet NRC criteria for license termination. At September 30, 1997, the present value of the estimated future decommissioning cost of \$318 million was included in other liabilities. The decommissioning cost estimates from a 1995 study are based on prompt dismantlement and removal of the plant from service. The actual decommissioning costs may vary from the estimates because of changes in the assumed dates of decommissioning, changes in regulatory requirements, changes in technology and changes in costs of labor, materials and equipment.

TVA maintains an investment trust fund to provide funding for the decommissioning of nuclear power plants. In September 1993, TVA sold the investment portfolio and realized a gain of \$163 million. TVA sold the investment portfolio and realized a gain of \$163 million. TVA recognized \$82 million of this gain in 1994 and \$81 million in 1995. During 1996, TVA took a number of related actions to establish a decommissioning fund that could reasonably be expected to provide substantially all of the funding required for decommissioning. TVA contributed an additional \$123 million, and separate decommissioning trusts were established for each of TVA's nuclear plants. As of September 30, 1996, the entire fund was invested in equity market index funds.

In May 1997, TVA sold the entire \$402 million equity index fund portfolio and transferred the proceeds to trust portfolios managed by independent money managers. During 1997, TVA recognized \$151 million of income related to the fund, which included an \$81 million gain on the sale of fund investments and \$70 million in net appreciation and interest income. As of September 30, 1997, the decommissioning trust fund investments totaled \$553 million and were invested in securities designed to achieve a return in line with overall equity market performance.

**Cost-based regulation.** As a regulated entity, TVA is subject to the provisions of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Accordingly, TVA records certain assets and liabilities that result from the effects of the ratemaking process that would not be recorded under generally accepted accounting principles for non-regulated entities. Currently, the electric utility industry is predominantly regulated on a basis designed to recover the cost of providing electric power to its customers. If cost-based regulation were to be discontinued in the industry for any reason, profits could be reduced and utilities might be required to reduce their asset balances to reflect a market basis less than cost. Discontinuance of cost-based regulation would also require affected utilities to write off their associated regulatory assets. Such regulatory assets for TVA total approximately \$1.9 billion at September 30, 1997, along with approximately \$6.3 billion of deferred nuclear plants. Management cannot predict the potential impact, if any, of these competitive forces on TVA's future financial position and results of operations. However, TVA continues to position itself to effectively meet these challenges by maintaining prices that are locally, regionally and nationally competitive.

**TENNESSEE VALLEY AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS — (Continued)**

**11. NON-POWER PROGRAMS**

TVA's non-power programs provide various public services, including managing navigable river channels, providing flood control and overseeing certain recreation facilities. The non-power programs encompass general stewardship of land, water and wildlife resources. TVA's non-power programs also conduct certain research and development activities in pollution prevention and remediation.

Funding for the non-power programs is primarily provided through federal appropriations. During 1997 and 1996, the non-power programs received appropriations of \$106 million and \$109 million, respectively. The 1998 appropriations bill approved \$70 million for non-power programs in 1998 and anticipates no further appropriation to TVA thereafter. Certain non-power program activities are also funded by user fees and outside services revenues. Notwithstanding the historical separation of the power and non-power programs and provisions of the TVA Act and bond covenants to the contrary, public law authorizes TVA to use power revenues to pay for non-power activities beginning in 1999.

During 1995, the non-power programs had a net expense of \$182 million, which included a \$69 million charge for the write-off of the Columbia Dam and Reservoir project. The Columbia Dam and Reservoir, a multipurpose project financed by congressional appropriations, was suspended in prior years due to budget restrictions and environmental concerns. During 1995, TVA determined that the Columbia Dam would not be completed, and accordingly, the project cost was expensed.

The completed plant of the non-power programs consists of multipurpose dams and other plant. At September 30, 1997, the net completed plant balances for multipurpose dams and other plant were \$700 million and \$113 million, respectively. At September 30, 1996, the net completed plant balances for multipurpose dams and other plant were \$705 million and \$108 million, respectively.

## REPORT OF INDEPENDENT ACCOUNTANTS

### To the Board of Directors of the Tennessee Valley Authority

We have audited the accompanying balance sheets (power program and all programs) of the Tennessee Valley Authority as of September 30, 1997 and 1996, and the related statements of income (power program), changes in proprietary capital (power program and non-power programs), net expense (non-power programs) and cash flows (power program and all programs) for each of the three years in the period ended September 30, 1997. These financial statements are the responsibility of the Tennessee Valley Authority'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 and Government Auditing Standards issued by the Comptroller General of the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the financial statements referred to above present fairly, in all material respects, the financial position of the power program and all programs of the Tennessee Valley Authority as of September 30, 1997 and 1996, the results of operations of the power program and nonpower programs and cash flows of the power program and all programs for each of the three years in the period ended September 30, 1997, in conformity with generally accepted accounting principles.

