

EDISON MISSION ENERGY
Form 10-Q
October 29, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-Q

(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2010

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____
Commission file number 333-68630

EDISON MISSION ENERGY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation
or organization)

95-4031807

(I.R.S. Employer Identification No.)

**18101 Von Karman Avenue, Suite 1700
Irvine, California**

(Address of principal executive offices)

92612

(Zip Code)

Registrant's telephone number, including area code: **(949) 752-5588**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been

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subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

Number of shares outstanding of the registrant's Common Stock as of October 29, 2010: 100 shares (all shares held by an affiliate of the registrant).

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GLOSSARY

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

AOI	adjusted operating income (loss)
bcf	billion cubic feet
Big 4	Kern River, Midway-Sunset, Sycamore and Watson natural gas power projects
Btu	British thermal units
CAA	Clean Air Act
Commonwealth Edison	Commonwealth Edison Company
CPS	Combined Pollutant Standard
EME	Edison Mission Energy
EMMT	Edison Mission Marketing & Trading, Inc.
FASB	Financial Accounting Standards Board
Fossil-fueled facilities	Midwest Generation fossil-fueled power plants and Homer City electric generating station
GAAP	United States generally accepted accounting principles
GHG	greenhouse gas
GWh	gigawatt-hours
Homer City	EME Homer City Generation L.P.
Illinois EPA	Illinois Environmental Protection Agency
LIBOR	London Interbank Offered Rate
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
Midwest Generation	Midwest Generation, LLC
MMBtu	million British thermal units
Moody's	Moody's Investors Service, Inc.
MW	megawatts
MWh	megawatt-hours
NAAQS	National Ambient Air Quality Standards
NOV	Notice of Violation
NO _x	nitrogen oxide
NYISO	New York Independent System Operator
PJM	PJM Interconnection, LLC
PRB	Powder River Basin
PSD	Prevention of Significant Deterioration
RPM	Reliability Pricing Model
S&P	Standard & Poor's Ratings Services
SO ₂	sulfur dioxide
US EPA	United States Environmental Protection Agency

Table of Contents**PART I FINANCIAL INFORMATION**
ITEM 1. FINANCIAL STATEMENTS**EDISON MISSION ENERGY AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(in millions, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Operating Revenues	\$ 691	\$ 593	\$ 1,835	\$ 1,762
Operating Expenses				
Fuel	228	228	602	587
Plant operations	135	131	523	426
Plant operating leases	44	44	133	132
Depreciation and amortization	62	62	181	174
Administrative and general	43	48	133	144
Total operating expenses	512	513	1,572	1,463
Operating income	179	80	263	299
Other Income (Expense)				
Equity in income from unconsolidated affiliates	60	60	99	88
Dividend income	1	1	18	11
Interest income			2	6
Interest expense	(64)	(78)	(198)	(225)
Total other expense	(3)	(17)	(79)	(120)
Income from continuing operations before income taxes	176	63	184	179
Provision for income taxes	58	10	11	27
Income from Continuing Operations	118	53	173	152
Income (Loss) from Operations of Discontinued Subsidiaries, net of tax (Note 5)	(5)	(1)	4	(5)
Net Income	113	52	177	147

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Net (Income) Loss Attributable to Noncontrolling Interests			1			2
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Net Income Attributable to EME Common Shareholders	\$	113	\$	53	\$	177	\$	149
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Amounts Attributable to EME Common Shareholders

Income from continuing operations, net of tax	\$	118	\$	54	\$	173	\$	154
Income (loss) from discontinued operations, net of tax		(5)		(1)		4		(5)

Net Income Attributable to EME Common Shareholders	\$	113	\$	53	\$	177	\$	149
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The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**EDISON MISSION ENERGY AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(in millions, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net Income	\$ 113	\$ 52	\$ 177	\$ 147
Other comprehensive income (loss), net of tax				
Pension and postretirement benefits other than pensions:				
Amortization of net loss and prior service adjustment included in expense, net of tax		1		2
Unrealized gains (losses) on derivatives qualified as cash flow hedges:				
Unrealized holding gains (losses) arising during period, net of income tax expense (benefit) of \$29 and \$(4) for the three months and \$41 and \$44 for the nine months ended September 30, 2010 and 2009, respectively	43	(5)	61	56
Reclassification adjustments included in net income, net of income tax benefit of \$5 and \$52 for the three months and \$54 and \$75 for the nine months ended September 30, 2010 and 2009, respectively	(7)	(72)	(80)	(104)
Other comprehensive income (loss)	36	(76)	(19)	(46)
Comprehensive Income (Loss)	149	(24)	158	101
Comprehensive Loss Attributable to Noncontrolling Interests		1		2
Comprehensive Income (Loss) Attributable to EME Common Shareholders	\$ 149	\$ (23)	\$ 158	\$ 103

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

Table of Contents**EDISON MISSION ENERGY AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in millions, unaudited)

	September 30, 2010	December 31, 2009
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,097	\$ 796
Accounts receivable trade	141	201
Receivables from affiliates	8	93
Inventory	221	196
Derivative assets	105	197
Restricted cash	15	69
Margin and collateral deposits	89	120
Prepaid expenses and other	63	190
Total current assets	1,739	1,862
Investments in Unconsolidated Affiliates	578	361
Property, Plant and Equipment	6,884	6,279
Less accumulated depreciation and amortization	1,690	1,474
Net property, plant and equipment	5,194	4,805
Other Assets		
Deferred financing costs	53	43
Long-term derivative assets	74	81
Restricted deposits	42	40
Rent payments in excess of levelized rent expense under plant operating leases	1,186	1,038
Other long-term assets	216	403
Total other assets	1,571	1,605
Total Assets	\$ 9,082	\$ 8,633

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

Table of Contents**EDISON MISSION ENERGY AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in millions, unaudited)

	September 30, 2010	December 31, 2009
Liabilities and Shareholder's Equity		
Current Liabilities		
Accounts payable	\$ 79	\$ 97
Payables to affiliates	19	14
Accrued liabilities	182	247
Derivative liabilities	6	5
Interest payable	101	30
Deferred taxes	131	119
Current maturities of long-term obligations	43	37
Construction loans	98	
Total current liabilities	659	549
Long-term obligations net of current maturities	4,087	3,929
Deferred taxes and tax credits	677	672
Deferred revenues	163	153
Long-term derivative liabilities	32	15
Other long-term liabilities	533	478
Total Liabilities	6,151	5,796
Commitments and Contingencies (Note 10)		
Equity		
Common stock, par value \$0.01 per share; 10,000 shares authorized; 100 shares issued and outstanding as of September 30, 2010 and December 31, 2009	64	64
Additional paid-in capital	1,339	1,339
Retained earnings	1,464	1,280
Accumulated other comprehensive income	59	78
Total EME common shareholder's equity	2,926	2,761
Noncontrolling Interests	5	76
Total Equity	2,931	2,837
Total Liabilities and Equity	\$ 9,082	\$ 8,633

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

Table of Contents**EDISON MISSION ENERGY AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in millions, unaudited)

	Nine Months Ended September 30,	
	2010	2009
Cash Flows From Operating Activities		
Net income	\$ 177	\$ 147
(Income) loss from discontinued operations	(4)	5
Income from continuing operations, net	173	152
Adjustments to reconcile income to net cash provided by (used in) operating activities:		
Equity in income from unconsolidated affiliates	(98)	(86)
Distributions from unconsolidated affiliates	75	46
Depreciation and amortization	190	180
Deferred taxes and tax credits	35	314
Changes in operating assets and liabilities:		
Decrease (increase) in margin and collateral deposits	31	(118)
Decrease (increase) in accounts receivables	147	(70)
Increase in inventory	(22)	(28)
Decrease in prepaid expenses and other		39
Decrease (increase) in restricted cash	53	(148)
Increase in rent payments in excess of levelized rent expense	(148)	(161)
Decrease in accounts payable and other current liabilities	(129)	(130)
Increase in interest payable	71	71
Decrease (increase) in derivative assets and liabilities	86	(55)
Proceeds from U.S. Treasury grants	92	
Other operating assets	8	12
Other operating liabilities	24	69
Operating cash flow from continuing operations	588	87
Operating cash flow from discontinued operations	4	(5)
Net cash provided by operating activities	592	82
Cash Flows From Financing Activities		
Borrowings on long-term debt	118	189
Payments on long-term debt agreements	(26)	(409)
Borrowings under construction loans	98	
Payments to affiliates related to stock-based awards	(2)	(2)
Financing costs	(16)	(14)
Net cash provided by (used in) financing activities from continuing operations	172	(236)
Cash Flows From Investing Activities		
Capital expenditures	(469)	(177)
Proceeds from return of capital and loan repayments and sale of assets	16	11
Purchase of interest of acquired companies	(4)	(7)

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Maturities of short-term investments	1	2
Decrease in restricted cash		3
Investments in other assets	(7)	(277)
Net cash used in investing activities from continuing operations	(463)	(445)
Net increase (decrease) in cash and cash equivalents	301	(599)
Cash and cash equivalents at beginning of period	796	1,807
Cash and cash equivalents at end of period	\$ 1,097	\$ 1,208

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

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EDISON MISSION ENERGY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
(Unaudited)

Note 1. Summary of Significant Accounting Policies*Basis of Presentation*

EME's significant accounting policies were described in "Note 1 Summary of Significant Accounting Policies" on page 114 of EME's annual report on Form 10-K for the year ended December 31, 2009. EME follows the same accounting policies for interim reporting purposes, with the exception of accounting principles adopted as of January 1, 2010 as discussed below in " New Accounting Guidance." This quarterly report should be read in conjunction with such financial statements.

