DYNEGY INC.
Form 10-Q
November 14, 2011
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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, 2011

o 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: 001-33443

DYNEGY INC.

(Exact name of registrant as specified in its charter)

State of Incorporation	**I.R.S. Employer Identification No.**
Delaware	**20-5653152**
1000 Louisiana, Suite 5800 Houston, Texas	**77002**
(Address of principal executive offices)	(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. 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). Yes x 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 o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of our classes of common stock, as of the latest practicable date: Common stock, $0.01 par value per share, 122,710,776 shares outstanding as of November 8, 2011.

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DEFINITIONS

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

ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BACT	Best available control technology
BART	Best available retrofit technology
BTA	Best technology available
CAA	Clean Air Act
CAIR	Clean Air Interstate Rule
CAISO	The California Independent System Operator
CAMR	Clean Air Mercury Rule
CARB	California Air Resources Board
CAVR	The Clean Air Visibility Rule
CCR	Coal Combustion Residuals
CEQA	California Environmental Quality Act
CERCLA	The Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended
CO_2	Carbon Dioxide
CSAPR	Cross-State Air Pollution Rule
CWA	Clean Water Act
DH	Dynegy Holdings, LLC (formerly known as Dynegy Holdings Inc.)
DMSLP	Dynegy Midstream Services L.P.
EBITDA	Earnings before interest, taxes, depreciation and amortization
EGU	Electric generating unit
EPA	Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
GAAP	Generally Accepted Accounting Principles of the United States of America
GEN Finance	Dynegy Gen Finance Company, LLC
GHG	Greenhouse Gas
HAPs	Hazardous air pollutants, as defined by the Clean Air Act
ICC	Illinois Commerce Commission
IMA	In-market asset availability
ISO	Independent System Operator
ISO-NE	Independent System Operator New England
MACT	Maximum achievable control technology
MGGA	Midwest Greenhouse Gas Accord
MGGRP	Midwestern Greenhouse Gas Reduction Program
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	One million British thermal units
MW	Megawatts
MWh	Megawatt hour
NOL	Net operating loss
NO_x	Nitrogen oxide
NPDES	National Pollutant Discharge Elimination System
NRG	NRG Energy, Inc.
NSPS	New Source Performance Standard
NYISO	New York Independent System Operator
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
PPEA Holding	Plum Point Energy Associates Holding Company, LLC
PSD	Prevention of significant deterioration
RACT	Reasonably available control technology
RCRA	Resource Conservation and Recovery Act
RGGI	Regional Greenhouse Gas Initiative
RMR	Reliability Must Run
SEC	U.S. Securities and Exchange Commission
SIP	State Implementation Plan
SO_2	Sulfur dioxide
SPDES	State Pollutant Discharge Elimination System
VaR	Value at Risk
VIE	Variable Interest Entity
WCI	Western Climate Initiative

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PART I. FINANCIAL INFORMATION

Item 1 FINANCIAL STATEMENTS

DYNEGY INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited) (in millions, except share data)

	September 30, 2011	December 31, 2010
ASSETS		
Current Assets		
Cash and cash equivalents	$ 881	$ 291
Restricted cash and investments	164	81
Short-term investments		106
Accounts receivable, net of allowance for doubtful accounts of $31 and $32, respectively	180	230
Accounts receivable, affiliates		1
Inventory	105	121
Assets from risk-management activities	2,016	1,199
Deferred income taxes	4	12
Broker margin account	22	80
Prepayments and other current assets	208	123
Total Current Assets	3,580	2,244
Property, Plant and Equipment	8,749	8,593
Accumulated depreciation	(2,571)	(2,320)
Property, Plant and Equipment, Net	6,178	6,273
Other Assets		
Restricted cash and investments	633	859
Assets from risk-management activities	136	72
Intangible assets	104	141
Other long-term assets	475	424
Total Assets	$ 11,106	$ 10,013
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 166	$ 134
Accrued interest	118	36
Accrued liabilities and other current liabilities	95	109
Liabilities from risk-management activities	2,099	1,138
Notes payable and current portion of long-term debt (Note 10)	3,357	148
Short term debt, affiliates (Note 10)	200	
Total Current Liabilities	6,035	1,565
Long-term debt	1,656	4,426
Long-term debt, affiliates		200

