DYNEGY HOLDINGS INC
Form 10-Q
November 09, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

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

For the transition period from ________ to ________

DYNEGY INC.
DYNEGY HOLDINGS INC.
(Exact name of registrant as specified in its charter)

Entity	Commission File Number	State of Incorporation	I.R.S. Employer Identification No.
Dynegy Inc.	001-33443	Delaware	20-5653152
Dynegy Holdings Inc.	000-29311	Delaware	94-3248415

1000 Louisiana, Suite 5800 Houston, Texas (Address of principal executive offices)	77002 (Zip Code)

(713) 507-6400
(Registrant's telephone number, including area code)

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 subject to such filing requirements for the past 90 days.

Dynegy Inc.	Yes x No o
Dynegy Holdings Inc.	Yes x No o

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).

Dynegy Inc.	Yes x No o
Dynegy Holdings Inc.	Yes o No o

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 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 (Do not check if a smaller reporting company)	Smaller reporting company
Dynegy Inc.	x	o	o	o
Dynegy Holdings Inc.	o	o	x	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Dynegy Inc.	Yes o No x
Dynegy Holdings Inc.	Yes o No x

Indicate the number of shares outstanding of Dynegy Inc.'s class of common stock, as of the latest practicable date: Common stock, $0.01 par value per share, 120,894,257 shares outstanding as of November 1, 2010. All of Dynegy Holdings Inc.'s outstanding common stock is owned by Dynegy Inc.

This combined Form 10-Q is separately filed by Dynegy Inc. and Dynegy Holdings Inc. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information relating to a registrant other than itself.

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DYNEGY INC. and DYNEGY HOLDINGS INC.

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EXPLANATORY NOTE

This report includes the combined filing of Dynegy Inc. (“Dynegy”) and Dynegy Holdings Inc. (“DHI”). DHI is the principal subsidiary of Dynegy, providing nearly 100 percent of Dynegy’s total consolidated revenue for the nine-month period ended September 30, 2010 and constituting nearly 100 percent of Dynegy’s total consolidated asset base as of September 30, 2010. Unless the context indicates otherwise, throughout this report, the terms “the Company,” “we,” “us,” “our” and “ours” are used to refer to both Dynegy and DHI and their direct and indirect subsidiaries. Discussions or areas of this report that apply only to Dynegy or DHI are clearly noted in such section.

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DEFINITIONS

As used in this Form 10-Q, the abbreviations contained herein have the meanings set forth below.

ASU	Accounting Standard Update
BACT	Best available control technology
BART	Best available retrofit technology
BTA	Best technology available
CAISO	The California Independent System Operator
CAA	Clean Air Act
CCR	Coal combustion residuals
CO2	Carbon Dioxide
DHI	Dynegy Holdings Inc.
DMSLP	Dynegy Midstream Services L.P.
DOJ	U.S. Department of Justice
EPA	Environmental Protection Agency
FERC	Federal Energy Regulatory Commission
FTC	Federal Trade Commission
GAAP	Generally Accepted Accounting Principles of the United States of America
GEN	Our power generation business
GEN-MW	Our power generation business - Midwest segment
GEN-NE	Our power generation business - Northeast segment
GEN-WE	Our power generation business - West segment
GHG	Greenhouse Gas
ISO	Independent System Operator
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	One million British thermal units
MW	Megawatts
MWh	Megawatt hour
NPDES	National Pollutant Discharge Elimination System
NRG	NRG Energy, Inc.
NYSDEC	New York State Department of Environmental Conservation
OAL	Office of Administrative Law
OTC	Over-the-counter
PJM	PJM Interconnection, LLC
PPEA	Plum Point Energy Associates, LLC
PSD	Prevention of significant deterioration
RACT	Reasonably available control technology
RCRA	Resource Conservation and Recovery Act
RMR	Reliability Must Run
SC Services	Sandy Creek Services LLC
SCH	Sandy Creek Holdings LLC
SEC	U.S. Securities and Exchange Commission
SPDES	State Pollutant Discharge Elimination System
VaR	Value at Risk
VIE	Variable Interest Entity

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PART I. FINANCIAL INFORMATION

Item 1—FINANCIAL STATEMENTS—DYNEGY INC. AND DYNEGY HOLDINGS INC.

DYNEGY INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited) (in millions, except share data)

	September 30, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 491	$ 471
Restricted cash and investments	119	78
Short-term investments	182	9
Accounts receivable, net of allowance for doubtful accounts of $33 and $22, respectively	202	212
Accounts receivable, affiliates	1	2
Inventory	121	141
Assets from risk-management activities	1,691	713
Deferred income taxes	25	6
Broker margin account	36	286
Prepayments and other current assets	110	120
Total Current Assets	2,978	2,038
Property, Plant and Equipment	8,653	9,071
Accumulated depreciation	(2,289)	(1,954)
Property, Plant and Equipment, Net	6,364	7,117
Other Assets		
Restricted cash and investments	870	877
Assets from risk-management activities	344	163
Intangible assets	153	380
Other long-term assets	412	378
Total Assets	$ 11,121	$ 10,953
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 180	$ 181
Accounts payable, affiliates	12	—
Accrued interest	110	36
Accrued liabilities and other current liabilities	128	127
Liabilities from risk-management activities	1,548	696
Notes payable and current portion of long-term debt	146	807
Total Current Liabilities	2,124	1,847
Long-term debt	4,461	4,575
Long-term debt, affiliates	200	200
Long-Term Debt	4,661	4,775
Other Liabilities		
Liabilities from risk-management activities	347	213
Deferred income taxes	757	780

Other long-term liabilities	342	359
Total Liabilities	$ 8,231	$ 7,974
Commitments and Contingencies (Note 14)		
Stockholders’ Equity (Note 17)		
Common Stock, $0.01 par value, 420,000,000 shares authorized at September 30, 2010 and December 31, 2009, and 121,444,560 and 120,715,515 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively	1	1
Additional paid-in capital	6,064	6,061
Subscriptions receivable	(2)	(2)
Accumulated other comprehensive loss, net of tax	(70)	(150)
Accumulated deficit	(3,032)	(2,937)
Treasury stock, at cost, 627,655 and 557,677 shares at September 30, 2010 and December 31, 2009, respectively	(71)	(71)
Total Dynegy Inc. Stockholders’ Equity	2,890	2,902
Noncontrolling interests	—	77
Total Stockholders’ Equity	2,890	2,979
Total Liabilities and Stockholders’ Equity	$ 11,121	$ 10,953

See the notes to condensed consolidated financial statements.

