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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

(Mark One)

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

For the Quarterly Period Ended September 30, 2007

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 333-59348

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**MIDWEST GENERATION, LLC**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation  
or organization)

**33-0868558**

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

**One Financial Place**

**440 South LaSalle Street, Suite 3500**

**Chicago, Illinois**

(Address of principal executive offices)

**60605**

(Zip Code)

Registrant's telephone number, including area code: **(312) 583-6000**

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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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Number of units outstanding of the registrant's Membership Interests as of November 2, 2007: 100 units (all units held by an affiliate of the registrant).

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## GLOSSARY

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

Ameren . . . . .	Ameren Corporation
Btu . . . . .	British thermal units
CAIR . . . . .	Clean Air Interstate Rule
CERCLA . . . . .	Comprehensive Environmental Response, Compensation and Liability Act of 1980
CPS . . . . .	Combined Pollutant Standard
Commonwealth Edison . . . . .	Commonwealth Edison Company
DOJ . . . . .	United States Department of Justice
EME . . . . .	Edison Mission Energy
EMMT . . . . .	Edison Mission Marketing & Trading, Inc.
ERP . . . . .	enterprise resource planning
Exelon Generation . . . . .	Exelon Generation Company LLC
FASB . . . . .	Financial Accounting Standards Board
FERC . . . . .	Federal Energy Regulatory Commission
FIN No. 39-1 . . . . .	Financial Accounting Standards Board Staff Position No. 39-1, “Amendment of FASB Interpretation No. 39”
FIN No. 48 . . . . .	Financial Accounting Standards Interpretation No. 48, “Accounting for Uncertainty in Income Taxes”
Fitch . . . . .	Fitch Ratings
GWh . . . . .	gigawatt-hours
Illinois Plants . . . . .	EME’s largest power plants (fossil fuel), located in Illinois
ISO . . . . .	independent system operator
LIBOR . . . . .	London Interbank Offered Rate
MD&A . . . . .	Management’s Discussion and Analysis of Financial Condition and Results of Operations
Midwest Generation . . . . .	Midwest Generation, LLC
MISO . . . . .	Midwest Independent Transmission System Operator
MMBtu . . . . .	million British thermal units
Moody’s . . . . .	Moody’s Investors Service, Inc.
MW . . . . .	megawatts
MWh . . . . .	megawatt-hours
NOV . . . . .	Notice of Violation
PJM . . . . .	PJM Interconnection, LLC
PRB . . . . .	Powder River Basin
RPM . . . . .	Reliability Pricing Model

S&P .....	Standard & Poor’s Ratings Services
SFAS .....	Statement of Financial Accounting Standards issued by the FASB
SFAS No. 133 .....	Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities”
SFAS No. 155 .....	Statement of Financial Accounting Standards No. 155, “Accounting for Certain Hybrid Financial Instruments”
SFAS No. 157 .....	Statement of Financial Accounting Standards No. 157, “Fair Value Measurements”
SFAS No. 159 .....	Statement of Financial Accounting Standards No. 159, “Fair Value Option for Financial Assets and Liabilities, Including an Amendment of FASB Statement No. 115”
SIP .....	state implementation plan
SO <sub>2</sub> .....	sulfur dioxide
US EPA .....	United States Environmental Protection Agency

**PART I – FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**MIDWEST GENERATION, LLC AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
<b>Operating Revenues from Marketing Affiliate . . . .</b>	\$ 448,551	\$ 438,065	\$ 1,213,670	\$ 1,050,311
<b>Operating Expenses</b>				
Fuel . . . . .	116,764	121,078	310,520	287,532
Gain on sale of emission allowances . . . . .	(4,081)	—	(12,055)	(8)
Plant operations . . . . .	83,973	74,336	300,046	270,471
Depreciation and amortization . . . . .	34,827	35,290	105,679	105,721
Loss (gain) from disposal of assets . . . . .	5,054	(1,343)	5,570	8,839
Administrative and general . . . . .	5,170	7,534	16,021	19,906
Total operating expenses . . . . .	241,707	236,895	725,781	692,461
Operating income . . . . .	206,844	201,170	487,889	357,850
<b>Other Income (Expense)</b>				
Interest and other income . . . . .	31,221	30,170	91,820	88,224
Interest expense . . . . .	(18,160)	(51,227)	(97,205)	(153,408)
Loss on early extinguishment of debt . . . . .	—	—	(128,271)	—
Total other expense . . . . .	13,061	(21,057)	(133,656)	(65,184)
Income before income taxes . . . . .	219,905	180,113	354,233	292,666
Provision for income taxes . . . . .	84,588	69,818	133,754	113,953
<b>Net Income . . . . .</b>	<b>\$ 135,317</b>	<b>\$ 110,295</b>	<b>\$ 220,479</b>	<b>\$ 178,713</b>