Long-Term Debt		1,656		4,626
Other Liabilities				
Liabilities from risk-management activities		159		99
Deferred income taxes		454		641
Other long-term liabilities		315		336
Total Liabilities		8,619		7,267
Commitments and Contingencies (Note 9)				
Stockholders Equity				
Common Stock, $0.01 par value, 420,000,000 shares authorized at September 30, 2011 and December 31, 2010; 123,316,599 and 121,687,198 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively		1		1
Additional paid-in capital		6,073		6,067
Subscriptions receivable		(2)		(2)
Accumulated other comprehensive loss, net of tax		(50)		(53)
Accumulated deficit		(3,464)		(3,196)
Treasury stock, at cost, 729,190 and 628,014 shares at September 30, 2011 and December 31, 2010, respectively		(71)		(71)
Total Stockholders Equity		2,487		2,746
Total Liabilities and Stockholders Equity	$	11,106	$	10,013

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, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenues	$ 516	$ 775	$ 1,347	$ 1,872
Cost of sales	(298)	(334)	(801)	(873)
Gross margin, exclusive of depreciation shown separately below	218	441	546	999
Operating and maintenance expense, exclusive of depreciation shown separately below	(107)	(110)	(323)	(341)
Depreciation and amortization expense	(73)	(96)	(274)	(261)
Impairment and other charges	(1)	(134)	(2)	(135)
General and administrative expenses	(32)	(51)	(97)	(110)
Operating income (loss)	5	50	(150)	152
Losses from unconsolidated investments				(34)
Interest expense	(107)	(92)	(285)	(272)
Debt extinguishment costs	(21)		(21)	
Other income and expense, net		1	4	3
Loss from continuing operations before income taxes	(123)	(41)	(452)	(151)
Income tax benefit (Note 12)	48	17	184	80
Loss from continuing operations	(75)	(24)	(268)	(71)
Income from discontinued operations, net of taxes				1
Net loss	$ (75)	$ (24)	$ (268)	$ (70)
Loss Per Share (Note 13):				
Basic loss per share:				
Loss from continuing operations	$ (0.61)	$ (0.20)	$ (2.20)	$ (0.59)
Income from discontinued operations				0.01
Basic loss per share	$ (0.61)	$ (0.20)	$ (2.20)	$ (0.58)
Diluted loss per share:				
Loss from continuing operations	$ (0.61)	$ (0.20)	$ (2.20)	$ (0.59)
Income from discontinued operations				0.01
Diluted loss per share	$ (0.61)	$ (0.20)	$ (2.20)	$ (0.58)
Basic shares outstanding	122	120	122	120
Diluted shares outstanding	122	121	122	121

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, 2011	Nine Months Ended September 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (268)	$ (70)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	291	273
Impairment and other charges	2	135
Losses from unconsolidated investments, net of cash distributions		34
Risk-management activities	139	(123)
Deferred income taxes	(183)	(79)
Debt extinguishment costs	21	
Other	37	55
Changes in working capital:		
Accounts receivable	48	11
Inventory	11	15
Broker margin account	(26)	353
Prepayments and other assets	(46)	7
Accounts payable and accrued liabilities	87	111
Changes in non-current assets	(67)	(51)
Changes in non-current liabilities	4	(1)
Net cash provided by operating activities	50	670
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(185)	(270)
Unconsolidated investments		(15)
Maturities of short-term investments	475	143
Purchases of short-term investments	(284)	(428)
Decrease (increase) in restricted cash and investments	142	(53)
Other investing	11	9
Net cash provided by (used in) investing activities	159	(614)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term borrowings, net of financing costs of $44 and $5, respectively	2,022	(5)
Repayments of borrowings	(1,623)	(31)
Debt extinguishment costs	(21)	
Net proceeds from issuance of capital stock	3	
Net cash provided by (used in) financing activities	381	(36)
Net increase in cash and cash equivalents	590	20
Cash and cash equivalents, beginning of period	291	471

Cash and cash equivalents, end of period	$	881	$	491
Other non-cash investing activity:				
Non-cash capital expenditures	$	(1)	$	10

See the notes to condensed consolidated financial statements.