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DYNEGY INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited) (in millions, except per share data)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenues	$775	$673	$1,872	$2,027
Cost of sales	(334)	(286)	(873)	(927)
Operating and maintenance expense, exclusive of depreciation shown separately below	(110)	(121)	(341)	(373)
Depreciation and amortization expense	(96)	(83)	(261)	(258)
Goodwill impairments	—	—	—	(433)
Impairment and other charges, exclusive of goodwill impairments shown separately above	(134)	(148)	(135)	(535)
General and administrative expenses	(51)	(42)	(110)	(125)
Operating income (loss)	50	(7)	152	(624)
Earnings (losses) from unconsolidated investments	—	(8)	(34)	13
Interest expense	(92)	(115)	(272)	(311)
Other income and expense, net	1	2	3	10
Loss from continuing operations before income taxes	(41)	(128)	(151)	(912)
Income tax benefit (Note 16)	17	34	80	147
Loss from continuing operations	(24)	(94)	(71)	(765)
Income (loss) from discontinued operations, net of tax benefit of zero, $84, zero and $91, respectively (Note 3)	—	(129)	1	(141)
Net loss	(24)	(223)	(70)	(906)
Less: Net loss attributable to the noncontrolling interests	—	(11)	—	(14)
Net loss attributable to Dynegy Inc.	$(24)	$(212)	$(70)	$(892)
Loss Per Share (Notes 13 and 17):				
Basic loss per share attributable to Dynegy Inc. common stockholders:				
Loss from continuing operations	$(0.20)	$(0.49)	$(0.59)	$(4.47)
Income (loss) from discontinued operations	—	(0.77)	0.01	(0.84)
Basic loss per share attributable to Dynegy Inc. common stockholders	$(0.20)	$(1.26)	$(0.58)	$(5.31)
Diluted loss per share attributable to Dynegy Inc. common stockholders:				
Loss from continuing operations	$(0.20)	$(0.49)	$(0.59)	$(4.47)
Income (loss) from discontinued operations	—	(0.77)	0.01	(0.84)
	$(0.20)	$(1.26)	$(0.58)	$(5.31)

Diluted loss per share attributable to Dynegy Inc. common stockholders				
Basic shares outstanding	120	168	120	168
Diluted shares outstanding	121	169	121	169

See the notes to condensed consolidated financial statements.

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DYNEGY INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited) (in millions)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(70)	$(906)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	273	279
Goodwill impairments	—	433
Impairment and other charges, exclusive of goodwill impairments shown separately above	135	793
(Earnings) losses from unconsolidated investments, net of cash distributions	34	(13)
Risk-management activities	(123)	73
Gain on sale of assets	—	(10)
Deferred income taxes	(79)	(246)
Other	55	66
Changes in working capital:		
Accounts receivable	11	(4)
Inventory	15	(7)
Broker margin account	353	(104)
Prepayments and other assets	7	(30)
Accounts payable and accrued liabilities	111	81
Changes in non-current assets	(51)	(91)
Changes in non-current liabilities	(1)	(10)
Net cash provided by operating activities	670	304
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(270)	(429)
Unconsolidated investments	(15)	1
Proceeds from asset sales, net	—	105
Maturities of short-term investments	152	14
Purchases of short-term investments	(428)	—
Increase in restricted cash and restricted investments	(53)	(35)
Other investing	—	3
Net cash used in investing activities	(614)	(341)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term borrowings, net of financing costs	(5)	75
Repayments of borrowings	(31)	(28)
Net cash used in financing activities	(36)	47
Net increase in cash and cash equivalents	20	10
Cash and cash equivalents, beginning of period	471	693

Cash and cash equivalents, end of period	$491	$703
Other non-cash investing activity:		
Non-cash capital expenditures	$10	$19

See the notes to condensed consolidated financial statements.

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DYNEGY INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(unaudited) (in millions)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009
Net loss	$(24)	$(223)
Cash flow hedging activities, net:		
Unrealized mark-to-market gains arising during period, net	—	45
Reclassification of mark-to-market losses to earnings, net	—	1
Deferred losses on cash flow hedges, net	—	(2)
Changes in cash flow hedging activities, net (net of tax expense of zero and $11, respectively)	—	44
Amortization of unrecognized prior service cost and actuarial gain (loss) (net of tax benefit of zero and $2)	1	(1)
Unconsolidated investments other comprehensive loss, net (net of tax benefit of zero and $3)	—	(3)
Other comprehensive income, net of tax	1	40
Comprehensive loss	(23)	(183)
Less: Comprehensive income attributable to the noncontrolling interests	—	25
Comprehensive loss attributable to Dynegy Inc.	$(23)	$(208)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net loss	$(70)	$(906)
Cash flow hedging activities, net:		
Unrealized mark-to-market gains arising during period, net	—	160
Reclassification of mark-to-market losses to earnings, net	—	1
Deferred losses on cash flow hedges, net	—	(8)
Changes in cash flow hedging activities, net (net of tax benefit (expense) of $1 and ($26), respectively)	—	153
Amortization of unrecognized prior service cost and actuarial gain (net of tax expense of $1 and $3)	3	1
Unconsolidated investments other comprehensive income, net (net of tax expense of $1 and $2)	—	3
Other comprehensive income, net of tax	3	157
Comprehensive loss	(67)	(749)
Less: Comprehensive income attributable to the noncontrolling interests	—	107
Comprehensive loss attributable to Dynegy Inc.	$(67)	$(856)

See the notes to condensed consolidated financial statements.

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DYNEGY HOLDINGS INC.
CONDENSED CONSOLIDATED BALANCE SHEET
(unaudited) (in millions)

	September 30, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 457	$ 419
Restricted cash and investments	119	78
Short-term investments	163	8
Accounts receivable, net of allowance for doubtful accounts of $14 and $20, respectively	201	214
Accounts receivable, affiliates	1	2
Inventory	121	141
Assets from risk-management activities	1,691	713
Deferred income taxes	23	7
Broker margin account	36	286
Prepayments and other current assets	110	120
Total Current Assets	2,922	1,988
Property, Plant and Equipment	8,653	9,071
Accumulated depreciation	(2,289)	(1,954)
Property, Plant and Equipment, Net	6,364	7,117
Other Assets		
Restricted cash and investments	870	877
Assets from risk-management activities	344	163
Intangible assets	153	380
Other long-term assets	412	378
Total Assets	$ 11,065	$ 10,903
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 180	$ 181
Accounts payable, affiliates	12	—
Accrued interest	110	36
Accrued liabilities and other current liabilities	124	128
Liabilities from risk-management activities	1,548	696
Notes payable and current portion of long-term debt	146	807
Total Current Liabilities	2,120	1,848
Long-term debt	4,461	4,575
Long-term debt, affiliates	200	200
Long-Term Debt	4,661	4,775
Other Liabilities		
Liabilities from risk-management activities	347	213
Deferred income taxes	686	704
Other long-term liabilities	342	360
Total Liabilities	8,156	7,900
Commitments and Contingencies (Note 14)		
Stockholders' Equity		

Capital Stock, $1 par value, 1,000 shares authorized at September 30, 2010 and December 31, 2009	—	—
Additional paid-in capital	5,135	5,135
Affiliate receivable	(774)	(777)
Accumulated other comprehensive loss, net of tax	(70)	(150)
Accumulated deficit	(1,382)	(1,282)
Total Dynegy Holdings Inc. Stockholder's Equity	2,909	2,926
Noncontrolling interests	—	77
Total Stockholders' Equity	2,909	3,003
Total Liabilities and Stockholders' Equity	$ 11,065	$ 10,903

See the notes to condensed consolidated financial statements.