In the opinion of management, all adjustments, including recurring accruals, have been made that are necessary to fairly state the consolidated financial position and results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America for the periods covered by this quarterly report on Form 10-Q. The results of operations for the three months and nine months ended September 30, 2010 are not necessarily indicative of the operating results for the full year. Except as indicated, amounts reflected in the notes to the consolidated financial statements relate to continuing operations of EME.

Certain prior year reclassifications have been made to conform to the current year financial statement presentation pertaining to immaterial items.

Cash and Cash Equivalents

Cash and cash equivalents consisted of the following:

(in millions)	September 30, 2010	December 31, 2009
Cash	\$ 258	\$ 106
Money market funds	839	690
Total cash and cash equivalents	\$ 1,097	\$ 796

The carrying value of cash equivalents, which consists of money market funds, equals the fair value as all investments have maturities of less than three months. For further discussion of money market funds, see Note 2 Fair Value Measurements.

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Inventory is stated at the lower of weighted average cost or market. Inventory consisted of the following:

(in millions)	September 30, 2010	December 31, 2009
Coal, fuel oil and other raw materials	\$ 150	\$ 132
Spare parts, materials and supplies	71	64
Total	\$ 221	\$ 196

New Accounting Guidance*Accounting Guidance Adopted in 2010*

Consolidation Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities

The FASB issued an accounting standards update that changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an ability to direct the activities of the entity that most significantly impact the entity's economic performance and whether the entity has the obligation to absorb losses or the right to receive expected returns of the entity. This guidance requires a company to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. EME adopted this guidance effective January 1, 2010. The impact of adopting this guidance resulted in the deconsolidation of certain wind assets totaling \$253 million and the consolidation of coal assets totaling \$99 million at January 1, 2010. Deconsolidation did not result in a gain or loss. The consolidation of EME's 50% partnership interest in American Bituminous Power Partners, L.P., referred to as the Ambit project, a coal-fired electrical plant project with a capacity of 80 MW, resulted in a cumulative effect adjustment that increased retained earnings by \$10 million. For further discussion, see Note 7 Variable Interest Entities.

Fair Value Measurements and Disclosures

The FASB issued an accounting standards update that provides for new disclosure requirements related to fair value measurements. Requirements, effective January 1, 2010, include separate disclosure of significant transfers in and out of Levels 1 and 2 and the reasons for the transfers. The update also clarified existing disclosure requirements for the level of disaggregation, inputs and valuation techniques. In addition, effective January 1, 2011, the Level 3 reconciliation of fair value measurements using significant unobservable inputs should include gross rather than net information about purchases, sales, issuances and settlements. The guidance impacts disclosures only. For further discussion, see Note 2 Fair Value Measurements.

Accounting Guidance Not Yet Adopted

Revenue Multiple-Deliverables

In October 2009, the FASB issued amended guidance for identifying separate deliverables in a revenue-generating transaction where multiple deliverables exist, and provides guidance for allocating and

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recognizing revenue based on those separate deliverables. This update also requires additional disclosure related to the significant assumptions used to determine the revenue recognition of the separate deliverables. This guidance is effective beginning January 1, 2011 and is required to be applied prospectively to new or significantly modified revenue arrangements. EME is currently assessing the effects this guidance may have on its consolidated financial statements.

Note 2. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (referred to as an "exit price"). Fair value for a liability should reflect the entity's nonperformance risk. Fair value is determined using a hierarchy to prioritize inputs to valuation models. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets and liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities;

Level 2 Pricing inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the derivative instrument; and

Level 3 Prices or valuations that require inputs that are both significant to the fair value measurements and unobservable.

EME's assets and liabilities carried at fair value primarily consist of derivative contracts and money market funds. Derivative contracts are primarily commodity contracts for the purchase and sale of power and include contracts for forward physical sales and purchases, options and forward price swaps which settle only on a financial basis (including futures contracts). Derivative contracts can be exchange or over-the-counter traded.

The fair value of derivative contracts takes into account quoted market prices, time value of money, volatility of the underlying commodities and other factors. Derivatives that are exchange traded in active markets for identical assets or liabilities are classified as Level 1. Investments in money market funds are generally classified as Level 1 as fair value is determined by observable market prices in active markets.

Derivative contracts, valued based on forward market prices in active markets (PJM West Hub, Northern Illinois Hub peak and AEP/Dayton) adjusted for nonperformance risks, are classified as Level 2. EME obtains forward market prices from traded exchanges (Intercontinental Exchange Futures U.S. or New York Mercantile Exchange) and available broker quotes. Then, EME selects a primary source that best represents traded activity for each market to develop observable forward market prices in determining the fair value of these positions. Broker quotes or prices from exchanges are used to validate and corroborate the primary source. These price quotations reflect mid-market prices (average of bid and ask) and are obtained from sources that EME believes to provide the most liquid market for the commodity. EME considers broker quotes to be observable when corroborated with other information which may include a combination of prices from exchanges, other brokers, and comparison to executed trades.

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Financial transmission rights and over-the-counter derivatives that trade infrequently at illiquid locations, and long-term power agreements are classified as Level 3. For illiquid financial transmission rights, EME reviews objective criteria related to system congestion on a quarterly basis and other underlying drivers and adjusts fair value when EME concludes a change in objective criteria would result in a new valuation that better reflects fair value. Changes in fair values are based on the hypothetical sale of illiquid positions. For illiquid long-term power agreements, fair value is based upon a discounting of future electricity prices derived from a proprietary model using the risk free discount rate for a similar duration contract, adjusted for credit risk and market liquidity. Changes in fair value are based on changes to forward market prices, including forecasted prices for illiquid forward periods. In circumstances where EME cannot verify fair value with observable market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value. As markets continue to develop and more pricing information becomes available, EME continues to assess valuation methodologies used to determine fair value. Derivative contracts with counterparties that have significant nonperformance risks are classified as Level 3.

In assessing nonperformance risks, EME reviews credit ratings of counterparties (and related default rates based on such credit ratings) and prices of credit default swaps. The market price (or premium) for credit default swaps represents the price that a counterparty would pay to transfer the risk of default, typically bankruptcy, to another party. A credit default swap is not directly comparable to the credit risks of derivative contracts, but provides market information of the related risk of nonperformance. The fair value of derivative assets nonperformance risk was \$2 million at September 30, 2010.

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The following table sets forth EME's assets and liabilities that were accounted for at fair value by level within the fair value hierarchy:

(in millions)	As of September 30, 2010				Total
	Level 1	Level 2	Level 3	Netting and Collateral ²	
Assets at Fair Value					
Money market funds ¹	\$ 854	\$	\$	\$	\$ 854
Derivatives					
Electricity	\$	\$ 192	\$ 135	\$ (148)	\$ 179
Natural gas	3			(3)	
Fuel oil	10			(10)	
Total commodity contracts	13	192	135	(161)	179
Total derivatives	\$ 13	\$ 192	\$ 135	\$ (161)	\$ 179
Liabilities at Fair Value					
Derivatives					
Electricity	\$	\$ (37)	\$ (13)	\$ 44	\$ (6)
Natural gas		(3)			(3)
Coal		(3)		3	
Total commodity contracts		(43)	(13)	47	(9)
Interest rate contracts		(29)			(29)
Total derivatives	\$	\$ (72)	\$ (13)	\$ 47	\$ (38)

As of December 31, 2009

Assets at Fair Value					
Money market funds ¹	\$ 758	\$	\$	\$	\$ 758
Derivatives					
Electricity	\$	\$ 235	\$ 179	\$ (136)	\$ 278
Natural gas	2			(2)	
Fuel oil	15			(15)	
Total commodity contracts	17	235	179	(153)	278
Total derivatives	\$ 17	\$ 235	\$ 179	\$ (153)	\$ 278
Liabilities at Fair Value					
Derivatives					
Electricity	\$	\$ (85)	\$ (6)	\$ 73	\$ (18)
Natural gas	(3)	(1)		4	
Total commodity contracts	(3)	(86)	(6)	77	(18)
Interest rate contracts		(2)			(2)
Total derivatives	\$ (3)	\$ (88)	\$ (6)	\$ 77	\$ (20)

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At September 30, 2010 and December 31, 2009, included in cash and cash equivalents and restricted cash, and at December 31, 2009, also included in prepaid expenses and other on EME's consolidated balance sheets.