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DYNEGY INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited) (in millions)

	Three Months Ended September 30,	
	2011	**2010**
Net loss	$ (75)	$ (24)
Amortization of unrecognized prior service cost and actuarial loss (net of tax expense of $1 and zero)	1	1
Other comprehensive income, net of tax	1	1
Comprehensive loss	$ (74)	$ (23)

	Nine Months Ended September 30,	
	2011	**2010**
Net loss	$ (268)	$ (70)
Amortization of unrecognized prior service cost and actuarial loss (net of tax expense of $2 and $1)	3	3
Other comprehensive income, net of tax	3	3
Comprehensive loss	$ (265)	$ (67)

See the notes to condensed consolidated financial statements.

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DYNEGY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

For the Interim Periods Ended September 30, 2011 and 2010

Note 1 Organization and Basis of Presentation

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. Unless the context indicates otherwise, throughout this report, the terms the Company, we, us, our, and ours are used to refer to Dynegy Inc. and its direct and indirect subsidiaries. The year-end condensed consolidated balance sheet data was derived from audited consolidated financial statements but does 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 our annual report on Form 10-K for the year ended December 31, 2010, filed on March 8, 2011, which we refer to as our Form 10-K .

Reorganization

In August 2011, we completed a reorganization of our subsidiaries (the Reorganization), whereby, (i) substantially all of our coal-fired power generation facilities are held by Dynegy Midwest Generation, LLC (DMG), (ii) substantially all of our natural gas-fired power generation facilities are held by Dynegy Power, LLC (DPC), an indirect wholly owned subsidiary of Dynegy Holdings, LLC (DH) and (iii) 100 percent of the ownership interests of Dynegy Northeast Generation, Inc., the entity that indirectly holds the equity interest in the subsidiaries that operate the Roseton and Danskammer power generation facilities, including the leased units, are held by DH. As a result of the Reorganization, DPC owns a portfolio of eight primarily natural gas-fired intermediate (combined cycle) and peaking (combustion and steam turbines) power generation facilities diversified across the West, Midwest and Northeast regions of the United States, totaling 6,771 MW of generating capacity. DMG owns a portfolio of six primarily coal-fired baseload power generation facilities located in the Midwest, totaling 3,132 MW of generating capacity. The DPC and DMG asset portfolios were designed to be separately financeable. DPC and DMG are bankruptcy remote, thereby accommodating the financings reflected by the credit agreements and to provide us with greater flexibility in our efforts to address leverage and liquidity issues and to realize the value of our assets. Please read Note 10 Debt New Credit Agreements for discussion of the new credit agreements. Our remaining assets (including our leasehold interests in the Danskammer and Roseton facilities) are not a part of either DPC or DMG.

DMG Acquisition. On September 1, 2011, Dynegy and Dynegy Gas Investments, LLC (DGIN), a direct wholly owned subsidiary of DH, entered into a Membership Interest Purchase Agreement pursuant to which DGIN sold 100 percent of the outstanding membership interests of Dynegy Coal HoldCo, LLC (Coal HoldCo), a wholly owned subsidiary of DGIN, to Dynegy (the DMG Acquisition). Our management and Board of Directors, as well as DGIN s board of managers, concluded that the fair value of the acquired equity stake in Coal HoldCo at the time of the transaction was approximately $1.25 billion, after taking into account all debt obligations of DMG, including in particular DMG s $600 million, five-year senior secured term loan facility. Dynegy provided this value to DGIN in exchange for Coal HoldCo through Dynegy s obligation, pursuant to an Undertaking Agreement (the Undertaking Agreement), to make certain specified payments over time which coincide in timing and amount with the payments of principal and interest that DH is obligated to make under a portion of its $1.1 billion of 7.75 percent senior unsecured notes due 2019 and its $175 million of 7.625 percent senior debentures due 2026. The Undertaking Agreement does not provide any rights or obligations with respect to any outstanding DH notes or debentures, including the notes and debentures due in 2019 and 2026.