DYNEGY HOLDINGS INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited) (in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues	$775	$673	$1,872	$2,027
Cost of sales	(334)	(286)	(873)	(927)
Operating and maintenance expense, exclusive of depreciation shown separately below	(110)	(121)	(341)	(375)
Depreciation and amortization expense	(96)	(83)	(261)	(258)
Goodwill impairments	—	—	—	(433)
Impairment and other charges, exclusive of goodwill impairments shown separately above	(134)	(148)	(135)	(535)
General and administrative expenses	(47)	(42)	(106)	(125)
Operating income (loss)	54	(7)	156	(626)
Earnings (losses) from unconsolidated investments	—	(8)	(34)	12
Interest expense	(92)	(115)	(272)	(311)
Other income and expense, net	1	2	3	9
Loss from continuing operations before income taxes	(37)	(128)	(147)	(916)
Income tax benefit (Note 16)	15	35	71	152
Loss from continuing operations	(22)	(93)	(76)	(764)
Income (loss) from discontinued operations, net of tax benefit of zero, $74, zero and $91, respectively (Note 3)	—	(139)	1	(141)
Net loss	(22)	(232)	(75)	(905)
Less: Net loss attributable to the noncontrolling interests	—	(11)	—	(14)
Net loss attributable to Dynegy Holdings Inc.	$(22)	$(221)	$(75)	$(891)

See the notes to condensed consolidated financial statements.

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DYNEGY HOLDINGS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited) (in millions)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(75)	$(905)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	273	279
Goodwill impairments	—	433
Impairment and other charges, exclusive of goodwill impairments shown separately above	135	793
(Earnings) losses from unconsolidated investments, net of cash distributions	34	(12)
Risk-management activities	(123)	73
Gain on sale of assets, net	—	(10)
Deferred income taxes	(69)	(248)
Other	51	64
Changes in working capital:		
Accounts receivable	14	(4)
Inventory	15	(7)
Broker margin account	353	(104)
Prepayments and other assets	7	(30)
Accounts payable and accrued liabilities	108	100
Changes in non-current assets	(51)	(91)
Changes in non-current liabilities	(2)	(9)
Net cash provided by operating activities	670	322
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(270)	(429)
Unconsolidated investments	(15)	—
Proceeds from asset sales, net	—	105
Maturities of short-term investments	149	13
Purchases of short-term investments	(406)	—
Increase in restricted cash and restricted investments	(53)	(35)
Affiliate transactions	(1)	(2)
Other investing	—	3
Net cash used in investing activities	(596)	(345)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term borrowings, net of financing costs	(5)	75
Repayments of borrowings	(31)	(28)
Dividend to affiliate	—	(175)
Net cash used in financing activities	(36)	(128)

Net increase (decrease) in cash and cash equivalents	38	(151)
Cash and cash equivalents, beginning of period	419	670
Cash and cash equivalents, end of period	$457	$519
Other non-cash investing activity:		
Non-cash capital expenditures	$10	$19

See the notes to condensed consolidated financial statements.

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DYNEGY HOLDINGS INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(unaudited) (in millions)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009
Net loss	$(22)	$(232)
Cash flow hedging activities, net:		
Unrealized mark-to-market gains arising during period, net	—	45
Reclassification of mark-to-market losses to earnings, net	—	1
Deferred losses on cash flow hedges, net	—	(2)
Changes in cash flow hedging activities, net (net of tax expense of zero and $11, respectively)	—	44
Amortization of unrecognized prior service cost and actuarial gain (loss) (net of tax expense of zero and $2)	1	(1)
Unconsolidated investments other comprehensive loss, net (net of tax benefit of zero and $3)	—	(3)
Other comprehensive income, net of tax	1	40
Comprehensive loss	(21)	(192)
Less: Comprehensive income attributable to the noncontrolling interests	—	25
Comprehensive loss attributable to Dynegy Holdings Inc.	$(21)	$(217)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net loss	$(75)	$(905)
Cash flow hedging activities, net:		
Unrealized mark-to-market gains arising during period, net	—	160
Reclassification of mark-to-market losses to earnings, net	—	1
Deferred losses on cash flow hedges, net	—	(8)
Changes in cash flow hedging activities, net (net of tax benefit (expense) of $1 and ($26), respectively)	—	153
Amortization of unrecognized prior service cost and actuarial gain (net of tax expense of $2 and $3)	2	1
Unconsolidated investments other comprehensive income, net (net of tax expense of $1 and $2)	—	3
Other comprehensive income, net of tax	2	157
Comprehensive loss	(73)	(748)
Less: Comprehensive income attributable to the noncontrolling interests	—	107

Comprehensive loss attributable to Dynegy Holdings Inc.	$(73)	$(855)

See the notes to condensed consolidated financial statements.

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DYNEGY INC. and DYNEGY HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

Note 1—Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to interim financial reporting as prescribed by the SEC. These interim financial statements do not include all disclosures required by accounting principles generally accepted in the United States of America. These interim financial statements should be read together with the consolidated financial statements and notes thereto included in Dynegy's and DHI's Form 10-K for the year ended December 31, 2009 filed on February 25, 2010, which we refer to as each registrant's "Form 10-K".

The December 31, 2009 condensed consolidated balance sheet data was derived from audited consolidated financial statements, as adjusted for the 1-for-5 reverse stock split of Dynegy's common stock that became effective on May 25, 2010. Please read Note 17—Capital Stock for further discussion.

The unaudited condensed consolidated financial statements contained in this report include all material adjustments of a normal and recurring nature that, in the opinion of management, are necessary for a fair statement of the results for the interim periods. The results of operations for the interim periods presented in this Form 10-Q are not necessarily indicative of the results to be expected for the full year or any other interim period due to seasonal fluctuations in demand for our energy products and services, changes in commodity prices, timing of maintenance and other expenditures and other factors. The preparation of the unaudited condensed consolidated financial statements in conformity with GAAP requires management to make informed estimates and judgments that affect our reported financial position and results of operations. These estimates and judgments also impact the nature and extent of disclosure, if any, of our contingent liabilities based on currently available information. We review significant estimates and judgments affecting our consolidated financial statements on a recurring basis and record the effect of any necessary adjustments. Uncertainties with respect to such estimates and judgments are inherent in the preparation of financial statements. Estimates and judgments are used in, among other things, (i) developing fair value assumptions, including estimates of future cash flows and discount rates, (ii) analyzing tangible and intangible assets for possible impairment, (iii) estimating the useful lives of our assets, (iv) assessing future tax exposure and the realization of tax assets, (v) determining amounts to accrue for contingencies, guarantees and indemnifications, (vi) estimating various factors used to value our pension assets and liabilities and (vii) determining the primary beneficiary of certain VIEs from a set of related parties. Actual results could differ materially from any such estimates. Certain reclassifications have been made to prior period amounts in order to conform to current year presentation.