2

Represents cash collateral and the impact of netting across the levels of the fair value hierarchy. Netting among positions classified within the same level is included in that level.

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The following table sets forth a summary of changes in the fair value of assets and liabilities, net categorized as Level 3:

(in millions)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	Money Market Funds	2010	2009	Money Market Funds
	Deriva- tives	Deriva- tives		Deriva- tives	Deriva- tives	
Fair value at beginning of periods	\$ 166	\$ 240	\$ 1	\$ 173	\$ 213	\$ 3
Total realized/unrealized gains (losses)						
Included in earnings ¹	24	30		51	127	
Included in accumulated other comprehensive income (loss)	1			5		
Purchases and settlements, net	(73)	(55)		(116)	(113)	(2)
Transfers in or out of Level 3	4	1		9	(11)	
Fair value at September 30	\$ 122	\$ 216	\$ 1	\$ 122	\$ 216	\$ 1
Change during the periods in unrealized gains (losses) related to assets and liabilities, net held at September 30 ¹	\$ (3)	\$ 38	\$	\$ 1	\$ 75	\$

¹

Reported in operating revenues on EME's consolidated statements of income.

EME determines the fair value of transfers in and transfers out of each level at the end of each reporting period. Transfers in and out of Levels 1 and 2 were not significant during the third quarters and nine months ended September 30, 2010 and 2009.

Long-term Obligations

The carrying amounts and fair values of EME's long-term obligations were as follows:

(in millions)	As of September 30, 2010		As of December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term obligations, including current portion	\$ 4,130	\$ 3,180	\$ 3,966	\$ 3,150

In assessing the fair value of EME's long-term obligations, EME primarily uses quoted market prices, except for floating-rate debt for which the carrying amounts were considered a reasonable estimate of fair value.

The carrying amount of trade receivables, payables and construction loans approximates fair value and, therefore, is not included in the table above.

Note 3. Derivative Instruments and Risk Management

EME uses derivative instruments to reduce EME's exposure to market risks that arise from fluctuations in prices of electricity, capacity, fuel, emission allowances, and transmission rights. Additionally, EME's financial results can be affected by fluctuations in interest rates. To the extent that EME does not use

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derivative instruments to hedge these market risks, the unhedged portions will be subject to the risks and benefits of spot market price movements.

Risk management positions may be designated as cash flow hedges or economic hedges, which are derivatives that are not designated as cash flow hedges. Economic hedges are accounted for at fair value on EME's consolidated balance sheets with offsetting changes recorded in the consolidated statements of income. For transactions that qualify for accounting hedge treatment, the fair value is recognized, to the extent effective, on EME's consolidated balance sheets with offsetting changes in fair value recognized in accumulated other comprehensive income until the related forecasted transaction occurs.

Derivative instruments that are utilized for trading purposes are measured at fair value and included in the balance sheet as derivative assets or liabilities. Changes in fair value are recognized in the consolidated statements of income.

Notional Volumes of Derivative Instruments

The following table summarizes the notional volumes of derivatives used for hedging and trading activities:

September 30, 2010

Commodity	Instrument	Classification	Unit of Measure	Hedging Activities		
				Cash Flow Hedges	Economic Hedges	Trading Activities
Electricity	Forwards/Futures	Sales	GWh	26,322 ¹	15,995 ³	33,485
Electricity	Forwards/Futures	Purchases	GWh	408 ¹	16,529 ³	35,741
Electricity	Capacity	Sales	MW-Day (in thousands)	195 ²		150 ²
Electricity	Capacity	Purchases	MW-Day (in thousands)	12 ²		461 ²
Electricity	Congestion	Sales	GWh		136 ⁴	10,977 ⁴
Electricity	Congestion	Purchases	GWh		1,016 ⁴	210,974 ⁴
Natural gas	Forwards/Futures	Sales	bcf		0.6	37.3
Natural gas	Forwards/Futures	Purchases	bcf			36.4
Fuel oil	Forwards/Futures	Sales	barrels		150,000	319,000
Fuel oil	Forwards/Futures	Purchases	barrels		495,000	329,000
Coal	Forwards/Futures	Sales	tons			1,794,750
Coal	Forwards/Futures	Purchases	tons			1,748,250

(in millions)

Instrument	Purpose	Type of Hedge	Notional Amount	Expiration Date
Amortizing interest rate swap	Convert floating rate (6-month LIBOR) debt to fixed rate (3.175%) debt	Cash flow	\$ 145	June 2016
Amortizing forward starting interest rate swap	Convert floating rate (3-month LIBOR) debt to fixed rate (4.29%) debt	Cash flow	122	December 2025
Amortizing forward starting interest rate swap	Convert floating rate (3-month LIBOR) debt to fixed rate (3.46%) debt	Cash flow	68	March 2026

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December 31, 2009

Commodity	Instrument	Classification	Unit of Measure	Hedging Activities		
				Cash Flow Hedges	Economic Hedges	Trading Activities
Electricity	Forwards/Futures	Sales	GWh	24,355 ¹	26,838 ³	23,306
Electricity	Forwards/Futures	Purchases	GWh	106 ¹	25,971 ³	23,404
Electricity	Capacity	Sales	MW-Day (in thousands)	254 ²	1 ²	597 ²
Electricity	Capacity	Purchases	MW-Day (in thousands)	11 ²	2 ²	736 ²
Electricity	Congestion	Sales	GWh		136 ⁴	10,212 ⁴
Electricity	Congestion	Purchases	GWh		1,576 ⁴	181,930 ⁴
Natural gas	Forwards/Futures	Sales	bcf		3.3	30.8
Natural gas	Forwards/Futures	Purchases	bcf			30.6
Fuel oil	Forwards/Futures	Sales	barrels		250,000	120,000
Fuel oil	Forwards/Futures	Purchases	barrels		625,000	120,000

(in millions)

Instrument	Purpose	Type of Hedge	Notional Amount	Expiration Date
Amortizing interest rate swap	Convert floating rate (6-month LIBOR) debt to fixed rate (3.175%) debt	Cash flow	\$ 160	June 2016

¹ EME's hedge products include forward and futures contracts that qualify for hedge accounting. This category excludes power contracts for the fossil-fueled facilities which meet the normal sales and purchase exception and are accounted for on the accrual method.

² EME's hedge transactions for capacity result from bilateral trades. Capacity sold in the PJM RPM auction is not accounted for as a derivative.

³ EME also entered into transactions that adjust financial and physical positions, or day-ahead and real-time positions to reduce costs or increase gross margin. These positions largely offset each other. The net sales positions of these categories are primarily related to hedge transactions that are not designated as cash flow hedges.

⁴ Congestion contracts include financial transmission rights, transmission congestion contracts or congestion revenue rights. These positions are similar to a swap, where the buyer is entitled to receive a stream of revenues (or charges) based on the hourly day-ahead price differences between two locations.

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Fair Value of Derivative Instruments

The following table summarizes the fair value of derivative instruments reflected on EME's consolidated balance sheets:

September 30, 2010		Derivative Assets			Derivative Liabilities			Net
(in millions)	Short-term	Long-term	Subtotal	Short-term	Long-term	Subtotal	Assets	
Non-trading activities								
Cash flow hedges	\$ 151	\$ 33	\$ 184	\$ 4	\$ 36	\$ 40	\$ 144	
Economic hedges	108	7	115	101	7	108	7	
Trading activities	246	137	383	209	70	279	104	
	505	177	682	314	113	427	255	
Netting and collateral received ¹	(400)	(103)	(503)	(308)	(81)	(389)	(114)	
Total	\$ 105	\$ 74	\$ 179	\$ 6	\$ 32	\$ 38	\$ 141	
December 31, 2009								
Non-trading activities								
Cash flow hedges	\$ 240	\$ 17	\$ 257	\$ 69	\$ 6	\$ 75	\$ 182	
Economic hedges	202	8	210	180		180	30	
Trading activities	234	111	345	182	41	223	122	
	676	136	812	431	47	478	334	
Netting and collateral received ¹	(479)	(55)	(534)	(426)	(32)	(458)	(76)	
Total	\$ 197	\$ 81	\$ 278	\$ 5	\$ 15	\$ 20	\$ 258	

¹

Netting of derivative receivables and derivative payables and the related cash collateral received and paid is permitted when a legally enforceable master netting agreement exists with a derivative counterparty.