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

**MIDWEST GENERATION, LLC AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands, Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
<b>Net Income</b> . . . . .	\$ 135,317	\$ 110,295	\$ 220,479	\$ 178,713
Other comprehensive income (loss), net of tax:				
Pension and postretirement benefits other than pensions:				
Amortization of prior service credit, net of tax expense of \$93 for the nine months ended September 30, 2007 . . . . .	(122)	—	(270)	—
Amortization of actuarial loss, net of tax benefit of \$80 for the nine months ended September 30, 2007 . . . . .	104	—	231	—
Unrealized gains (losses) on derivatives qualified as cash flow hedges:				
Other unrealized holding gains (losses) arising during period, net of income tax expense (benefit) of \$(16,864) and \$28,145 for the three months and \$(46,681) and \$114,915 for the nine months ended September 30, 2007 and 2006, respectively . . . . .	(26,842)	41,870	(73,592)	178,353
Reclassification adjustments included in net income (loss), net of income tax expense (benefit) of \$(3,069) and \$3,887 for the three months and \$(5,940) and \$7,322 for the nine months ended September 30, 2007 and 2006, respectively . . . . .	4,863	(5,388)	9,364	(11,366)
Other comprehensive income (loss) . . . . .	(21,997)	36,482	(64,267)	166,987
<b>Comprehensive Income</b> . . . . .	<u>\$ 113,320</u>	<u>\$ 146,777</u>	<u>\$ 156,212</u>	<u>\$ 345,700</u>

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

**MIDWEST GENERATION, LLC AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, Unaudited)

	<u>September 30,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents . . . . .	\$ 111,776	\$ 170,755
Due from affiliates . . . . .	136,829	104,666
Fuel inventory . . . . .	61,416	64,900
Spare parts inventory . . . . .	22,100	20,390
Loans to affiliate for margin deposits . . . . .	27,845	43,450
Interest receivable from affiliate . . . . .	27,832	56,097
Derivative assets . . . . .	35,958	132,221
Deferred taxes . . . . .	14,014	—
Other current assets . . . . .	12,998	8,323
Total current assets . . . . .	450,768	600,802
<b>Property, Plant and Equipment</b> . . . . .	4,192,859	4,210,743
Less accumulated depreciation . . . . .	1,059,073	990,409
Net property, plant and equipment . . . . .	3,133,786	3,220,334
<b>Notes receivable from affiliate</b> . . . . .	1,356,368	1,359,276
<b>Deferred taxes</b> . . . . .	—	46,277
<b>Long-term derivative assets</b> . . . . .	16,939	19,288
<b>Other assets</b> . . . . .	16,289	37,593
<b>Total Assets</b> . . . . .	\$ 4,974,150	\$ 5,283,570
<b>Liabilities and Member's Equity</b>		
<b>Current Liabilities</b>		
Accounts payable . . . . .	\$ 5,802	\$ 11,467
Book overdrafts . . . . .	2,789	1,761
Accrued liabilities . . . . .	92,781	82,953
Due to affiliates . . . . .	54,808	21,522
Interest payable . . . . .	16,721	57,072
Derivative liabilities . . . . .	58,607	50,874
Deferred taxes . . . . .	—	23,391
Current maturities of long-term obligations . . . . .	—	3,450
Current portion of lease financing . . . . .	118,267	110,956
Total current liabilities . . . . .	349,775	363,446
<b>Lease financing, net of current portion</b> . . . . .	911,538	1,029,805
<b>Long-term obligations</b> . . . . .	—	1,326,096
<b>Deferred taxes</b> . . . . .	55,204	—
<b>Long-term derivative liabilities</b> . . . . .	31,460	6,652
<b>Benefit plans and other long-term liabilities</b> . . . . .	179,554	176,933
<b>Total Liabilities</b> . . . . .	1,527,531	2,902,932
<b>Commitments and Contingencies (Note 6)</b>		
<b>Member's Equity</b>		
Membership interests, no par value; 100 units authorized, issued and outstanding . . . . .	—	—
Additional paid-in capital . . . . .	3,772,253	2,862,485
Accumulated deficit . . . . .	(309,044)	(529,524)
Accumulated other comprehensive income (loss) . . . . .	(16,590)	47,677
Total Member's Equity . . . . .	3,446,619	2,380,638
<b>Total Liabilities and Member's Equity</b> . . . . .	\$ 4,974,150	\$ 5,283,570