Short-Term Investments. Short-term investments consist of highly liquid investments, primarily U.S. Treasury, U.S. Agency and corporate debt securities, with original maturities over three months from the date of purchase. Our investment policy restricts investments to high credit quality investments with limits on the length to maturity and the amount invested with any one issuer. Debt securities which we have the ability and positive intent to hold to maturity are carried at amortized cost, net of unamortized premiums and unaccreted discounts, which approximates fair value. At September 30, 2010, we did not hold any short-term investments that were classified as held-to-maturity.

Debt securities not held-to-maturity are classified as available for sale and are recorded at fair value. Unrealized gains and losses, after applicable taxes, resulting from changes in fair value are recorded as a component of Other comprehensive loss.

Declines in the value of individual equity securities that are considered other than temporary result in write-downs to the individual securities to their fair value and the write-downs are included in the condensed consolidated statements of operations. Declines in debt securities held-to-maturity and available for sale, that are considered other than temporary, result in write-downs when it is more likely than not that we will sell the securities before we recover our cost. If we do not intend to sell an impaired debt security but do not expect to recover its cost, we determine whether a credit loss exists, and if so, the credit loss is recognized in the condensed consolidated statements of operations and any remaining impairment is recognized in Other comprehensive loss. The review for other-than-temporary declines considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and our intent and ability to retain the investment for a period of time sufficient to allow for recovery.

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DYNEGY INC. and DYNEGY HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

We consider all available for sale securities, including those with maturity dates beyond twelve months, as available to support current operational liquidity needs and therefore classify these securities as short-term investments within current assets on the consolidated balance sheets. As of September 30, 2010, Dynegy and DHI held $286 million and $267 million, respectively, of available for sale securities with maturity dates within one year. Of these amounts, $104 million is included in the Broker margin account on our unaudited condensed consolidated balance sheets.

Interest on securities, including the amortization of premiums and the accretion of discounts, is reported in Other income and expense, net using the interest method over the lives of the securities, adjusted for actual prepayments. Gains and losses on the sale of securities are recorded on the trade date and recognized using the specific identification method and reported in Other income and expense, net.

Change in Accounting Estimate. In accordance with our policy, we review fixed assets for known facts that potentially would impact their estimated useful lives. Based on events occurring in September 2010, we determined that it is not currently economical to continue to operate our Vermilion facility for the remainder of its estimated useful life. As a result, effective September 1, 2010, we changed our estimate of the useful life of this facility to better reflect the estimated periods during which we expect the asset will remain in service. The facility's previously estimated remaining useful life of 15 years was decreased to 8 months. The effect of this change in estimate was to increase depreciation expense by approximately $13 million ($8 million net of tax), or $0.07 per share (basic and diluted), for the three and nine months ended September 30, 2010.

Accounting Principle Adopted

Variable Interest Entities. On January 1, 2010, we adopted Accounting Standards Update ("ASU") No. 2009-17—Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities ("ASU No. 2009-17"). This guidance replaces the previous quantitative-based analysis for determining the primary beneficiary of a variable interest entity with a framework that is based on qualitative judgments. The new guidance identifies the primary beneficiary of a variable interest entity as the party that both: (i) has the power to direct the activities of a variable interest entity that most significantly impact its economic performance and (ii) has an obligation to absorb losses or a right to receive benefits that could potentially be significant to the variable interest entity. As a result of applying this guidance, we have determined that we are not the primary beneficiary of PPEA Holding Company, LLC ("PPEA Holding") because we lack the power to direct the activities that most significantly impact PPEA Holding's economic performance. The activities that most significantly impact PPEA Holding's economic performance are changes to the costs to construct and operate the facility, modifications to the off-take agreements, and/or changes in the financing structure. As PPEA Holding's LLC Agreement currently requires that those activities be approved by all members, the power to direct these activities is shared with the other owners of PPEA Holding and the participants in the 665 MW coal-fired power generation facility (the "Plum Point Project"). We have historically consolidated PPEA Holding in our consolidated financial statements. On September 14, 2010, we entered into an agreement to sell our interest in PPEA Holding. Please read Note 10—Variable Interest Entities—PPEA Holding Company LLC for further discussion.

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The adoption of ASU No. 2009-17 resulted in a deconsolidation of our investment in PPEA Holding, which resulted in the cumulative effect of a change in accounting principle of approximately $41 million ($25 million after tax), which was recorded as an increase in Accumulated deficit on our unaudited condensed consolidated balance sheets as of January 1, 2010. This pre-tax charge reflects the difference in the assets, liabilities and equity (including Other comprehensive loss) that we have historically included in our consolidated balance sheets and the carrying value of the equity investment and related accumulated other comprehensive loss that we would have recorded had we accounted for our investment in PPEA Holding as an equity method investment since April 2, 2007, the date we acquired an interest in PPEA Holding. On January 1, 2010, we recorded an equity investment of approximately $19 million and accumulated other comprehensive loss of approximately $29 million ($17 million after tax). The $19 million equity investment balance at January 1, 2010 reflects the fair value of our investment at that date, after an other than temporary pre-tax impairment charge of approximately $32 million that would have been recorded in 2009 had we accounted for our investment in PPEA Holding as an equity investment at that time. Our assessment of the fair value of our investment in PPEA Holding at January 1, 2010 reflects the risk associated with PPEA Holding's financing arrangement at that date. Please read Note 7— Fair Value Measurements for further discussion about the assumptions used to determine the fair value of our investment as of January 1, 2010. Please read Note 17—Debt—Plum Point (including PPEA Credit Agreement Facility and PPEA Tax Exempt Bonds) and Note 14—Variable Interest Entities—PPEA Holding Company, LLC in our Form 10-K for further discussion. Summarized aggregate financial information for PPEA Holding, included in our December 31, 2009 consolidated balance sheets, is included below (in millions):

Current assets	$6
Property, plant and equipment, net	611
Intangible asset	190
Other non-current asset	20
Total assets	827
Current portion of long-term debt	744
Current liabilities	74
Noncontrolling interest	77
Accumulated other comprehensive loss	(157)

The adoption of ASU No. 2009-17 had no impact on our investment in the Hydroelectric Generation Facilities, which we sold in the third quarter of 2010. Please read Note 10—Variable Interest Entities—Hydroelectric Generation Facilities for further discussion.

Disclosures about Fair Value Measurements. On January 1, 2010, we adopted ASU No. 2010-06—Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. Please read Note 7—Fair Value Measurements for further discussion.