Income Statement Impact of Derivative Instruments

The following table provides the activity of accumulated other comprehensive income, containing the information about the changes in the fair value of cash flow hedges and reclassification from accumulated other comprehensive income into results of operations:

Cash Flow Hedge Activity¹
Nine Months Ended

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(in millions)	September 30,		Income Statement Location
	2010	2009	
Accumulated other comprehensive income derivative gain at January 1	\$ 175	\$ 398	
Effective portion of changes in fair value	102	100	
Reclassification from accumulated other comprehensive income to net income	(134)	(179)	Operating revenues
Accumulated other comprehensive income derivative gain at September 30	\$ 143	\$ 319	

1

Unrealized derivative gains are before income taxes. The after-tax amounts recorded in accumulated other comprehensive income at September 30, 2010 and 2009 were \$86 million and \$192 million, respectively.

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The portion of a cash flow hedge that does not offset the change in the value of the transaction being hedged, which is commonly referred to as the ineffective portion, is immediately recognized in earnings.

EME recorded a net gain of \$4 million and \$11 million during the third quarters of 2010 and 2009, respectively, and \$5 million and \$16 million during the nine months ended September 30, 2010 and 2009, respectively, representing the amount of cash flow hedge ineffectiveness and are reflected in operating revenues on the consolidated statements of income.

The effect of realized and unrealized gains (losses) from derivative instruments used for economic hedging and trading purposes on the consolidated statements of income is presented below:

(in millions)	Income Statement Location	Three Months Ended September 30,		Nine Months Ended September 30,	
		2010	2009	2010	2009
Economic hedges	Operating revenues	\$ 7	\$ 19	\$ 35	\$ 35
	Fuel costs	2	(2)		12
Trading activities	Operating revenues	28	16	108	43

Contingent Features/Credit Related Exposure

Certain derivative instruments contain margin and collateral deposit requirements. Since EME's credit ratings are below investment grade, EME has provided collateral in the form of cash and letters of credit for the benefit of counterparties related to the net of accounts payable, accounts receivable, unrealized losses and unrealized gains in connection with derivative activities. Certain derivative contracts do not require margin, but contain provisions that require EME or Midwest Generation to comply with the terms and conditions of their respective credit facilities. The credit facilities each contain financial covenants. Some hedge contracts include provisions related to a change in control or material adverse effect resulting from amendments or modifications to the related credit facility. Failure by EME or Midwest Generation to comply with these provisions may result in a termination event under the hedge contracts, enabling the counterparties to terminate and liquidate all outstanding transactions and demand immediate payment of amounts owed to them. EMMT has hedge contracts that do not require margin, but provide that each party can request additional credit support in the form of adequate assurance of performance in the case of an adverse development affecting the other party. The aggregate fair value of all derivative instruments with credit-risk-related contingent features is in an asset position at September 30, 2010 and, accordingly, the contingent features described above do not currently have a liquidity exposure. Future increases in power prices could expose EME, Midwest Generation or EMMT to termination payments or additional collateral postings under the contingent features described above.

Margin and Collateral Deposits

Margin and collateral deposits include cash deposited with counterparties and brokers as credit support under energy contracts. The amount of margin and collateral deposits generally varies based on changes in fair value of the related positions. EME nets counterparty receivables and payables where balances exist under master netting arrangements. EME presents the portion of its margin and cash collateral deposits netted with its derivative positions on EME's consolidated balance sheets. The

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following table summarizes margin and collateral deposits provided to and received from counterparties:

(in millions)	September 30, 2010	December 31, 2009
Collateral provided to counterparties		
Offset against derivative liabilities	\$ 4	\$ 49
Reflected in margin and collateral deposits	89	120
Collateral received from counterparties		
Offset against derivative assets	118	124

Note 4. Accumulated Other Comprehensive Income

Accumulated other comprehensive income consisted of the following:

(in millions)	Unrealized Gains on Cash Flow Hedges, Net	Unrecognized Losses and Prior Service Adjustments, Net ¹	Accumulated Other Comprehensive Income
Balance at December 31, 2009	\$ 105	\$ (27)	\$ 78
Current period change	(19)		(19)
Balance at September 30, 2010	\$ 86	\$ (27)	\$ 59

¹ For further detail, see Note 8 Compensation and Benefit Plans.

Included in accumulated other comprehensive income at September 30, 2010 was \$104 million, net of tax, in unrealized gains on commodity-based cash flow hedges; and an \$18 million, net of tax, unrealized loss related to interest rate hedges. The maximum period over which a cash flow hedge is designated is through March 31, 2026.

Unrealized gains on commodity hedges consist of futures and forward electricity contracts that qualify for hedge accounting. These gains arise because current forecasts of future electricity prices in these markets are lower than the contract prices. Approximately \$89 million of unrealized gains on cash flow hedges, net of tax, are expected to be reclassified into earnings during the next 12 months. Management expects that reclassification of net unrealized gains will increase energy revenues recognized at market prices. Actual amounts ultimately reclassified into earnings over the next 12 months could vary materially from this estimated amount as a result of changes in market conditions. The maximum period over which a commodity cash flow hedge is designated is through May 31, 2014.

Table of Contents**Note 5. Discontinued Operations**

Summarized financial information for discontinued operations is as follows:

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Income (loss) before income taxes	\$ (4)	\$ (1)	\$ 11	\$ (7)
Provision (benefit) for income taxes	1		7	(2)
Income (loss) from operations of discontinued foreign subsidiaries	\$ (5)	\$ (1)	\$ 4	\$ (5)

During the nine months ended September 30, 2010, EME made payments of \$41 million for a tax indemnity related to EME's previous sale of an international project. EME recorded year-to-date discontinued operations income before taxes of \$11 million due primarily to expiration of a contract indemnity during the first nine months of 2010 and changes in foreign exchange rates.

Discontinued operations includes \$2 million, net adjustments to unrecognized tax benefits. For further detail, see Note 9 Income Taxes.

Table of Contents**Note 6. Consolidated Statement of Changes in Equity**

Consolidated statement of changes in equity at the beginning and the end of the nine months ended September 30, 2009 and 2010:

(in millions)	EME Shareholder's Equity					
	Total Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non-controlling Interest
Balance at December 31, 2008	\$ 2,764	\$ 64	\$ 1,335	\$ 1,085	\$ 200	\$ 80
Net income (loss)	147			149		(2)
Other comprehensive loss	(46)				(46)	
Payments to Edison International for stock purchases related to stock-based compensation	(2)			(2)		
Other stock transactions, net	3		3			
Balance at September 30, 2009	\$ 2,866	\$ 64	\$ 1,338	\$ 1,232	\$ 154	\$ 78
Balance at December 31, 2009	\$ 2,837	\$ 64	\$ 1,339	\$ 1,280	\$ 78	\$ 76
Impact of deconsolidation of variable interest entities (Note 7)	(71)					(71)
Cumulative effect of a change in accounting principle, net of tax ¹	10			10		
Net income	177			177		
Other comprehensive loss	(19)				(19)	
Payments to Edison International for stock purchases related to stock-based compensation	(3)			(3)		
Other stock transactions, net	5		5			
Purchase of noncontrolling interests ²	(5)		(5)			
Balance at September 30, 2010	\$ 2,931	\$ 64	\$ 1,339	\$ 1,464	\$ 59	\$ 5

¹ For the nine months ended September 30, 2010, reflects the impact of adopting accounting guidance related to variable interest entities.

² During the second quarter of 2010, EME purchased a noncontrolling interest in Laredo Ridge, which is now 100% owned by EME. The purchase of the noncontrolling interest was accounted for as an equity transaction between controlling and noncontrolling interest holders.