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

**MIDWEST GENERATION, LLC AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands, Unaudited)

	<b>Nine Months Ended September 30,</b>	
	<u>2007</u>	<u>2006</u>
<b>Cash Flows From Operating Activities</b>		
Net income . . . . .	\$ 220,479	\$ 178,713
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization . . . . .	111,646	109,724
Loss on disposal of assets . . . . .	5,570	8,839
Gain on sale of emission allowances . . . . .	(12,055)	(8)
Deferred taxes . . . . .	13,323	109,165
Loss on early extinguishment of debt . . . . .	128,271	—
Decrease in due to/from affiliates . . . . .	99,387	93,298
Decrease (increase) in inventory . . . . .	1,774	(31,429)
Decrease in loans to affiliate for margin deposit . . . . .	15,604	266,036
Decrease in interest receivable from affiliate . . . . .	28,265	28,318
Increase in other current assets . . . . .	(4,675)	(2,379)
Decrease (increase) in other assets . . . . .	(494)	1,813
Increase (decrease) in accounts payable and other current liabilities . . . . .	5,191	(1,264)
Decrease in interest payable . . . . .	(40,351)	(456)
Decrease in other liabilities . . . . .	(7,981)	(1,502)
Decrease (increase) in derivative assets and liabilities . . . . .	26,183	(16,441)
Net cash provided by operating activities . . . . .	<u>590,137</u>	<u>742,427</u>
<b>Cash Flows From Financing Activities</b>		
Borrowing on long-term debt . . . . .	230,000	395,000
Repayment of long-term debt . . . . .	(1,559,546)	(537,588)
Capital contributions from parent . . . . .	1,385,000	—
Capital distribution to parent . . . . .	(475,232)	(380,134)
Repayment of capital lease obligation . . . . .	(110,956)	(103,927)
Premium paid on extinguishment of debt and financing costs . . . . .	(108,748)	—
Net cash used in financing activities . . . . .	<u>(639,482)</u>	<u>(626,649)</u>
<b>Cash Flows From Investing Activities</b>		
Capital expenditures . . . . .	(28,614)	(21,822)
Proceeds from sale of assets . . . . .	528	3,563
Proceeds from sale of emission allowances . . . . .	15,544	8
Decrease in restricted cash . . . . .	—	1,000
Repayment of loan to affiliate . . . . .	2,908	2,740
Net cash used in investing activities . . . . .	<u>(9,634)</u>	<u>(14,511)</u>
<b>Net increase (decrease) in cash and cash equivalents . . . . .</b>	<b>(58,979)</b>	<b>101,267</b>
<b>Cash and cash equivalents at beginning of period . . . . .</b>	<b>170,755</b>	<b>124,118</b>
<b>Cash and cash equivalents at end of period . . . . .</b>	<b>\$ 111,776</b>	<b>\$ 225,385</b>

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

**MIDWEST GENERATION, LLC AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2007**  
**(Unaudited)**

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

*Basis of Presentation*

Midwest Generation's significant accounting policies are described in Note 2 to its consolidated financial statements included in its annual report on Form 10-K for the year ended December 31, 2006. Midwest Generation follows the same accounting policies for interim reporting purposes, with the exception of the change in accounting for uncertain tax positions (discussed below in "New Accounting Pronouncements"). This quarterly report should be read in connection with such financial statements.