Note 2—Proposed Blackstone Merger and NRG Sale

On August 13, 2010, Dynegy entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Denali Parent Inc., a Delaware corporation (“Parent”), and Denali Merger Sub Inc., a Delaware corporation and a wholly owned subsidiary of Parent (“Merger Sub”), providing for the merger of Merger Sub with and into Dynegy (the “Blackstone Merger”). Both Parent and Merger Sub are affiliates of The Blackstone Group L.P. (“Blackstone”). In the Blackstone Merger, each outstanding share of Dynegy common stock (except for shares owned by Parent, Merger Sub, Dynegy and their respective wholly owned subsidiaries and not held on behalf of third parties, and shares owned by stockholders who have properly demanded appraisal rights under applicable law) will be converted into the right to receive $4.50 in cash, without interest, less any applicable withholding taxes. Dynegy will be the surviving corporation in the Blackstone Merger and will continue to do business following the Blackstone Merger. As a result of the Blackstone Merger, Dynegy will cease to be a publicly traded company.

Concurrently with the execution of the Merger Agreement, Merger Sub entered into a Purchase and Sale Agreement (the “NRG PSA”) with NRG Energy, Inc., a Delaware corporation (“NRG”), pursuant to which NRG will, simultaneously with the closing of the Blackstone Merger, acquire the Casco Bay, Moss Landing, Morro Bay and Oakland power generation facilities and related assets currently owned by us for cash consideration of approximately $1.36 billion (the “NRG Sale”). The completion of the Blackstone Merger between Dynegy and Merger Sub is contingent upon the concurrent closing of the NRG Sale. The NRG Sale will not occur if the Blackstone Merger is not consummated.

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The respective obligations of Dynegy, Parent and Merger Sub to consummate the Blackstone Merger are subject to the satisfaction or waiver of certain customary conditions, including the adoption of the Merger Agreement by Dynegy's stockholders, receipt of required regulatory approvals, the absence of any legal prohibitions, the accuracy of the representations and warranties of the parties and compliance by the parties with their respective obligations under the Merger Agreement. Parent's and Merger Sub's obligations to consummate the Blackstone Merger are also subject to the satisfaction or waiver of the conditions to the obligations of NRG and Merger Sub to effect the NRG Sale under the NRG PSA (other than those conditions that by their nature are to be satisfied at the closing of the NRG Sale, and the condition relating to the consummation of the Blackstone Merger) and to NRG being ready, willing and able to complete the NRG Sale.

Under the Merger Agreement, between the date thereof and the effective time of the Blackstone Merger, Dynegy has agreed, subject to certain exceptions in the Merger Agreement and the disclosure schedules Dynegy delivered in connection with the Merger Agreement, to conduct the businesses of Dynegy and its subsidiaries, in the ordinary course and has also agreed to certain customary negative covenants, including but not limited to limitations on our ability to incur indebtedness, issue letters of credit, issue equity interests, make acquisitions or dispositions and sell or purchase derivative products or commodities.

Under specified circumstances, Dynegy, Parent or Merger Sub may have the right to terminate the Merger Agreement, or NRG or Merger Sub may have the right to terminate the NRG PSA. In the event of a termination of the Merger Agreement and under specified circumstances, Dynegy may be required to pay to Parent a fee of up to $50 million in the aggregate (including any expenses of Parent, Merger Sub and their respective affiliates previously reimbursed by Dynegy) with respect to the termination of the Merger Agreement, or Dynegy may be required to reimburse Parent, Merger Sub and their affiliates for documented out-of-pocket expense up to $10 million, as applicable. Under other specified circumstances, Parent may be obligated to pay Dynegy a $100 million fee less the sum of certain expense reimbursement and indemnification amounts paid by Parent in connection with certain financial and third party investment activities and/or 50 percent of certain negotiated amounts Merger Sub or any of its affiliates receive from NRG in connection with a termination of the NRG PSA or a failure of the NRG Sale to be consummated.

NRG is an intended third party beneficiary of the Merger Agreement. NRG has the right to enforce the rights and obligations of Parent, Merger Sub and Dynegy to the extent such rights and obligations directly relate to the assets it is acquiring, and the liabilities it is assuming, in the NRG Sale. No party to the Merger Agreement may amend or waive any condition thereunder if such waiver or amendment would be adverse to NRG as a third party beneficiary in any material respect without NRG's consent.

Dynegy is an intended third party beneficiary of the NRG PSA. Dynegy has the right of enforcement in respect of Merger Sub's and NRG's obligations under the NRG PSA. No party to the NRG PSA may amend, supplement or otherwise modify the NRG PSA in a manner adverse to Dynegy as a third party beneficiary in any material respect without Dynegy's consent.

The DOJ and the FTC granted early termination of the waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, applicable to the Blackstone Merger and NRG Sale on September 7, 2010 and September 8, 2010, respectively. Further, on October 29, 2010, FERC approved the joint applications related to the Blackstone Merger and NRG Sale. Assuming receipt of the remaining required regulatory approvals and timely satisfaction of other closing conditions, including the approval by Dynegy stockholders of the proposal to adopt the Merger Agreement for which a special meeting of stockholders is scheduled for November 17, 2010, we anticipate that the Blackstone Merger will be completed by the end of November 2010. We cannot assure you that the conditions to the Blackstone Merger will be satisfied or that the Blackstone Merger will be consummated on the terms agreed, if at all.

At the signing of the Merger Agreement and NRG PSA, on August 13, 2010 there was an expectation that it is more likely than not the facilities subject to the NRG PSA will be disposed of before the end of their previously estimated useful lives, requiring us to perform an impairment analysis. Based on the terms of the NRG PSA and the recent impairment analysis of the impact of such agreement on the recoverability of the carrying value of our long-lived assets, we recorded a pre-tax impairment charge of $134 million during the third quarter 2010 to reduce the carrying value of our Casco Bay facility and related assets to its fair value. After giving effect to this impairment charge, the carrying value of the net assets to be sold will exceed the expected sales price by approximately $180 million. However, if the Merger Agreement is completed, the carrying value of the assets to be sold to NRG will be adjusted to reflect their fair value in purchase accounting for the Merger Agreement, and we would not record additional losses or impairment charges related to the NRG Sale. Actual losses and impairment charges recorded could differ materially from these estimates based on various factors, including failure to satisfy closing conditions, changes to working capital adjustments and additional costs incurred in connection with the NRG Sale. Please read Note 8—Impairment Charges for further discussion of these impairments.

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Upon closing of the Blackstone Merger, the change in ownership of Dynegy's stock may impact our ability to fully utilize our federal net operating loss carry forwards ("NOLs") and our alternative minimum tax credits ("AMT") under Sections 382 and 383 of the Internal Revenue Code. As a result, if the proposed Blackstone Merger closes, we may be required to record a valuation allowance with respect to certain of our deferred tax assets. At September 30, 2010, our net operating loss deferred tax asset attributable to our previously incurred federal NOLs was approximately $98 million and $77 million, for Dynegy and DHI, respectively.

Note 3—Dispositions and Discontinued Operations

Dispositions

LS Power Transactions. We consummated our transactions (the "LS Power Transactions") with LS Power Partners, L.P. and certain of its affiliates ("LS Power") in two parts, with the issuance of $235 million of notes by DHI on December 1, 2009, and the remainder of the transactions closing on November 30, 2009. Please read Note 4—Dispositions, Contract Terminations and Discontinued Operations—Dispositions and Contract Terminations in our Form 10-K for further discussion of these transactions.