Note 7. Variable Interest Entities

Effective January 1, 2010, EME adopted the FASB's new guidance regarding variable interest entities. A variable interest entity is defined as a legal entity whose equity owners do not have sufficient equity at risk, or, as a group, the holders of the equity investment at risk lack any of the following three characteristics: decision-making rights, the obligation to absorb losses, or the right to receive the expected residual returns of the entity. The new guidance replaces the predominantly quantitative model for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with a qualitative approach. Under this new qualitative model, the primary beneficiary is identified as the variable interest holder that has both the power to direct the activities of the variable

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interest entity that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. The primary beneficiary is required to consolidate the variable interest entity unless specific exceptions or exclusions are met. Commercial and operating activities are generally the factors that most significantly impact the economic performance of variable interest entities in which EME has a variable interest. Commercial and operating activities include construction, operation and maintenance, fuel procurement, dispatch and compliance with regulatory and contractual requirements.

Projects or Entities that are Consolidated

At September 30, 2010 and December 31, 2009, EME had majority interests in 15 wind projects with a total generating capacity of 700 MW that have minority interests held by others. The projects are located in Iowa, Minnesota, New Mexico, Nebraska and Texas. As of December 31, 2009, all of these projects were consolidated by EME. Upon the application of the new guidance effective January 1, 2010, EME deconsolidated two of these projects. See further discussion in " Projects that are not Consolidated." In determining that EME was the primary beneficiary of the 13 projects consolidated at September 30, 2010, the key factors considered were EME's ability to direct commercial and operating activities and EME's obligation to absorb losses and right to receive benefits that could potentially be significant to the variable interest entities.

The following table presents summarized financial information of the wind projects that had minority interests held by others and were consolidated by EME:

(in millions)	September 30, 2010	December 31, 2009
Current assets	\$ 22	\$ 73
Net property, plant and equipment ¹	669	944
Other long-term assets	2	2
 Total assets ¹	 \$ 693	 \$ 1,019
Current liabilities	\$ 15	\$ 17
Long-term obligations net of current maturities	17	20
Deferred revenues	57	58
Other long-term liabilities	19	21
 Total liabilities	 \$ 108	 \$ 116
 Noncontrolling interests	 \$ 4	 \$ 76

¹

Amounts included assets of \$253 million (\$247 million of net property, plant and equipment) that were deconsolidated on January 1, 2010.

Assets serving as collateral for the debt obligations had a carrying value of \$75 million and \$81 million at September 30, 2010 and December 31, 2009, respectively, and primarily consist of property, plant and equipment.

EME has a 50% partnership interest in the Ambit project. EME has the power to direct the commercial and operating activities of the project pursuant to the existing contracts and has the obligation to absorb losses and right to receive benefits from the project. Therefore, under the new guidance, EME is the primary beneficiary. As the primary beneficiary, EME consolidated Ambit project assets totaling \$99 million on January 1, 2010.

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The following table presents the summarized financial information of the Ambit project consolidated by EME:

(in millions)	September 30, 2010	
Current assets	\$	15
Net property, plant and equipment		80
Other long-term assets		4
 Total assets	 \$	 99
Current liabilities	\$	12
Long-term obligations net of current maturities		64
Deferred revenues		14
Other long-term liabilities		2
 Total liabilities	 \$	 92

Substantially all of the assets above are pledged as collateral for the partnership's debt obligations.

The consolidated statements of income and cash flows for the nine months ended September 30, 2010 were not significantly impacted by the consolidation of the Ambit project.

Projects that are not Consolidated

EME accounts for domestic energy projects in which it has a 50% or less ownership interest, and cannot exercise unilateral control, under the equity method. As of September 30, 2010 and December 31, 2009, EME had five significant variable interests in projects that are not consolidated consisting of the Big 4 projects and the Sunrise project. The following table presents summarized financial information of these five significant projects:

(in millions)	Nine Months Ended September 30,			
	2010		2009	
Revenues	\$	600	\$	549
Expenses		(440)		(390)
 Net income	 \$	 160	 \$	 159

A subsidiary of EME operates the Big 4 projects and EME's partner provides the fuel management services. In addition, the executive director of these projects is provided by EME's partner. Commercial and operating activities are jointly controlled by a management committee of each variable interest entity. Accordingly, EME continues to account for its variable interests under the equity method.

As noted previously in " Projects or Entities that are Consolidated," EME deconsolidated two renewable wind energy generating facilities, the Elkhorn Ridge wind project and San Juan Mesa wind project, on January 1, 2010. The primary purpose of these projects is to operate renewable wind energy facilities. The commercial and operating activities of these entities are directed by a management committee comprised of representatives of each partner. Thus, EME is not the primary beneficiary of these projects. Accordingly, effective January 1, 2010, EME accounts for its interests in these projects under the equity method.

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The following table presents the carrying amount of EME's investments in unconsolidated variable interest entities and the maximum exposure to loss for each investment:

(in millions)	As of September 30, 2010	
	Investment	Maximum Exposure
Natural gas-fired projects	\$ 360	\$ 360
Wind projects	218	218

EME's maximum exposure to loss in its variable interest entities accounted for under the equity method is generally limited to its investment in these entities. Two of EME's domestic energy projects have long-term debt that is secured by a pledge of assets of the project entity, but does not provide for recourse to EME. Accordingly, a default on a long-term financing of a project could result in foreclosure on the assets of the project entity resulting in a loss of some or all of EME's investment, but would not require EME to contribute additional capital. At September 30, 2010, entities which EME has accounted for under the equity method had indebtedness of \$141 million, of which \$53 million is proportionate to EME's ownership interest in these projects.

Note 8. Compensation and Benefit Plans

Pension Plans and Postretirement Benefits Other Than Pensions

Pension Plans

Contributions to EME's pension plans were \$19 million for the nine months ended September 30, 2010 and are estimated at \$3 million for the last three months of 2010.

The following are components of pension expense:

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Service cost	\$ 4	\$ 3	\$ 12	\$ 10
Interest cost	3	3	10	9
Expected return on plan assets	(2)	(1)	(7)	(5)
Amortization of net loss	1	1	2	3
Total expense	\$ 6	\$ 6	\$ 17	\$ 17

Postretirement Benefits Other Than Pensions

Contributions to EME's postretirement benefits other than pensions were \$1 million for the nine months ended September 30, 2010 and are estimated at \$1 million for the last three months of 2010.

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The following are components of postretirement benefits expense:

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Service cost	\$ 1	\$ 1	\$ 2	\$ 2
Interest cost	1	2	4	5
Amortization of prior service credit			(1)	(1)
Amortization of net loss				1
Total expense	\$ 2	\$ 3	\$ 5	\$ 7

Note 9. Income Taxes

The table below contains a reconciliation of income tax expense computed at the federal statutory income tax rate to the income tax provision from continuing operations attributable to common shareholders:

(in millions)	Nine Months Ended September 30,	
	2010	2009
Provision for income tax at federal statutory rate of 35%	\$ 65	\$ 63
State tax net of federal benefit (excludes state tax settlement)	5	13
Production tax credits	(45)	(40)
Federal settlement of tax disputes		(6)
Resolution of 1986-2002 state tax issues	(16)	
Other	2	(3)
Income tax expense from continuing operations	\$ 11	\$ 27

EME recorded a tax benefit of \$16 million in 2010 resulting from acceptance by the California Franchise Tax Board of the tax positions finalized with the Internal Revenue Service in 2009 for the tax years 1986 through 2002.

During the nine months ended September 30, 2009, Edison International and the Internal Revenue Service completed a settlement of federal tax disputes and affirmative claims for open tax years 1986 through 2002. EME recorded an income tax benefit of \$6 million due to the settlement and related estimated impact of interest and state income taxes.

Table of Contents**Unrecognized Tax Benefits**

The following table provides a reconciliation of unrecognized tax benefits:

(in millions)	Nine Months Ended September 30, 2010	
Balance at January 1	\$	115
Tax positions taken during the current year		
Increases		
Decreases		
Tax positions taken during a prior year		
Increases		78
Decreases		(72)
Decreases for settlements during the period		(8)
Balance at September 30	\$	113

As of September 30, 2010, if recognized, \$110 million of unrecognized tax benefits would impact the effective tax rate.

The Internal Revenue Service examination phase of Edison International's federal income tax returns for tax years 2003 through 2006 is anticipated to be completed by the end of 2010. During the third quarter, Edison International received a proposed adjustment increasing the taxable gain on the 2004 sale of EME's international assets, which, if sustained, would result in federal and state tax payments of approximately \$152 million, including interest. The Internal Revenue Service examination team is considering whether to assess penalties in addition to this proposed tax adjustment. Edison International does not agree with the proposed adjustment and expects to file an appeal with the Internal Revenue Service after the examination phase is completed. In addition, the Internal Revenue Service examination team, during the third quarter, has informed Edison International that it has completed its review of certain other tax positions and will not be proposing adjustments.