In the opinion of management, all adjustments, including recurring accruals, have been made that are necessary to fairly state the consolidated financial position and results of operations and cash flows in accordance with accounting principles generally accepted in the United States for the periods covered by this quarterly report on Form 10-Q. The results of operations for the nine months ended September 30, 2007 are not necessarily indicative of the operating results for the full year.

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

*Income Taxes*

Midwest Generation is included in the consolidated federal and state income tax returns of Edison International and is party to a tax-allocation agreement with its parent Edison Mission Midwest Holdings. As long as Edison International continues to own, directly or indirectly, at least 80% of the voting power of the stock of EME and its existing subsidiaries and at least 80% of the value of such stock, Midwest Generation will be included in the consolidated federal and state income tax returns of Edison International. In accordance with the agreement and the tax-allocation procedures that have been in effect since Midwest Generation's formation, its current tax liability or benefit is generally determined on a separate return basis, except for calculating consolidated state income taxes, for which Midwest Generation uses the long-term state tax apportionment factors of the Edison International group. The amount on the balance sheet associated with this tax-allocation agreement totaled \$41.7 million and \$19.1 million at September 30, 2007 and December 31, 2006, respectively, included in due to affiliates.

Midwest Generation accounts for deferred income taxes using the asset-and-liability method, wherein deferred tax assets and liabilities are recognized for future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities using enacted income tax rates. Interest expense and penalties associated with income taxes are reflected in the caption "Provision for income taxes" on the consolidated statements of income. For further discussion of income taxes, see Note 5—Income Taxes.

## *New Accounting Pronouncements*

### *Accounting Principles Adopted*

#### Statement of Financial Accounting Standards Interpretation No. 48—

In July 2006, the FASB issued FIN No. 48, which clarifies the accounting for uncertain tax positions. FIN No. 48 requires an enterprise to recognize, in its financial statements, the best estimate of the impact of a tax position by determining if the weight of the available evidence indicates it is more likely than not, based solely on the technical merits, that the position will be sustained on audit. Midwest Generation adopted FIN No. 48 effective January 1, 2007. Adoption of FIN No. 48 did not result in a cumulative-effect adjustment to accumulated deficit.

#### Statement of Financial Accounting Standards No. 155—

In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133 and SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 is effective for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007. The fair value election provided for in paragraph 4(c) of this Statement may also be applied upon adoption of this Statement for hybrid financial instruments that had been bifurcated under paragraph 12 of SFAS No. 133 prior to the adoption of this Statement. The adoption of this standard had no effect on Midwest Generation’s consolidated financial statements for the nine months ended September 30, 2007.

### *Accounting Principles Not Yet Adopted*

#### FASB Staff Position FIN No. 39-1—

In April 2007, the FASB issued FIN No. 39-1. FIN No. 39-1 amends paragraph 3 of FIN No. 39 to replace the terms conditional contracts and exchange contracts with the term derivative instruments as defined in SFAS No. 133. FIN No. 39-1 also states that under master netting arrangements if collateral is based on fair value, then it must be netted with the fair value of derivative assets/liabilities if an entity qualified and elected the option to net those amounts. Midwest Generation will adopt FIN No. 39-1 on January 1, 2008. Midwest Generation is currently evaluating the impact of adopting FIN No. 39-1 on its consolidated financial statements.

#### Statement of Financial Accounting Standards No. 157—

In September 2006, the FASB issued SFAS No. 157, which clarifies the definition of fair value, establishes a framework for measuring fair value and expands the disclosures on fair value measurements. Midwest Generation will adopt SFAS No. 157 on January 1, 2008. Midwest Generation is currently evaluating the impact of adopting SFAS No. 157 on its consolidated financial statements.