Discontinued Operations

Arlington Valley, Griffith and Bluegrass. On November 30, 2009, we completed the sale of our interests in the Arlington Valley and Griffith power generation assets (collectively, the "Arizona power generation facilities") and Bluegrass power generation facility as part of the LS Power Transactions.

The Arizona power generation facilities, as well as our Bluegrass facility, met the criteria of held for sale during the third quarter 2009. At that time, we discontinued depreciation and amortization of the Arizona power generation facilities' and Bluegrass' property, plant and equipment. Depreciation and amortization expense related to the Arizona power generation facilities totaled approximately $4 million and $14 million in the three- and nine-month periods ended September 30, 2009, respectively. Depreciation and amortization expense related to Bluegrass totaled approximately zero and $1 million in the three- and nine-month periods ended September 30, 2009, respectively. We recorded an impairment charge of $235 million related to the Arizona power generation facilities during the third quarter 2009. We previously recorded impairment charges of $5 million and $18 million related to the Bluegrass facility during the first and second quarters of 2009, respectively. We are reporting the results of operations for the Arizona power generation facilities and the Bluegrass power generation facility in discontinued operations for all periods presented.

Heard County. On April 30, 2009, we completed the sale of our interest in the Heard County power generation facility for approximately $105 million.

Heard County was classified as held for sale during the first quarter 2009. At that time, we discontinued depreciation and amortization of Heard County's property, plant and equipment. Depreciation and amortization expense related to Heard County totaled zero and $1 million in the three- and nine-month periods ended September 30, 2009, respectively. We are reporting the results of Heard County's operations in discontinued operations for all periods presented.

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(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

Summary. The following table summarizes information related to Dynegy's discontinued operations:

	GEN-MW	GEN-WE (in millions)	Total
Three Months Ended September 30, 2009			
Revenues	$ 1	$ 54	$ 55
Loss from operations before taxes (2)	—	(213)	(213)
Loss from operations after taxes	—	(129)	(129)
Nine Months Ended September 30, 2010			
Revenues	$ —	$ —	$ —
Income from operations before taxes	—	1	1
Income from operations after taxes	—	1	1
Nine Months Ended September 30, 2009			
Revenues	$ 4	$ 96	$ 100
Loss from operations before taxes (1) (2)	(23)	(219)	(242)
Loss from operations after taxes	(14)	(133)	(147)
Gain on sale before taxes	—	10	10
Gain on sale after taxes	—	6	6

(1) Includes $23 million of impairment charges related to our Bluegrass power generation facility.
(2) Includes $235 million of impairment charges related to our Arizona power generation facilities.

Summary. The following table summarizes information related to DHI's discontinued operations:

	GEN-MW	GEN-WE (in millions)	Total
Three Months Ended September 30, 2009			
Revenues	$ 1	$ 54	$ 55
Income (loss) from operations before taxes (2)	—	(213)	(213)
Income (loss) from operations after taxes	—	(139)	(139)
Nine Months Ended September 30, 2010			
Revenues	$ —	$ —	$ —
Income from operations before taxes	—	1	1
Income from operations after taxes	—	1	1
Nine Months Ended September 30, 2009			
Revenues	$ 4	$ 96	$ 100

Loss from operations before taxes (1) (2)	(23)	(219)	(242)
Loss from operations after taxes	(14)	(139)	(153)
Gain on sale before taxes	—	10	10
Gain on sale after taxes	—	12	12

(1) Includes $23 million of impairment charges related to our Bluegrass power generation facility.
(2) Includes $235 million of impairment charges related to our Arizona power generation facilities.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

Note 4—Noncontrolling Interests

On January 1, 2009, we adopted authoritative guidance which requires: (i) ownership interests in subsidiaries held by parties other than the parent to be clearly identified, labeled, and presented in the consolidated statements of financial position within equity, but separate from the parent's equity; (ii) the amount of consolidated net income (loss) attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statements of operations; (iii) changes in a parent's ownership interests that do not result in deconsolidation to be accounted for as equity transactions; and (iv) that a parent recognize a gain or loss in net income upon deconsolidation of a subsidiary, with any retained noncontrolling equity investment in the former subsidiary initially measured at fair value. The following table presents the net loss attributable to Dynegy's and DHI's stockholders:

	Three Months Ended September 30, 2009	
	Dynegy Inc.	Dynegy Holdings Inc.
	(in millions)	
Loss from continuing operations	$ (83)	$ (82)
Loss from discontinued operations, net of tax benefit of $84 and $74, respectively	(129)	(139)
Net loss	$ (212)	$ (221)

	Nine Months Ended September 30, 2009	
	Dynegy Inc.	Dynegy Holdings Inc.
	(in millions)	
Loss from continuing operations	$ (751)	$ (750)
Loss from discontinued operations, net of tax benefit of $91 and $91, respectively	(141)	(141)
Net loss	$ (892)	$ (891)

As a result of the deconsolidation of PPEA Holding, effective January 1, 2010, there are no longer any noncontrolling interests in any of our consolidated subsidiaries, and as a result, no reconciliation is needed for the nine months ended September 30, 2010. The following table presents a reconciliation of the carrying amount of total equity, equity attributable to Dynegy and the equity attributable to the noncontrolling interests at the beginning and the end of the nine months ended September 30, 2009.

	Controlling Interest	Noncontrolling Interests (in millions)	Total
December 31, 2008	$ 4,515	$ (30)	$ 4,485
Net loss	(892)	(14)	(906)
Other comprehensive income (loss), net of tax:			
Unrealized mark-to-market gains arising during period	33	127	160
Reclassification of mark-to-market (gains) losses to earnings	(1)	2	1
Deferred losses on cash flow hedges	—	(8)	(8)
Amortization of unrecognized prior service cost and actuarial gain	1	—	1
Unconsolidated investments other comprehensive income	3	—	3
Total other comprehensive income, net of tax	36	121	157
Other equity activity:			
Options exercised	(1)	—	(1)
Options and restricted stock granted	7	—	7
401(k) plan and profit sharing stock	5	—	5
Board of directors stock compensation	(2)	—	(2)
September 30, 2009	$ 3,668	$ 77	$ 3,745

DYNEGY INC. and DYNEGY HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

As a result of the deconsolidation of PPEA Holding, effective January 1, 2010, there are no longer any noncontrolling interests in any of our consolidated subsidiaries, and as a result, no reconciliation is needed for the nine months ended September 30, 2010. The following table presents a reconciliation of the carrying amount of total equity, equity attributable to DHI and the equity attributable to the noncontrolling interests at the beginning and the end of the nine months ended September 30, 2009.