As discussed in note 8 to the financial statements, in 1995 the Tennessee Valley Authority adopted Statement of Financial Accounting Standard No. 112, *Employers Accounting for Postemployment Benefits*.

In accordance with Government Auditing Standards, we have also issued a report, dated October 23, 1997, on our consideration of the Tennessee Valley Authority's internal controls over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants.

Coopers & Lybrand L.L.P.  
Knoxville, Tennessee  
October 23, 1997

## REPORT OF MANAGEMENT

Management is responsible for the preparation, integrity, and objectivity of the financial statements of the Tennessee Valley Authority as well as all other information contained in the annual report. The financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and, in some cases, reflect amounts based on the best estimates and judgments of management, giving due consideration to materiality. Financial information contained in the annual report is consistent with that in the financial statements.

The Tennessee Valley Authority maintains an adequate system of internal controls to provide reasonable assurance that transactions are executed in accordance with management's authorization, that financial statements are prepared in accordance with generally accepted accounting principles, and that the assets of the corporation are properly safeguarded. The system of internal controls is documented, evaluated, and tested on a continuing basis. No internal control system can provide absolute assurance that errors and irregularities will not occur due to the inherent limitations of the effectiveness of internal controls; however, management strives to maintain a balance, recognizing that the cost of such a system should not exceed the benefits derived. No material internal control weaknesses have been reported to management.

Coopers & Lybrand L.L.P. was engaged to audit the financial statements of the Tennessee Valley Authority and issue reports thereon. Its audits were conducted in accordance with generally accepted auditing standards. Such standards require a review of internal controls and an examination of selected transactions and other procedures sufficient to provide reasonable assurance that the financial statements neither are misleading nor contain material errors. The Report of Independent Accountants does not limit the responsibility of management for information contained in the financial statements and elsewhere in the annual report.

David N. Smith  
Chief Financial Officer  
and Executive Vice President of Financial Services

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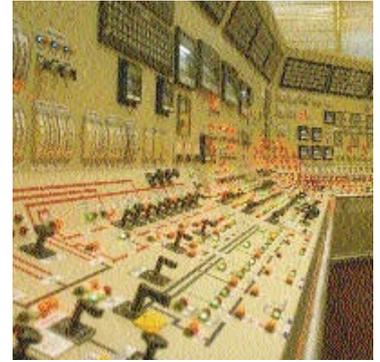
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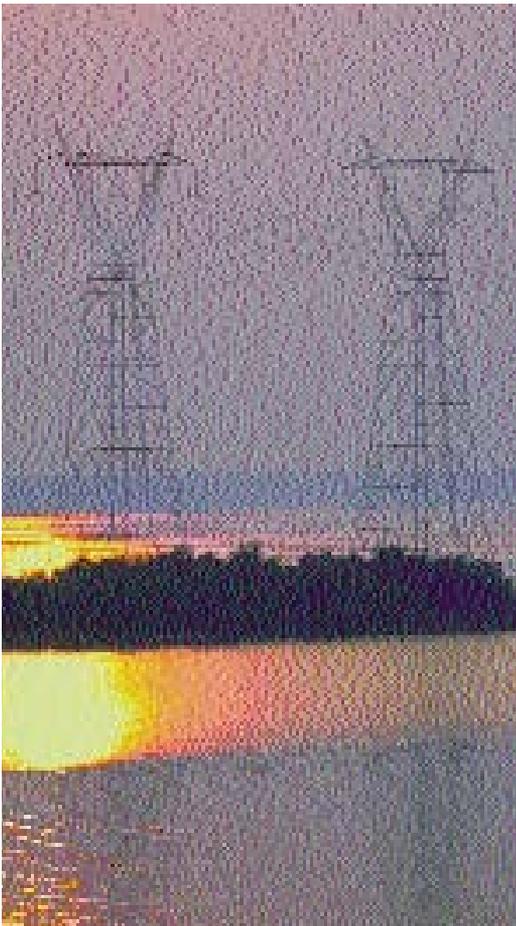
Certain principles are essential to the protection of the public interest, most notably reliability of service, universal access, environmental responsibility, and the promotion of economic development.



▲ *TVA is one of the largest power producers in the United States.*



▲ *TVA's electric generation facilities include state of the art computer controlled production.*



▲ *TVA's 16,600-mile system of transmission lines through seven states serves as a vital part of the United States energy infrastructure.*



▲ *TVA is environmentally sensitive in managing the thousands of acres along the Tennessee River system.*



▲ *The energy right program was developed jointly by TVA and its customers to promote energy conservation through more efficient power use.*



▲ *TVA manages the nation's fifth largest river system for flood control, navigation, power production and recreation.*