Immediately after closing the DMG Acquisition, DGIN assigned its right to receive payments under the Undertaking Agreement to DH in exchange for a promissory note (the Promissory Note) in the amount of $1.25 billion that matures in 2027 (the Assignment). The Promissory Note bears annual interest at a rate of 4.24 percent, which will be payable upon maturity. As a condition to Dynegy s consent to the Assignment, the Undertaking Agreement was amended and restated to be between DH and Dynegy and to provide for the reduction of Dynegy s obligations if the outstanding principal amount of any of DH s $3.5 billion of outstanding notes and debentures is decreased as a result of any exchange offer, tender offer or other purchase or repayment by Dynegy or its subsidiaries (other than DH and its subsidiaries, unless Dynegy guarantees the debt securities of DH or such subsidiary in connection with such exchange offer, tender offer or other purchase or repayment); provided, that such principal amount is retired, cancelled or otherwise forgiven.

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DYNEGY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2011 and 2010

There was no impact on our condensed consolidated financial position, results of operations or cash flows as the transaction was between Dynegy and its wholly owned subsidiaries.

Overview of Bankruptcy Remote and Ring-Fencing Measures. The Reorganization created new companies, some of which are bankruptcy remote. In addition, as part of the Reorganization, some companies within our portfolio were reorganized into ring-fenced groups. The special purpose bankruptcy remote entities entered into limited liability company operating agreements, which contain certain restrictions including not allowing the bankruptcy remote or ring-fenced companies to act as an agent for a non ring-fenced company. Furthermore, bankruptcy remote and ring-fenced companies are required to present themselves to the public as separate entities and correct misunderstandings that they are not separate entities. They maintain separate books, records and bank accounts and separately appoint officers. Additionally, they pay liabilities from their own funds, they conduct business in their own names (other than any business relating to the trading activities of us and our subsidiaries), they observe a higher level of formalities, and they have restrictions on pledging their assets for the benefit of certain other persons.

Further, the bankruptcy remote entities each have one independent manager. Unanimous consent of such a ring-fenced entity s board of managers, including the independent manager, is required for filing any bankruptcy proceeding, seeking or consenting to the appointment of any receiver, making or consenting to any assignment for the benefit of creditors, admitting in writing the inability to pay the entity s debts, consenting to substantive consolidation, dissolving or liquidating, engaging in any business beyond those set forth in the entity s organizational documents, amending the bankruptcy remoteness provisions in such entity s organizational documents and, at any time following execution of the applicable credit agreement, amending, terminating or entering material intercompany relationships with other entities.

Relationships with Third Parties. Each ring-fenced entity bills its customers on invoices clearly referencing solely such ring-fenced entity. Other than in the limited context of Services (defined and described below), when transacting business with third parties, including vendors and customers, employees of the ring-fenced entities do not hold themselves out as agents or representatives of non-ring-fenced entities. Similarly, other than in the limited context of Services, when transacting business with third parties, employees of non-ring-fenced entities do not hold themselves out as agents or representatives of ring-fenced entities.

Service Agreements. Service Agreements between us and each of Dynegy Gas Investments Holdings, LLC (DGIH), Dynegy Coal Investments Holdings, LLC (DCIH), Dynegy Northeast Generation, Inc. and certain other subsidiaries of Dynegy, which were entered into at the Reorganization, govern the terms under which identified services (the Services) are provided. Under the Service Agreements, we and certain of

our subsidiaries (the Providers) provide Services to DGIH, DCIH, Dynegy Northeast Generation, Inc., their respective subsidiaries and certain of our subsidiaries (the Recipients).