	Controlling Interest	Noncontrolling Interests (in millions)	Total
December 31, 2008	$ 4,613	$ (30)	$ 4,583
Net loss	(891)	(14)	(905)
Other comprehensive income (loss), net of tax:			
Unrealized mark-to-market gains arising during period	33	127	160
Reclassification of mark-to-market (gains) losses to earnings	(1)	2	1
Deferred losses on cash flow hedges	—	(8)	(8)
Amortization of unrecognized prior service cost and actuarial gain	1	—	1
Unconsolidated investments other comprehensive income	3	—	3
Total other comprehensive income, net of tax	36	121	157
Other equity activity:			
Dividend to Dynegy	(175)	—	(175)
Contribution from Dynegy	36	—	36
Affiliate activity	4	—	4
September 30, 2009	$ 3,623	$ 77	$ 3,700

Note 5—Investments

The amortized cost basis, unrealized gains and losses and fair values of investments in available for sale investments as of September 30, 2010, is shown in the table below:

	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in millions)		
Available for Sale investments:				
Commercial Paper	$20	$—	$—	$20
Certificates of Deposit	16	—	—	16
Corporate Securities	13	—	—	13
U.S. Treasury and Government Securities (1)	218	—	—	218
Total—DHI	$267	$—	$—	$267
Commercial Paper	2	—	—	2
Certificates of Deposit	2	—	—	2
Corporate Securities	5	—	—	5
U.S. Treasury and Government Securities	10	—	—	10
Total—Dynegy	$286	$—	$—	$286

(1) Includes $104 million in Broker margin account on our consolidated balance sheets in support of transactions with our futures clearing manager.

DYNEGY INC. and DYNEGY HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

During the three and nine months ended September 30, 2010, we received proceeds of $7 million and $53 million, respectively from the sale of available for sale securities. We realized an immaterial amount of gains and losses on the sale of these available for sale securities in earnings for the three and nine months ended September 30, 2010.

Note 6—Risk Management Activities, Derivatives and Financial Instruments

The nature of our business necessarily involves market and financial risks. Specifically, we are exposed to commodity price variability related to our power generation business. Our commercial team seeks to manage these commodity price risks with financially settled and other types of contracts consistent with our commodity risk management policy. Our commercial team also uses financial instruments in an attempt to capture the benefit of fluctuations in market prices in the geographic regions where our assets operate. Our treasury team seeks to manage our financial risks and exposures associated with interest expense variability.

Our commodity risk management strategy gives us the flexibility to sell energy and capacity through a combination of spot market sales and near-term contractual arrangements (generally over a rolling 1 to 3 year time frame). Our commodity risk management goal is to increase predictability of cash flows in the near-term while keeping the ability to capture value from rising commodity prices that are anticipated over the longer term. Many of our contractual arrangements are derivative instruments and must be accounted for at fair value. We also manage commodity price risk by entering into capacity forward sales arrangements, tolling arrangements, RMR contracts, fixed price coal purchases and other arrangements that do not receive fair value accounting treatment because these arrangements do not meet the definition of a derivative or are designated as "normal purchase normal sales." As a result, the gains and losses with respect to these arrangements are not reflected in the unaudited condensed consolidated statements of operations until the settlement dates.

Quantitative Disclosures Related to Financial Instruments and Derivatives

The following disclosures and tables present information concerning the impact of derivative instruments on our unaudited condensed consolidated balance sheets and statements of operations. In the table below, commodity contracts primarily consist of derivative contracts related to our power generation business that we have not designated as accounting hedges, that are entered into for purposes of hedging future fuel requirements and sales commitments and securing commodity prices. Interest rate contracts primarily consist of derivative contracts related to managing our interest rate risk. As of September 30, 2010, our commodity derivatives were comprised of both long and short positions; a long position is a contract to purchase a commodity, while a short position is a contract to sell a commodity. As of September 30, 2010, we had net long/ (short) commodity derivative contracts outstanding and notional interest rate swaps outstanding in the following quantities:

Contract Type	Hedge Designation	Quantity (in millions)	Unit of Measure	Net Fair Value (in millions)
Commodity contracts:				
Electric energy (1)		(74)	MW	$ 432

	Not designated					
Natural gas (1)	Not designated	183		MMBtu	$	(273)
Heat rate derivatives	Not designated	(7)/65		MW/MMBtu	$	(23)
Other (2)	Not designated	1		Misc.	$	4
Interest rate contracts:						
Interest rate swaps	Fair value hedge	(25	)	Dollars	$	1
Interest rate swaps	Not designated	231		Dollars	$	(11)
Interest rate swaps	Not designated	(206	)	Dollars	$	10

(1) Mainly comprised of swaps, options and physical forwards.
(2) Comprised of emissions, coal, crude oil, fuel oil options, swaps and physical forwards.

DYNEGY INC. and DYNEGY HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

Derivatives on the Balance Sheet. We execute a significant volume of transactions through a futures clearing manager. Our daily cash payments (receipts) to (from) our futures clearing manager consist of three parts: (i) fair value of open positions (exclusive of options) ("Daily Cash Settlements"); (ii) initial margin requirements related to open positions (exclusive of options) ("Initial Margin"); and (iii) fair value and margin requirements related to options ("Options", and collectively with Initial Margin, "Collateral"). We do not offset fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting agreement and we do not elect to offset the fair value amounts recognized for the Daily Cash Settlements paid or received against the fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting agreement.

As a result, our consolidated balance sheets present derivative assets and liabilities, as well as related Daily Cash Settlements and Collateral, as applicable, on a gross basis. As of September 30, 2010, the net value of our Daily Cash Settlements and Collateral with our futures clearing manager totaled $19 million, which is included in the Broker margin account on our unaudited condensed consolidated balance sheets. The $19 million is comprised of approximately $87 million of Collateral offset by approximately $68 million of Daily Cash Settlements due to the broker. As of September 30, 2010, the Broker margin account includes $104 million of short-term investments posted as collateral, which is partially offset by $68 million of Daily Cash Settlements due to the broker as discussed above. In the second quarter 2010, we began using short-term investments to collateralize a portion of our collateral requirements. The broker requires that we post approximately 103 percent of any collateral requirement collateralized with short-term investments. Accordingly, our Broker margin account includes approximately $3 million related to this requirement. As of December 31, 2009, of the approximately $286 million included in Broker margin account on our consolidated balance sheets, approximately $288 million represented Collateral, offset by approximately $2 million representing Daily Cash Settlements.

The following table presents the fair value and balance sheet classification of derivatives in the unaudited condensed consolidated balance sheet as of September 30, 2010, and December 31, 2009 segregated between designated, qualifying hedging instruments and those that are not, and by type of contract segregated by assets and liabilities.