Note 10. Commitments and Contingencies**Contractual Obligations***Project Financing***Laredo Ridge**

In July 2010, EME completed through its subsidiary, Laredo Ridge Wind, LLC, a non-recourse financing of its interests in the Laredo Ridge wind project. The financing included: a \$75 million construction loan required to be converted to a 15-year amortizing term loan by August 31, 2011, subject to meeting specified conditions; a \$53 million bridge loan, secured by the expected U.S. Treasury grant, immediately due to be fully repaid upon receipt of the U.S. Treasury grant and no later than December 31, 2011; a \$9 million letter of credit facility; and a \$3 million working capital facility.

Interest under the construction loan and the term loan will accrue at LIBOR plus 2.75% initially, with the rate increasing 0.125% after the third, sixth, ninth and twelfth years. Pursuant to the financing agreement, Laredo Ridge entered into a forward starting interest rate swap agreement at 3.46% to hedge the majority of the variable interest rate debt effective March 31, 2011, the same date EME

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estimates that the construction loan will convert to the term loan. Interest under the bridge loan will accrue at LIBOR plus 2.50%.

As of September 30, 2010, there was \$20 million outstanding under the construction loan at a weighted average interest rate of 3.01% classified as a construction loan and \$50 million outstanding under the bridge loan at a weighted average interest rate of 2.76% classified as long-term obligations, both on EME's consolidated balance sheet, and \$3 million of outstanding letters of credit.

Cedro Hill

In March 2010, EME completed through its subsidiary, Cedro Hill Wind, LLC, a non-recourse financing of its interests in the Cedro Hill wind project. The financing included a \$135 million construction loan that is required to be converted to a 15-year amortizing term loan by May 31, 2011, subject to meeting specified conditions, a \$21 million letter of credit facility and a \$4 million working capital facility.

Interest under the construction loan and the term loan will accrue at LIBOR plus 3% initially, with the rate increasing 0.125% after the third, sixth, ninth and eleventh years and 0.25% after the thirteenth year. Pursuant to the financing agreement, Cedro Hill Wind entered into a forward starting interest rate swap agreement at 4.29% to hedge the majority of the variable interest rate debt effective December 31, 2010, the same date EME estimates that the construction loan will convert to the term loan.

As of September 30, 2010, there was \$78 million outstanding under the construction loan at a weighted average interest rate of 3.26% classified as a construction loan on EME's consolidated balance sheet and \$11.5 million of outstanding letters of credit.

Long-Term Debt

EME consolidated the Ambit project on January 1, 2010. At September 30, 2010, this project had \$71 million of bonds payable, which are supported by a letter of credit. Principal payments are due annually through October 1, 2017. Interest rates are reset weekly based on current bond yields for similar securities. The average interest rate for the nine months ended September 30, 2010 was 0.27%. Annual maturities of this debt at September 30, 2010 for the next five years are summarized as follows: \$8 million in 2010, \$8 million in 2011, \$9 million in 2012, \$10 million in 2013, and \$10 million in 2014.

The Ambit project is required to maintain funded reserve accounts primarily for debt servicing and maintenance costs. The required reserve account balance at September 30, 2010 was \$24 million and was under funded by \$15 million. The underfunded reserve does not create an event of default under the loan, but does restrict distributions from the Ambit project.

Commitments

Capital Improvements

At September 30, 2010, EME's subsidiaries had firm commitments to spend approximately \$199 million during the remainder of 2010 and \$79 million in 2011 on capital and construction expenditures. These expenditures primarily relate to the construction of wind projects. EME intends to fund these expenditures through project-level and turbine vendor financing, U.S. Treasury grants, cash on hand and cash generated from operations.

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Turbine Commitments

EME has entered into various turbine supply agreements with vendors to support its wind development efforts. As of September 30, 2010, EME had commitments, excluding turbines subject to the legal dispute described below, to purchase 46 wind turbines (69 MW) and had 2 wind turbines (6 MW) in storage to be used for future wind projects. EME has payment commitments related to wind turbines of \$82 million due in 2011.

Excluded from the turbine commitments referred to above are commitments under a turbine supply agreement between Mitsubishi Power Systems Americas, Inc. and EME, which was subject to a legal dispute as of September 30, 2010. On October 8, 2010, EME and the Mitsubishi entities entered into a settlement agreement with respect to the dispute. As a result of the settlement agreement, EME's \$68 million deposit previously paid under the original contract will be applied to the purchase price for 23 wind turbines (55 MW). Within the next three years, EME may elect to deploy 60 additional wind turbines (144 MW). EME may be obligated to make a payment of up to \$30 million following the end of the three-year period if it has not elected to deploy the additional turbines and if certain other criteria apply. EME further agreed to payments of up to \$40 million for settlement of remaining disputes on turbines purchased.

Fuel Supply and Transportation Contracts

At September 30, 2010, Midwest Generation and Homer City had fuel purchase commitments with various third-party suppliers for the purchase of coal. Based on the contract provisions, which consist of fixed prices, subject to adjustment clauses, these minimum commitments are estimated to aggregate \$883 million, summarized as follows: \$136 million for the remainder of 2010, \$461 million in 2011, \$253 million in 2012, and \$33 million in 2013.

At September 30, 2010, Midwest Generation and Homer City each had contractual agreements for the transport of coal to their respective facilities. The commitments under these contracts are based on either actual coal purchases or minimum quantities. Accordingly, contractual obligations for transportation based on actual coal purchases are derived from committed coal volumes set forth in fuel supply contracts. The minimum commitments under these contracts are estimated to aggregate \$300 million, summarized as follows: \$75 million for the remainder of 2010, and \$225 million in 2011.

Letters of Credit

At September 30, 2010, letters of credit under EME's credit facility aggregated \$101 million and were scheduled to expire as follows: \$6 million in 2010 and \$95 million in 2011. In addition, letters of credit under EME's subsidiaries' credit facilities aggregated \$32 million and were scheduled to expire as follows: \$2 million in 2010 and \$30 million in 2011.

Guarantees and Indemnities

EME and certain of its subsidiaries have various financial and performance guarantees and indemnifications which are issued in the normal course of business. As discussed below, these contracts include performance guarantees, guarantees of debt and indemnifications.

Environmental Indemnities Related to the Midwest Generation Plants

In connection with the acquisition of the Midwest Generation plants, EME agreed to indemnify Commonwealth Edison with respect to specified environmental liabilities before and after

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December 15, 1999, the date of sale. The indemnification claims are reduced by any insurance proceeds and tax benefits related to such claims and are subject to a requirement that Commonwealth Edison takes all reasonable steps to mitigate losses related to any such indemnification claim. This indemnification for environmental liabilities is not limited in term and would be triggered by a valid claim from Commonwealth Edison. Also, in connection with the sale-leaseback transaction related to the Powerton and Joliet Stations in Illinois, EME agreed to indemnify the lessors for specified environmental liabilities. Due to the nature of the obligations under these indemnities, a maximum potential liability cannot be determined. Commonwealth Edison has advised EME that Commonwealth Edison believes it is entitled to indemnification for all liabilities, costs, and expenses that it may be required to bear as a result of the litigation discussed below under " Contingencies Midwest Generation New Source Review Lawsuit." The sale-leaseback participants have requested similar indemnification. Except as discussed below, EME has not recorded a liability related to these environmental indemnities.

Midwest Generation entered into a supplemental agreement with Commonwealth Edison and Exelon Generation Company LLC on February 20, 2003 to resolve a dispute regarding interpretation of its reimbursement obligation for asbestos claims under the environmental indemnities set forth in the Asset Sale Agreement. Under this supplemental agreement, Midwest Generation agreed to reimburse Commonwealth Edison and Exelon Generation for 50% of specific asbestos claims pending as of February 2003 and related expenses less recovery of insurance costs, and agreed to a sharing arrangement for liabilities and expenses associated with future asbestos-related claims as specified in the agreement. As a general matter, Commonwealth Edison and Midwest Generation apportion responsibility for future asbestos-related claims based upon the number of exposure sites that are Commonwealth Edison locations or Midwest Generation locations. The obligations under this agreement are not subject to a maximum liability. The supplemental agreement had an initial five-year term with an automatic renewal provision for subsequent one-year terms (subject to the right of either party to terminate); pursuant to the automatic renewal provision, it has been extended until February 2011. There were approximately 220 cases for which Midwest Generation was potentially liable and that had not been settled and dismissed at September 30, 2010. Midwest Generation had recorded a \$57 million liability at September 30, 2010 for previous, pending and future claims.

The amounts recorded by Midwest Generation for the asbestos-related liability are based upon a number of assumptions. Future events, such as the number of new claims to be filed each year, the average cost of disposing of claims, as well as the numerous uncertainties surrounding asbestos litigation in the United States, could cause the actual costs to be higher or lower than projected.