The Providers act as agents for the Recipients for the limited purpose of providing the Services set forth in the Service Agreement. The Providers may perform additional services at the request of the Recipients, and will be reimbursed for all costs and expenses related to such additional services. Prior to the beginning of each fiscal year in which Services are to be provided pursuant to the Service Agreement, the Providers and the Recipients must agree on a budget for the Services, outlining, among other items, the contemplated scope of the Services to be provided in the following fiscal year and the cost of providing each Service. The Recipients will pay the Providers an annual management fee as agreed in the budget, which shall include reimbursement of out-of pocket costs and expenses related to the provision of the Services and will provide reasonable assistance, such as information, services and materials, to the Providers.

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DYNEGY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2011 and 2010

Going Concern

Our accompanying unaudited condensed consolidated financial statements have been prepared assuming that we will continue as a going concern, which contemplates realization of assets and the satisfaction of liabilities in the normal course of business for the twelve month period following the date of these unaudited condensed consolidated financial statements. However, continued low power prices over the past several years have had a significant adverse impact on our business and continue to negatively impact our projected future liquidity.

As noted above, we recently completed the Reorganization and in connection therewith, certain of our subsidiaries (DPC and DMG) entered into two new credit agreements on August 5, 2011 which resulted in the repayment in full and termination of commitments under our former Fifth Amended and Restated Credit Agreement. While these new credit agreements were designed to provide sufficient operating liquidity for DPC and DMG for the foreseeable future, they contain certain restrictions related to distributions by DPC and DMG to their respective parent companies, including us and DH. Please read Note 10 Debt New Credit Agreements for further discussion.

Also as noted above, on September 1, 2011, we completed the DMG Acquisition, pursuant to which Dynegy acquired 100 percent of the outstanding membership interests of Coal HoldCo from a wholly owned subsidiary of DH. As a result of that transaction, Dynegy has an unsecured obligation of $1.25 billion to DH under the Undertaking Agreement, and DH has an unsecured obligation of $1.25 billion to DGIN under the Promissory Note.

On November 7, 2011, DH still had significant debt service requirements in connection with its outstanding notes and debentures, and there were significant payment obligations related to the leasehold interests in the Danskammer and Roseton facilities. On that date, DH and four of its wholly owned subsidiaries, Dynegy Northeast Generation, Inc., Hudson Power, L.L.C., Dynegy Danskammer, L.L.C. and Dynegy Roseton, L.L.C. (collectively, the Debtor Entities), filed voluntary petitions for relief under Chapter 11 of the U.S. Bankruptcy Code (the Bankruptcy Code) in the United States Bankruptcy Court for the Southern District of New York, Poughkeepsie Division (the Chapter 11 Cases). We and our subsidiaries, other than the five Debtor Entities, did not file voluntary petitions for relief and are not debtors under Chapter 11 of the Bankruptcy Code. Please see Note 15 Subsequent Events Bankruptcy Filing for further information.

The Reorganization, DMG Acquisition, and Chapter 11 Cases represent steps in addressing our liquidity concerns. Over the next twelve months, under the strategic direction of the Finance and Restructuring Committee of our Board of Directors, we may participate in additional debt restructuring activities, which may include direct or indirect transfers of our subsidiaries equity interests, refinancing of existing debt and lease obligations, and/or further reorganizations of our subsidiaries as well as other similar initiatives. However, we cannot provide any assurances that we will be successful in accomplishing any such activities.

Our ability to continue as a going concern is dependent on many factors, including, among other things, the generation by DPC and DMG of sufficient positive operating results to enable DPC and DMG to make certain restricted distributions to their parents (as described in Note 10 Debt), the terms and conditions of an approved plan of reorganization that allows the Debtor Entities to emerge from bankruptcy, execution of any further restructuring strategies, and the successful execution of the company-wide cost reduction initiatives that are ongoing. The accompanying unaudited condensed consolidated financial statements do not include any adjustments that might result from the outcome of the foregoing uncertainties except for the reclassification of the DH Senior Notes and Debentures, including the Subordinated Capital Income Securities reflected as affiliated debt, and associated deferred financing costs due to the Chapter 11 Cases discussed above. Please read Note 10 Debt Senior Notes and Debentures and Subordinated Capital Income Securities for further discussion.