Contract Type	Balance Sheet Location	September 30, 2010	December 31, 2009
		(in millions)	
Derivatives designated as hedging instruments:			
Derivative Assets:			
Interest rate contracts	Assets from risk management activities	$ 1	$ 2
Derivative Liabilities:			
Interest rate contracts	Liabilities from risk management activities	—	—
Total derivatives designated as hedging instruments		1	2
Derivatives not designated as hedging instruments:			
Derivative Assets:			

Commodity contracts	Assets from risk management activities		2,024		861
Interest rate contracts	Assets from risk management activities		10		13
Derivative Liabilities:					
Commodity contracts	Liabilities from risk management activities		(1,884)		(844)
Interest rate contracts	Liabilities from risk management activities		(11)		(65)
Total derivatives not designated as hedging instruments			139		(35)
Total derivatives, net		$	140	$	(33)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

Impact of Derivatives on the Consolidated Statements of Operations

The following discussion and tables present the disclosure of the location and amount of gains and losses on derivative instruments in our unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2010 and 2009 segregated between designated, qualifying hedging instruments and those that are not, by type of contract.

Cash Flow Hedges. We enter into financial derivative instruments that qualify, and that we may elect to designate, as cash flow hedges. Interest rate swaps have been used to convert floating interest rate obligations to fixed interest rate obligations.

In 2007, a formerly consolidated variable interest entity, PPEA, entered into three interest rate swap agreements which were designated as cash flow hedges. PPEA Holding was deconsolidated on January 1, 2010 upon adoption of ASU No. 2009-17, and therefore these instruments are not reflected in our consolidated risk management accounts at September 30, 2010. Please read Note 1—Accounting Policies—Accounting Policies Adopted—Variable Interest Entities for further discussion.

During the three and nine months ended September 30, 2010 and 2009, we recorded no income or loss, related to ineffectiveness from changes in fair value of derivative positions and no amounts were excluded from the assessment of hedge effectiveness related to the hedge of future cash flows in either of the periods. During the three and nine months ended September 30, 2010 and 2009, no amounts were reclassified to earnings in connection with forecasted transactions that were considered probable of not occurring.

The balance in cash flow hedging activities within Accumulated other comprehensive loss, net, of $17 million at September 30, 2010, representing our share of the historical cash flow hedging activities of PPEA under the equity method, is expected to be reclassified to future earnings when the forecasted hedged transaction impacts earnings. Currently we do not expect to make any reclassifications into earnings over the 12-month period ending September 30, 2011, unless we complete the sale of our investment in PPEA Holding during such period. Upon completion of the sale, which is further described in Note 10—Variable Interest Entities—PPEA Holding Company LLC below, we would reclassify to earnings the $17 million currently deferred in Accumulated other comprehensive loss. The actual amounts that will be reclassified to earnings over this period and beyond could vary materially from this estimated amount as a result of changes in market prices, hedging strategies, the probability of forecasted transactions occurring and other factors.

The amount of gain recognized in Other comprehensive loss on the effective portion of interest rate derivatives for the three and nine months ended September 30, 2009 was $45 million and $160 million, respectively. As of July 28, 2009, these derivatives no longer qualified for cash flow hedge accounting, and therefore, no additional gains or losses have been recognized in Other comprehensive loss since that date. During the three months ended September 30, 2010 and 2009, zero and $1 million, respectively, of losses were reclassified from Accumulated other comprehensive loss into earnings. During the nine months ended September 30, 2010 and 2009, zero and $3 million, respectively, of losses were reclassified from Accumulated other comprehensive loss into earnings.

Fair Value Hedges. We also enter into derivative instruments that qualify, and that we may elect to designate, as fair value hedges. We use interest rate swaps to convert a portion of our non-prepayable fixed-rate debt into floating-rate debt. The maximum length of time for which we have hedged our exposure for fair value hedges is through 2011. During the three and nine months ended September 30, 2010 and 2009, there was no ineffectiveness from changes in the fair value of hedge positions and no amounts were excluded from the assessment of hedge effectiveness. During the three and nine months ended September 30, 2010 and 2009, there were no gains or losses related to the recognition of firm commitments that no longer qualified as fair value hedges.

The impact of interest rate swap contracts designated as fair value hedges and the related hedged item on our unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2010 and 2009 was immaterial.

DYNEGY INC. and DYNEGY HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

Financial Instruments Not Designated as Hedges. We elect not to designate derivatives related to our power generation business and certain interest rate instruments as cash flow or fair value hedges. Thus, we account for changes in the fair value of these derivatives within the unaudited condensed consolidated statements of operations (herein referred to as "mark-to-market accounting treatment"). As a result, these mark-to-market gains and losses are not reflected in the unaudited condensed consolidated statements of operations in the same period as the underlying activity for which the derivative instruments serve as economic hedges.

For the three months ended September 30, 2010, our revenues included approximately $132 million of mark-to-market gains related to this activity compared to $122 million of mark-to-market losses in the same period in the prior year. For the nine months ended September 30, 2010, our revenues included approximately $127 million of mark-to-market gains related to this activity compared to $67 million of mark-to-market losses in the same period in the prior year.

The impact of derivative financial instruments that have not been designated as hedges on our unaudited condensed consolidated statement of operations for the three months ended September 30, 2010 and 2009 is presented below. Note that this presentation does not reflect the expected gains or losses arising from the underlying physical transactions associated with these financial instruments. Therefore, this presentation is not indicative of the economic gross profit we expect to realize when the underlying physical transactions settle.

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives for the Three Months Ended September 30, 2010	2009
		(in millions)	
Commodity contracts	Revenues	$ 106	$ 59
Interest rate contracts	Interest expense	—	(14)

The impact of derivative financial instruments that have not been designated as hedges on our unaudited condensed consolidated statement of operations for the nine months ended September 30, 2010 and 2009 is presented below. Note that this presentation does not reflect the expected gains or losses arising from the underlying physical transactions associated with these financial instruments. Therefore, this presentation is not indicative of the economic gross profit we expect to realize when the underlying physical transactions settle.

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives for the Nine Months Ended September 30, 2010	2009
		(in millions)	
Commodity contracts	Revenues	$ 246	$ 345
Interest rate contracts	Interest expense	(1)	(14)

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DYNEGY INC. and DYNEGY HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2010 and 2009

Note 7—Fair Value Measurements

Financial Assets and Liabilities. The following tables set forth by level within the fair value hierarchy our financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2010 and December 31, 2009. These financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

	Fair Value as of September 30, 2010			
	Level 1	Level 2	Level 3	Total
	(in millions)			
Assets:				
Assets from commodity risk management activities:				
Electricity derivatives	$ —	$ 975	$ 84	$ 1,059
Natural gas derivatives	—	939	5	944
Heat rate derivatives	—	—	1	1
Other derivatives	—	20	—	20
Total assets from commodity risk management activities	$ —	$ 1,934	$ 90	$ 2,024
Assets from interest rate swaps	—	11	—	11
Short-term investments:				
Commercial paper	—	20	—	20
Certificates of deposit	—	16	—	16
Corporate securities	—	13	—	13
Non U.S. government securities	—	—	—	—
U.S. Treasury and government securities (1)	—	218	—	218
Total—DHI short-term investments	$ —	$ 267	$ —	$ 267
Total—DHI	—	2,212	90	2,302
Short-term investments:				
Commercial paper	—	2	—	2
Certificates of deposit	—	2	—	2
Corporate securities	—	5	—	5