Environmental Indemnity Related to the Homer City Facilities

In connection with the acquisition of the Homer City facilities, Homer City agreed to indemnify the sellers with respect to specified environmental liabilities before and after the date of sale. Payments would be triggered under this indemnity by a valid claim from the sellers. EME guaranteed this obligation of Homer City. Also, in connection with the sale-leaseback transaction related to the Homer City facilities, Homer City agreed to indemnify the lessors for specified environmental liabilities. Due to the nature of the obligation under this indemnity provision, it is not subject to a maximum potential liability and does not have an expiration date. For discussion of the NOV received by Homer City and associated indemnity claims, see " Contingencies Homer City New Source Review Notice of Violation." EME has not recorded a liability related to this indemnity.

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Indemnities Provided under Asset Sale and Sale-Leaseback Agreements

The asset sale agreements for the sale of EME's international assets contain indemnities from EME to the purchasers, including indemnification for taxes imposed with respect to operations of the assets prior to the sale and for pre-closing environmental liabilities. Not all indemnities under the asset sale agreements have specific expiration dates. Payments would be triggered under these indemnities by valid claims from the sellers or purchasers, as the case may be. At September 30, 2010, EME had recorded a liability of \$42 million related to these matters.

In connection with the sale of various domestic assets, EME has from time to time provided indemnities to the purchasers for taxes imposed with respect to operations of the asset prior to the sale. EME has also provided indemnities to purchasers for items specified in each agreement (for example, specific pre-existing litigation matters and/or environmental conditions). Due to the nature of the obligations under these indemnity agreements, a maximum potential liability cannot be determined.

Not all indemnities under the asset sale agreements have specific expiration dates. Payments would be triggered under these indemnities by valid claims from the sellers or purchasers, as the case may be. No significant amounts are recorded as a liability for these matters.

In connection with the sale-leaseback transactions related to the Homer City facilities in Pennsylvania, the Powerton and Joliet Stations in Illinois and, previously, the Collins Station in Illinois, EME and several of its subsidiaries entered into tax indemnity agreements. Although the Collins Station lease terminated in April 2004, Midwest Generation's tax indemnity agreement with the former lease equity investor is still in effect. Under these tax indemnity agreements, these entities agreed to indemnify the lessors in the sale-leaseback transactions for specified adverse tax consequences that could result in certain situations set forth in each tax indemnity agreement, including specified defaults under the respective leases. The potential indemnity obligations under these tax indemnity agreements could be significant. Due to the nature of these potential obligations, EME cannot determine a maximum potential liability which would be triggered by a valid claim from the lessors. No significant amounts are recorded as a liability for these matters.

Contingencies

Midwest Generation New Source Review Lawsuit

Recent Developments

In March 2010, the Federal District Court for the Northern District of Illinois dismissed nine of the ten counts related to PSD requirements in the complaint filed by the US EPA and the State of Illinois against Midwest Generation, holding that, as a subsequent owner, Midwest Generation could not be held liable under the PSD provisions for modifications allegedly made by Commonwealth Edison, the prior owner of the Midwest Generation plants. The Court also dismissed the tenth count to the extent it sought civil penalties under the CAA, as barred by the applicable statute of limitations. The decision did not address (i) other counts in the complaint that allege violations of opacity and particulate matter limitations under the Illinois State Implementation Plan and Title V of the CAA, or (ii) the complaint in intervention filed by a group of Chicago-based environmental action groups, which also alleges opacity and particulate matter violations.

In April 2010, the US EPA formally issued to EME the same NOV that was issued to Midwest Generation in 2007. The transmittal letter stated that the action was based on a review of the asset

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purchase agreement for the Midwest Generation plants and that the NOV was being issued to EME as a successor in interest to Commonwealth Edison.

In June 2010, the US EPA, the State of Illinois, and several environmental groups filed amended complaints in the New Source Review litigation. The amended complaints are similar to the prior complaints, but seek to add Commonwealth Edison and EME as defendants and introduce new legal theories to impose liability on Midwest Generation and EME. Midwest Generation and EME have filed a motion to dismiss the amended complaints, and a status hearing has been scheduled for February 2011.

Background

In August 2007, Midwest Generation received an NOV from the US EPA alleging that, beginning in the early 1990s and into 2003, Midwest Generation or Commonwealth Edison performed repair or replacement projects at six Illinois coal-fired electric generating stations in violation of the PSD requirements and of the New Source Performance Standards of the CAA, including alleged requirements to obtain a construction permit and to install controls sufficient to meet best available control technology (BACT) emissions rates. The US EPA also alleged that Midwest Generation and Commonwealth Edison violated certain operating permit requirements under Title V of the CAA. Finally, the US EPA alleged violations of certain opacity and particulate matter standards at the Midwest Generation plants. At approximately the same time, Commonwealth Edison received an NOV substantially similar to the Midwest Generation NOV. Midwest Generation, Commonwealth Edison, the US EPA, and the U.S. Department of Justice, along with several Chicago-based environmental action groups, had discussions designed to explore the possibility of a settlement but no settlement resulted.

In August 2009, the US EPA and the State of Illinois filed a complaint in the Northern District of Illinois against Midwest Generation, but not Commonwealth Edison, alleging claims substantially similar to those in the NOV. In addition to seeking penalties ranging from \$25,000 to \$37,500 per violation, per day, the complaint calls for an injunction ordering Midwest Generation to install controls sufficient to meet BACT emissions rates at all units subject to the complaint; to obtain new PSD or New Source Review permits for those units; to amend its applications under Title V of the CAA; to conduct audits of its operations to determine whether any additional modifications have occurred; and to offset and mitigate the harm to public health and the environment caused by the alleged CAA violations. The remedies sought by the plaintiffs in the lawsuit could go well beyond those required under the CPS. By order dated January 19, 2010, the Court allowed a group of Chicago-based environmental action groups to intervene in the case.

The owner participants of the Powerton and Joliet Stations have sought indemnification and defense from Midwest Generation and/or EME for costs and liabilities associated with these matters. EME responded by recognizing its indemnity obligation and defense of the claims on terms consistent with its contractual obligations.

An adverse decision could involve penalties and remedial actions that could have a material adverse impact on the financial condition and results of operations of EME at such time. EME cannot predict the outcome of these matters or estimate the impact on its facilities, its results of operations, financial position or cash flows.

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Homer City New Source Review Notice of Violation

Recent Developments

In May 2010, Homer City received an NOV from the US EPA. The new NOV alleges claims similar to those in the 2008 NOV, but it adds nonattainment New Source Review requirements to the alleged PSD violations. It also adds two prior owners of the Homer City facilities as parties.

In July 2010, Homer City received a 60-day Notice of Intent to Sue signed by the State of New York and the Pennsylvania Department of Environmental Protection (PADEP), stating their intent to file a citizen suit based on the same or similar theories advanced by the US EPA in the NOV. The Notice of Intent to Sue also named the sale-leaseback owner participants of the Homer City facilities, Homer City's general partner and limited partner, and two prior owners of the Homer City facilities.

Background

In June 2008, Homer City received an NOV from the US EPA alleging that, beginning in 1988, Homer City (or former owners of the Homer City facilities) performed repair or replacement projects at Homer City Units 1 and 2 without first obtaining construction permits as required by the PSD requirements of the CAA. The US EPA also alleges that Homer City has failed to file timely and complete Title V permits. The NOV does not specify the penalties or other relief that the US EPA seeks for the alleged violations. On June 30, 2009 and January 2, 2010, the US EPA issued requests for information to Homer City under Section 114 of the CAA. Homer City is working on a response to the requests. Homer City has met with the US EPA and has expressed its intent to explore the possibility of a settlement. If no settlement is reached and the U.S. Department of Justice files suit, litigation could take many years to resolve the issues alleged in the NOV. EME cannot predict the outcome of this matter or estimate the impact on its facilities, its results of operations, financial position or cash flows.

Homer City has sought indemnification for liability and defense costs associated with the NOV from the sellers under the asset purchase agreement pursuant to which Homer City acquired the Homer City facilities. The sellers responded by denying the indemnity obligation, but accepting a portion of defense costs related to the claims.

Homer City notified the sale-leaseback owner participants of the Homer City facilities of the NOV under the operative indemnity provisions of the sale-leaseback documents. The owner participants of the Homer City facilities, in turn, sought indemnification and defense from Homer City for costs and liabilities associated with the Homer City NOV. Homer City responded by recognizing its indemnity obligation and defense of the claims on terms consistent with its contractual obligations.