Note 2 Accounting Policies

Use of Estimates

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 presentation 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 consolidated financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make informed estimates and judgments that affect our reported financial position and results of operations 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 deferred 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 variable interest entities (VIEs). Actual results could differ materially from our estimates.

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DYNEGY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2011 and 2010

Accounting Principles Not Yet Adopted

Fair Value Measurement Disclosures. In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04 Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU No. 2011-04). This authoritative guidance changes the wording used to describe the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. ASU No. 2011-04 is effective for interim and annual periods beginning after December 15, 2011. We do not expect the implementation of this guidance to have a significant impact on our financial condition, results of operations or cash flows.

Presentation of Comprehensive Income. In June 2011, the FASB issued ASU 2011-05 Comprehensive Income (Topic 220): Presentation of Comprehensive Income (ASU No. 2011-05). The FASB s objective in issuing this guidance is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. ASU No. 2011-05 eliminates the option of presenting components of other comprehensive income as part of the statement of changes in stockholders equity. The standard requires that all nonowner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We do not expect the implementation of this guidance to have a significant impact on our financial condition, results of operations or cash flows.

Note 3 Investments

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

	Investments as of December 31, 2010			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			

Available for Sale investments:								
Commercial Paper	$	45	$		$		$	45
Certificates of Deposit		20						20
Corporate Securities		6						6
U.S. Treasury and Government Securities (1)		120						120
Total Dynegy	$	191	$		$		$	191

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DYNEGY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

For the Interim Periods Ended September 30, 2011 and 2010

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(1) Includes $85 million in Broker margin account on our unaudited condensed consolidated balance sheets in support of transactions with our futures clearing manager.

We did not have any investments as of September 30, 2011.

Note 4 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 manages 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 manages 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 protect cash flow in the near-term while keeping the ability to capture value longer-term. Increasing collateral requirements and our liquidity position could impact our ability to effectively employ our risk management strategy.

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 economically hedging future fuel requirements and sales commitments and securing commodity prices. As of September 30, 2011, 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, 2011, we had net long/(short) commodity derivative contracts 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)	Not designated	(26)	MW	$	73
Natural gas (1)	Not designated	(25)	MMBtu	$	(162)
Heat rate derivatives	Not designated	(3)/27	MW/MMBtu	$	(18)
Other (2)	Not designated	2	Misc.	$	1

(1) Mainly comprised of swaps, options and physical forwards.

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

Derivatives on the Balance Sheet. We execute a significant volume of transactions through futures clearing managers. Our daily cash payments (receipts) to (from) our futures clearing managers consist of three parts: (i) fair value of open positions (exclusive of options) (Daily Cash Settlements); (ii) initial margin requirements of open positions (Initial Margin); and (iii) fair value related to options (Options , and collectively with Daily Cash Settlements and 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 unaudited condensed consolidated balance sheets present derivative assets and liabilities, as well as related Collateral, as applicable, on a gross basis.

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We have used short-term investments to collateralize a portion of our collateral requirements. The broker required that we post approximately 103 percent of any collateral requirement collateralized with short-term investments. Accordingly, our Broker margin account included approximately $3 million related to this requirement at December 31, 2010. Additionally, we posted $7 million of short-term investments which were not utilized as collateral at December 31, 2010. There were no short-term investments in our Broker margin account at September 30, 2011.

In addition to the transactions we execute through the futures clearing managers, we also execute transactions through a bilateral counterparty. Our transactions with this counterparty are collateralized using only cash collateral. As of September 30, 2011, we had $41 million posted with this counterparty, which is included in Prepayments and other current assets on our unaudited condensed consolidated balance sheets.