#### Statement of Financial Accounting Standards No. 159—

In February 2007, the FASB issued SFAS No. 159, which provides an option to report eligible financial assets and liabilities at fair value, with changes in fair value recognized in earnings. Upon adoption, the first remeasurement to fair value would be reported as a cumulative-effect adjustment to

the opening balance of retained earnings. Midwest Generation is currently evaluating whether it will opt to report any current or future financial assets and liabilities at fair value and the impact, if adopted, on its consolidated financial statements, beginning January 1, 2008.

## **Note 2. Long-term Obligations**

### ***Early Extinguishment of Debt***

On May 7, 2007, EME completed a private offering of \$1.2 billion of its 7.00% senior notes due May 15, 2017, \$800 million of its 7.20% senior notes due May 15, 2019 and \$700 million of its 7.625% senior notes due May 15, 2027. EME used a portion of the net proceeds of the offering of the senior notes, together with cash on hand, to make an equity contribution (through intermediate holding companies) to Midwest Generation of approximately \$1.385 billion which enabled Midwest Generation to purchase \$999.8 million of its 8.75% second priority senior secured notes due 2034 and to repay the outstanding amount (\$327.8 million) of its senior secured term loan facility. Midwest Generation recorded a pre-tax loss of \$128.3 million (\$78.8 million after tax) on early extinguishment of debt during the second quarter of 2007.

### ***Credit Agreement Amendment***

On June 29, 2007, Midwest Generation completed a refinancing of indebtedness by amending and restating its existing credit facility. The refinancing provided, among other things, for: (a) the option to extend the maturity of the working capital facility by up to two years, subject to the satisfaction of enumerated conditions, (b) the option to grant first or second priority liens to eligible hedge counterparties, (c) the release of collateral in the event that the unsecured debt of Midwest Generation is rated investment grade, (d) a reduction in the interest rate applicable to the working capital facility, and (e) a modification of covenants, including the incurrence of indebtedness covenant and the financial covenants. The refinancing also eliminates the term loan facility.

After giving effect to the refinancing, the working capital facility interest rate was lowered to LIBOR + 0.55% from LIBOR + 1.50%. The working capital facility matures in 2012, with an option to extend for up to two years. Also, as part of the refinancing, Midwest Generation's financial covenants were modified, with its debt to capitalization ratio to be no greater than 0.60 to 1.

Midwest Generation intends to use its secured working capital facility to provide credit support for its hedging activities and for general working capital purposes. Midwest Generation may also support its hedging activities by granting first or second priority liens to eligible hedge counterparties. As of September 30, 2007, \$2.6 million had been utilized under the working capital facility.

### Note 3. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consisted of the following:

	Unrealized Gains (Losses) on Cash Flow Hedges	Unrecognized Losses and Prior Service Costs, Net(1)	Accumulated Other Comprehensive Income (Loss)
		(in thousands)	
Balance at December 31, 2006 . . . . .	\$ 52,867	\$ (5,190)	\$ 47,677
Current period change . . . . .	(64,228)	(39)	(64,267)
Balance at September 30, 2007 . . . . .	<u>\$ (11,361)</u>	<u>\$ (5,229)</u>	<u>\$ (16,590)</u>

(1) For further detail, see Note 4—Compensation and Benefit Plans.

Unrealized losses on cash flow hedges, net of tax, at September 30, 2007, included unrealized losses on commodity hedges primarily related to futures and forward energy sales contracts that qualify for hedge accounting. These losses arise because current forecasts of future electricity prices are greater than the contract prices. The change from unrealized gains to unrealized losses during the nine months ended September 30, 2007 resulted from an increase in market prices for power.

As Midwest Generation's hedged positions are realized, \$8.6 million, after tax, of the net unrealized gains on cash flow hedges at September 30, 2007 are expected to be reclassified into earnings during the next 12 months. Management expects that reclassification of net unrealized gains will increase energy revenue recognized at market prices. Actual amounts ultimately reclassified into earnings over the next 12 months could vary materially from this estimated amount as a result of changes in market conditions. The maximum period over which a cash flow hedge is designated is through December 31, 2010.