Environmental Remediation

Because EME does not own or operate any assets, other than the stock of its subsidiaries, it does not have any direct environmental obligations or liabilities. However, legislative and regulatory activities by federal, state, and local authorities in the United States relating to energy and the environment impose numerous restrictions and requirements with respect to the operation of EME's existing facilities and affect the timing, cost, location, design, construction, and operation of new facilities by EME's subsidiaries, as well as the cost of mitigating the environmental impacts of past operations. The facilities of EME's subsidiaries which are most affected by environmental regulation are located in Illinois and Pennsylvania.

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With respect to potential liabilities arising under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, commonly referred to as CERCLA, or similar laws for the investigation and remediation of contaminated property, EME accrues a liability to the extent the costs are probable and can be reasonably estimated. Midwest Generation had accrued approximately \$4 million at September 30, 2010 for estimated environmental investigation and remediation costs for the Midwest Generation plants. This estimate is based upon the number of sites, the scope of work and the estimated costs for investigation and/or remediation where such expenditures can be reasonably estimated. Future estimated costs may vary based on changes in regulations or requirements of federal, state, or local governmental agencies, changes in technology, and actual costs of disposal. In addition, future remediation costs will be affected by the nature and extent of contamination discovered at the sites that requires remediation. Given the prior history of the operations at its facilities, EME cannot be certain that the existence or extent of all contamination at its sites has been fully identified. However, based on available information, management believes that future remediation costs in excess of the amounts disclosed on all known and quantifiable environmental contingencies will not be material to EME's financial position.

Environmental Developments

Midwest Generation Environmental Compliance Plans and Costs

During the third quarter of 2010, Midwest Generation continued its permitting and planning activities for NO_x and SO₂ controls to meet the requirements of the CPS. Midwest Generation has received all necessary permits from the Illinois EPA allowing the installation of selective non-catalytic reduction (SNCR) technology on multiple units to meet the NO_x portion of the CPS, and is engaged with the Illinois EPA with respect to permitting the installation of equipment to meet required reductions for SO₂.

Work continued on the possible use of flue gas desulfurization (FGD) technology using dry scrubbing with sodium-based sorbents as a method to comply with the SO₂ portion of the CPS. Testing of this technology demonstrated significant reductions in SO₂ emissions when using the type of coal used by Midwest Generation. Use of this technology in combination with the type of coal employed by Midwest Generation is expected to require substantially less capital and installation time than the spray dryer absorber technology originally contemplated, but would likely result in higher ongoing operating costs and may consequently result in lower dispatch rates and competitiveness of Midwest Generation's plants, depending on competitors' costs. Also, the use of dry scrubbing with sodium-based sorbents to meet environmental regulations will likely require Midwest Generation to incur the costs of upgrading its particulate removal systems.

Based on the work to date, Midwest Generation estimates the cost of retrofitting all units, using dry scrubbing with sodium-based sorbents to comply with CPS requirements for SO₂ emissions, and associated upgrading of particulate removal systems, would be approximately \$1.2 billion in 2010 dollars. If completed, these expenditures would be incurred over multiple years.

Decisions regarding whether or not to proceed with the above projects or other approaches to compliance remain subject to a number of factors, such as market conditions, regulatory and legislative developments, and forecasted commodity prices and capital and operating costs applicable at the time decisions are required or made. Midwest Generation could also elect to shut down units, instead of installing controls, to be in compliance with the CPS. Therefore, decisions about any particular combination of retrofits and shutdowns it may ultimately employ also remain subject to conditions applicable at the time decisions are required or made. Due to existing uncertainties about these factors, Midwest Generation may defer final decisions about particular units for the maximum time available.

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Accordingly, final decisions on whether to install controls, to install particular kinds of controls, and to actually expend capital that is budgeted may not occur until 2012 for some of the units and potentially later for others.

Homer City Environmental Issues and Capital Resource Limitations

Homer City operates selective catalytic reduction equipment on all three units to reduce NO_x emissions, operates FGD equipment on Unit 3 to reduce SO₂ emissions, and uses coal-cleaning equipment on site to reduce the ash and sulfur content of raw coal to meet both combustion and environmental requirements. Homer City may be required to install additional environmental equipment on Unit 1 and Unit 2 to comply with environmental regulations for future operations. For further information, see "Transport Rule" and "Homer City New Source Review Notice of Violation." Restrictions under the agreements entered into as part of Homer City's 2001 sale-leaseback transaction could affect, and in some cases significantly limit or prohibit, Homer City's ability to incur indebtedness or make capital expenditures. Homer City will have limited ability to obtain additional outside capital for such projects without amending its lease and related agreements. EME is under no contractual obligation to provide funding to Homer City.

Climate Change

In June 2010, the US EPA finalized the PSD and Title V GHG tailoring rule. The effective date of the final rule is August 2, 2010. The emissions thresholds for carbon dioxide equivalents in the final rule are as follows:

January - June 2011	75,000 tons per year for new and modified sources already subject to PSD for pollutants other than GHGs
July 2011 - June 2013	100,000 tons per year for new sources, and 75,000 tons per year for modified sources

Numerous legal challenges to the GHG tailoring rule have been filed. As written, the rule applies to all sources meeting the thresholds that are built or modified after January 1, 2011. If controls are required to be installed at the facilities of EME's subsidiaries in the future in order to reduce GHG emissions pursuant to regulations issued by the US EPA or others, the potential impact will depend on the nature of the controls applied, which remains uncertain.

Transport Rule

In July 2010, the US EPA issued a Notice of Proposed Rulemaking for a proposed rule, known as the Transport Rule, which would require 31 eastern states (including Pennsylvania and Illinois) and the District of Columbia to reduce power plant emissions of NO_x and SO₂ substantially, starting in 2012, with additional reductions in 2014. The Transport Rule would replace the Clean Air Interstate Rule, which had been remanded to the US EPA in 2008 for revision.

The US EPA has proposed three possible approaches to emissions allowance trading. Under its preferred approach, a pollution limit would be set for each state, intrastate trading would be permitted among power plants, and limited interstate trading would also be permitted consistent with the requirement that each state meet its own pollution control obligations. Under the first alternative, a pollution limit would be set for each state, and only intrastate trading of allowances would be permitted. Under the second alternative, a pollution limit would be set for each state, an emissions

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limit would be set for each power plant, and limited emissions averaging would be permitted among affected units.

Under the Transport Rule, each covered state would initially be subject to a federal implementation plan designed to reduce pollution that significantly contributed to nonattainment of, or interferes with the maintenance of, NAAQS in other states. States would be able to choose to develop state implementation plans to replace the federal implementation plans.

The Transport Rule is scheduled to be finalized in 2011. The Clean Air Interstate Rule will remain in place until that time. EME believes that the US EPA's preferred approach to emissions allowance trading would provide allowance allocations which are adequate for the Midwest Generation plants based on projected emissions using the Illinois CPS allowable emission rates. If adopted as proposed, the Transport Rule may require the installation of additional environmental equipment to reduce SO₂ emissions at Units 1 and 2 of the Homer City facilities.

National Ambient Air Quality Standard for Sulfur Dioxide

In June 2010, the US EPA finalized the primary NAAQS for SO₂ by establishing a new one-hour standard at a level of 75 parts per billion. The final standard is in line with EME's expectations and is being taken into account in EME's environmental compliance strategy. Revisions to state implementation plans to achieve compliance with the new standard are due to be submitted to the US EPA by February 2014. The US EPA anticipates that the deadline for attainment with the SO₂ NAAQS will be August 2017 (five years after the US EPA intends to finalize initial determinations as to the areas of the country that are and are not in attainment with the primary SO₂ NAAQS).

Hazardous Substances and Hazardous Waste Laws

In June 2010, the US EPA published proposed regulations relating to coal combustion wastes. Two different proposed approaches are under consideration. The first approach, under which the US EPA would list these wastes as special wastes subject to regulation under Subtitle C of the Resource Conservation and Recovery Act (the section for hazardous wastes), could require EME to incur additional capital and operating costs. The second approach, under which the US EPA would regulate these wastes under Subtitle D of the Resource Conservation and Recovery Act (the section for nonhazardous wastes), is substantially similar to the requirements of existing regulations. Comments on the proposed regulations are due November 19, 2010.

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(in millions)	Nine Months Ended	
	2010	2009
Cash paid (received)		
Interest (net of amount capitalized ¹)	\$ 145	\$ 154
Income taxes	(100)	(124)
Cash payments under plant operating leases	280	293
Non-cash activities from consolidation of variable interest entity		
Assets	\$ 94	\$
Liabilities		