The following table presents the fair value and balance sheet classification of derivatives in the unaudited condensed consolidated balance sheet as of September 30, 2011, and December 31, 2010 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, 2011**	**December 31, 2010**
		(in millions)	
Derivatives designated as hedging instruments:			
Derivative Assets:			
Interest rate contracts	Assets from risk management activities	$	$ 1
Total derivatives designated as hedging instruments			1
Derivatives not designated as hedging instruments:			
Derivative Assets:			
Commodity contracts	Assets from risk management activities	2,152	1,265
Interest rate contracts	Assets from risk management activities		5
Derivative Liabilities:			
Commodity contracts	Liabilities from risk management activities	(2,258)	(1,231)
Interest rate contracts			(6)

	Liabilities from risk management activities				
Total derivatives not designated as hedging instruments			(106)		33
Total derivatives, net		$	(106)	$	34

Impact of Derivatives on the Consolidated Statements of Operations

The following discussion and tables include 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, 2011 and 2010, segregated between designated, qualifying hedging instruments and those that are not, by type of contract.

Cash Flow Hedges. We may 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. We had no cash flow hedges in place during the three and nine months ended September 30, 2011 and 2010.

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(Unaudited)

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Fair Value Hedges. We also enter into derivative instruments that qualify, and that we may elect to designate, as fair value hedges. We previously used interest rate swaps to convert a portion of our non-prepayable fixed-rate debt into floating-rate debt. These derivatives and the corresponding hedged debt matured April 1, 2011. During the three and nine months ended September 30, 2011 and 2010, 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, 2011 and 2010, 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 statement of operations for the three and nine months ended September 30, 2011 and 2010 was immaterial for all periods.

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 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-month period ended September 30, 2011, our revenues included approximately $16 million of mark-to-market losses related to this activity compared to $132 million of mark-to-market gains in the same period in the prior year. For the nine months ended September 30, 2011, our revenues included approximately $143 million of mark-to-market losses related to this activity compared to $127 million of mark-to-market gains 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 statements of operations for the three months ended September 30, 2011 and 2010 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 margin 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, 2011	2010
		(in millions)	
Commodity contracts	Revenues	$ (54)	$ 106

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(Unaudited)

For the Interim Periods Ended September 30, 2011 and 2010

The impact of derivative financial instruments that have not been designated as hedges on our unaudited condensed consolidated statements of operations for the nine months ended September 30, 2011 and 2010 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 margin 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, 2011	2010
		(in millions)	
Commodity contracts	Revenues	$ (124)	$ 246
Interest rate contracts	Interest expense		(1)

Note 5 Fair Value Measurements

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, 2011 and December 31, 2010. 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, 2011			
	Level 1	Level 2	Level 3	Total
	(in millions)			
Assets:				
Assets from commodity risk management activities:				
Electricity derivatives	$	$ 299	$ 31	$ 330
Natural gas derivatives		1,818	1	1,819

Other derivatives		3		3
Total	$	$ 2,120	$ 32	$ 2,152
Liabilities:				
Liabilities from commodity risk management activities:				
Electricity derivatives	$	$ (245)	$ (13)	$ (258)
Natural gas derivatives		(1,978)	(4)	(1,982)
Heat rate derivatives			(17)	(17)
Other derivatives		(1)		(1)
Total	$	$ (2,224)	$ (34)	$ (2,258)

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(Unaudited)

For the Interim Periods Ended September 30, 2011 and 2010

	Fair Value as of December 31, 2010 (in millions)			
	Level 1	Level 2	Level 3	Total
Assets:				
Assets from commodity risk management activities:				
Electricity derivatives	$	$ 526	$ 77	$ 603
Natural gas derivatives		613	5	618
Other derivatives		44		44
Total assets from commodity risk management activities		1,183	82	1,265
Assets from interest rate swaps		6		6
Short-term investments:				
Commercial paper		45		45
Certificates of deposit		20		20
Corporate securities		6		6
U.S. Treasury and government securities (1)		120		120
Total short-term investments		191		191
Total	$	$ 1,380	$ 82	$ 1,462
Liabilities:				
Liabilities from commodity risk management activities:				
Electricity derivatives	$	$ (311)	$ (28)	$ (339)
Natural gas derivatives		(825)		(825)
Heat rate derivatives			(31)	(31)
Other derivatives		(36)		(36)
Total liabilities from commodity risk management activities	$	$ (1,172)	$ (59)	$ (1,231)
Liabilities from interest rate swaps		(6)		(6)
Total	$	$ (1,178)	$ (59)	$ (1,237)