Under SFAS No. 133, the portion of a cash flow hedge that does not offset the change in value of the transaction being hedged, which is commonly referred to as the ineffective portion, is immediately recognized in earnings. Midwest Generation recorded net losses of \$7.8 million and \$0.1 million during the third quarters of 2007 and 2006, respectively, and \$8.3 million and \$1.6 million during the nine months ended September 30, 2007 and 2006, respectively, representing the amount of cash flow hedges' ineffectiveness, reflected in operating revenues in Midwest Generation's consolidated income statements.

### Note 4. Compensation and Benefit Plans

#### *Pension Plans and Postretirement Benefits Other Than Pensions*

##### *Pension Plans*

Midwest Generation previously disclosed in its financial statements for the year ended December 31, 2006 that it expected to contribute approximately \$8.8 million to its pension plans in 2007. As of September 30, 2007, \$7.3 million in contributions have been made. Midwest Generation continues to expect to contribute approximately \$1.5 million to its pension plans in the last three months of 2007. Expected contribution funding in 2007 could vary from anticipated amounts, depending on the funded status at year-end and the tax-deductible funding limitations.

Components of pension expense are:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in thousands)			
Service cost . . . . .	\$ 3,076	\$3,066	\$ 9,229	\$ 9,323
Interest cost . . . . .	1,370	1,195	4,110	3,470
Expected return on plan assets . . . . .	(1,273)	(975)	(3,821)	(2,933)
Amortization of prior service cost . . . . .	57	87	173	261
Amortization of net actuarial gain . . . . .	(40)	—	(122)	—
Total expense . . . . .	<u>\$ 3,190</u>	<u>\$3,373</u>	<u>\$ 9,569</u>	<u>\$10,121</u>

*Postretirement Benefits Other Than Pensions*

Midwest Generation previously disclosed in its financial statements for the year ended December 31, 2006 that it expected to contribute \$427,000 to its postretirement benefits other than pensions in 2007. As of September 30, 2007, \$320,000 in contributions have been made. Midwest Generation continues to expect to contribute \$107,000 to its postretirement benefits other than pensions in the last three months of 2007. Expected contribution funding in 2007 could vary from anticipated amounts, depending on the funded status at year-end and the tax-deductible funding limitations.

Components of postretirement benefits expense are:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in thousands)			
Service cost . . . . .	\$ 165	\$ 161	\$ 496	\$ 483
Interest cost . . . . .	382	344	1,147	1,031
Amortization of prior service credit . . . . .	(178)	(178)	(536)	(536)
Amortization of net actuarial loss . . . . .	144	165	433	497
Total expense . . . . .	<u>\$ 513</u>	<u>\$ 492</u>	<u>\$1,540</u>	<u>\$1,475</u>

**Note 5. Income Taxes**

Midwest Generation had an effective income tax provision rate of 37.8% and 38.9% for the nine months ended September 30, 2007 and 2006, respectively. Midwest Generation's effective income tax rate varies from the federal statutory rate of 35% primarily due to state income taxes, and estimated benefits from a federal deduction related to qualified domestic production activities under Section 199 of the Internal Revenue Code.

The total amount of unrecognized tax benefits (excluding the effect of federal income taxes on unrecognized state tax benefits) was \$11.7 million and \$21.3 million as of September 30, 2007 and the date of adoption of FIN No. 48, respectively. The change results from tax positions taken for prior periods. None of the unrecognized tax benefits as of the date of adoption, if recognized, would affect the effective tax rate. The total amount of accrued interest and penalties was \$1.4 million and \$2.1 million as of September 30, 2007 and at the date of adoption, respectively.

Midwest Generation and its subsidiaries remain subject to examination by the Internal Revenue Service, the California Franchise Tax Board, and other state authorities from 1994 to present. Midwest Generation continues its efforts to resolve open tax issues with the Internal Revenue Service and state authorities. The timing for resolving these open tax positions is subject to uncertainty, but it is reasonably possible that some portion of these open tax positions could be resolved in the next twelve months.

## **Note 6. Commitments and Contingencies**

### ***Commitments***

#### ***Capital Improvements***

At September 30, 2007, Midwest Generation had firm commitments to spend approximately \$25.9 million on capital expenditures during the remainder of 2007 and \$10.1 million in 2008, primarily related to environmental improvements. These capital expenditures are planned to be financed by cash generated from operations.

#### ***Fuel Supply Contracts***

Midwest Generation has entered into additional fuel purchase commitments during the first nine months of 2007. These additional commitments are currently estimated to be \$14.9 million for the remainder of 2007, \$105.8 million in 2008, \$73.5 million in 2009, and \$76.5 million in 2010.

#### ***Coal Transportation Agreements***

Midwest Generation has contractual agreements for the transport of coal to its facilities. The primary contract is with Union Pacific Railroad (and various delivering carriers), which extends through 2011. Midwest Generation's commitments under this contract are based on actual coal purchases from the PRB. Accordingly, contractual obligations for transportation are based on coal volumes set forth in fuel supply contracts. The increase in transportation commitments entered into during the first nine months of 2007 relates to additional volumes of fuel purchases using the terms of existing transportation agreements. These additional commitments are currently estimated to be \$17.6 million for the remainder of 2007, \$111.0 million for 2008, \$75.6 million for 2009, and \$77.1 million for 2010.

#### ***Interconnection Agreement***

Midwest Generation has entered into interconnection agreements with Commonwealth Edison to provide interconnection services necessary to connect the Illinois Plants with its transmission systems. Unless terminated earlier in accordance with their terms, the interconnection agreements will terminate on a date mutually agreed to by both parties. Midwest Generation is required to compensate Commonwealth Edison for all reasonable costs associated with any modifications, additions or replacements made to the interconnection facilities or transmission systems in connection with any modification, addition or upgrade to the Illinois Plants.

#### ***Guarantees and Indemnities***

##### ***Tax Indemnity Agreement***

In connection with the sale-leaseback transactions related to the Powerton and Joliet Stations and previously the Collins Station, EME, Midwest Generation and another wholly owned subsidiary of

EME entered into tax indemnity agreements. Under these tax indemnity agreements, these entities agreed to indemnify the lessors in the sale-leaseback transactions for specified adverse tax consequences that could result in certain situations set forth in the tax indemnity agreement, including specified defaults under the respective leases. The potential indemnity obligation under these tax indemnity agreements could be significant. Due to the nature of these obligations, Midwest Generation cannot determine a maximum potential liability which would be triggered by a valid claim from the lessors. Midwest Generation has not recorded a liability related to these indemnities. In connection with the termination of the Collins Station lease in April 2004, Midwest Generation continues to have obligations under the tax indemnity agreement with the former lease equity investor.

#### *Indemnity Provided as Part of the Acquisition from Commonwealth Edison*

In connection with the acquisition of the Illinois Plants, Midwest Generation agreed to indemnify Commonwealth Edison with respect to specified environmental liabilities before and after December 15, 1999, the date of sale. The indemnification claims are reduced by any insurance proceeds and tax benefits related to such claims and are subject to a requirement that Commonwealth Edison takes all reasonable steps to mitigate losses related to any such indemnification claim. Due to the nature of the obligation under this indemnity, a maximum potential liability cannot be determined. This indemnification for environmental liabilities is not limited in term and would be triggered by a valid claim from Commonwealth Edison. Except as discussed below, Midwest Generation has not recorded a liability related to this indemnity.

Midwest Generation entered into a supplemental agreement with Commonwealth Edison and Exelon Generation on February 20, 2003 to resolve a dispute regarding interpretation of its reimbursement obligation for asbestos claims under the environmental indemnities set forth in the Asset Sale Agreement. Under this supplemental agreement, Midwest Generation agreed to reimburse Commonwealth Edison and Exelon Generation for 50% of specific asbestos claims pending as of February 2003 and related expenses less recovery of insurance costs, and agreed to a sharing arrangement for liabilities and expenses associated with future asbestos-related claims as specified in the agreement. As a general matter, Commonwealth Edison and Midwest Generation apportion responsibility for future asbestos-related claims based upon the number of exposure sites that are Commonwealth Edison locations or Midwest Generation locations. The obligations under this agreement are not subject to a maximum liability. The supplemental agreement has a five-year term with an automatic renewal provision (subject to the right of either party to terminate). Payments are made under this indemnity upon tender by Commonwealth Edison of appropriate proof of liability for an asbestos-related settlement, judgment, verdict, or expense. There were approximately 208 cases for which Midwest Generation was potentially liable and that had not been settled and dismissed at September 30, 2007. Midwest Generation had recorded a \$64.2 million liability at September 30, 2007 related to this matter.