(1) Includes $85 million in Broker margin account on our unaudited condensed consolidated balance sheets in support of transactions with our futures clearing manager.

We primarily apply the market approach for recurring fair value measurements and endeavor to utilize the best available information. Accordingly, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. For example, assets and liabilities from risk management activities may include exchange-traded derivative contracts and OTC derivative contracts. Some exchange-traded derivatives are valued using broker or dealer quotations, or market transactions in either the listed or OTC markets. In such cases, these exchange-traded derivatives are classified within Level 2. OTC derivative trading instruments include swaps, forwards, options and complex structures that are valued at fair value. In certain instances, these instruments may utilize models to measure fair value. Generally, we use a similar model to value similar instruments. Valuation models utilize various inputs that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, other observable inputs for the asset or liability, and market-corroborated inputs. Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. Certain OTC derivatives trade in less active markets with a lower availability of pricing information. In addition, complex or structured transactions, such as heat-rate call options, can introduce the need for internally-developed model inputs that might not be observable in or corroborated by the market. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized in Level 3. We have consistently used this valuation technique for all periods presented. Please read Note 2 Summary of Significant Accounting Policies Fair Value Measurements in our Form 10-K for further discussion.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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For the Interim Periods Ended September 30, 2011 and 2010

The following tables set forth a reconciliation of changes in the fair value of financial instruments classified as Level 3 in the fair value hierarchy:

	Three Months Ended September 30, 2011			
	Electricity Derivatives	Natural Gas Derivatives	Heat Rate Derivatives	Total
	(in millions)			
Balance at June 30, 2011	$ 35	$	$ (23)	$ 12
Total losses included in earnings	(14)	(3)	(1)	(18)
Settlements	(3)		6	3
Balance at September 30, 2011	$ 18	$ (3)	$ (18)	$ (3)
Unrealized losses relating to instruments held as of September 30, 2011	$ (4)	$ (4)	$ (4)	$ (12)

	Nine Months Ended September 30, 2011			
	Electricity Derivatives	Natural Gas Derivatives	Heat Rate Derivatives	Total
	(in millions)			
Balance at December 31, 2010	$ 49	$ 5	$ (31)	$ 23
Total losses included in earnings	(22)	(8)	(1)	(31)
Settlements	(9)		14	5
Balance at September 30, 2011	$ 18	$ (3)	$ (18)	$ (3)
Unrealized losses relating to instruments held as of September 30, 2011	$ (1)	$ (7)	$ (4)	$ (12)

	Three Months Ended September 30, 2010			
	Electricity Derivatives	Natural Gas Derivatives	Heat Rate Derivatives	Total
	(in millions)			
Balance at June 30, 2010	$ 23	$ 5	$ (23)	$ 5
Total gains included in earnings	27		5	32

Sales and settlements:				
Sales			(1)	(1)
Settlements	(2)		(4)	(6)
Balance at September 30, 2010	$ 48	$ 5	$ (23)	$ 30
Unrealized gains relating to instruments still held as of September 30, 2010	$ 28	$	$ 1	$ 29

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	Nine Months Ended September 30, 2010				
	Electricity Derivatives	Natural Gas Derivatives	Heat Rate Derivatives	Interest Rate Swaps	Total
			(in millions)		
Balance at December 31, 2009	$ 6	$ 5	$ 17	$ (50)	$ (22)
Deconsolidation of Plum Point				50	50
Total gains included in earnings					