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

#### *Contingencies*

##### *FERC Notice Regarding Investigatory Proceeding against EMMT*

In October 2006, EMMT was advised by the enforcement staff at the FERC that it is prepared to recommend that the FERC initiate a formal investigatory proceeding and seek monetary sanctions

against EMMT for alleged violation of the Energy Policy Act of 2005 and the FERC's rules regarding market behavior, all with respect to certain bidding practices previously employed by EMMT. EMMT is engaged in discussions with the staff to explore the possibility of resolution of this matter. Discussions to date have been constructive and may lead to a settlement agreement acceptable to both parties. Should these discussions not result in a settlement and a formal proceeding commenced, EMMT will be entitled to contest any alleged violations before the FERC and an appropriate court. EMMT has advised Midwest Generation that EMMT believes that it has complied with all applicable laws and regulations and intends to contest vigorously any allegation of violation.

#### *Challenges of Illinois Power Procurement Auction Results*

EMMT participated successfully in the first Illinois power procurement auction, held in September 2006 according to rules approved by the Illinois Commerce Commission, and entered into two load requirements services contracts through which it is delivering electricity, capacity and specified ancillary, transmission and load following services necessary to serve a portion of Commonwealth Edison's residential and small commercial customer load, using contracted supply from Midwest Generation.

#### Settlement with Illinois Attorney General—

On March 16, 2007, the Office of the Attorney General for the State of Illinois filed a complaint at the FERC alleging that the prices resulting from the Illinois auction resulted in unjust and unreasonable rates under the Federal Power Act and that participating wholesale sellers in the Illinois auction had colluded and manipulated the results of the auction. All successful participants in the Illinois auction, including EMMT, were named as respondents. The Office of the Attorney General asked the FERC to order refunds and to revoke the respondents' market-based rate pricing authority.

On July 24, 2007, Midwest Generation and EMMT, along with other power generation companies and utilities, entered into a settlement agreement with the Illinois Attorney General. The settlement was subject to the passage of legislation which will, among other things, establish a new Illinois Power Agency to manage future power procurement for the Illinois regulated utilities, Commonwealth Edison and Ameren (beginning with the planning year June 1, 2009 through May 31, 2010). The settlement legislation was passed by the Illinois legislature on July 26, 2007, and was signed by the Governor of Illinois on August 28, 2007.

As part of the settlement, Midwest Generation has agreed to pay \$25 million over three years toward approximately \$1 billion in utility customer rate relief and startup costs of the new Illinois Power Agency. The remainder is to be funded by subsidiaries of Exelon Corporation, subsidiaries of Ameren, Dynegy Holdings Inc., and Mid-American Energy Company. Also as part of the settlement, all auction-related complaints filed by the Illinois Attorney General at the FERC, the Illinois Commerce Commission and in the Illinois courts have been dismissed. The private class action lawsuits described below remain pending.

Midwest Generation made a payment of \$7.5 million in September 2007 and is obligated to make monthly payments of \$750,000 beginning in January 2008 and continuing until the total commitment has been funded. These payments are non-refundable; however, Midwest Generation's obligations to make the monthly payments will cease if, at any time prior to December 2009, Illinois imposes an electric rate freeze or an additional tax on generators.

## Class Action Lawsuits—

On April 4, 2007, EMMT was served with a complaint filed in the Circuit Court of Cook County, Illinois, by Saul R. Wexler, individually and on behalf of an alleged class of similarly situated electric ratepayers in Illinois against Commonwealth Edison, Ameren, and all of the successful participants in the Illinois auction, including EMMT. The lawsuit alleges that the defendants, including EMMT, colluded and conspired to manipulate the auction results by price-fixing. The lawsuit seeks unspecified damages. On April 26, 2007, the defendants transferred the complaint to the U.S. District Court for the Northern District of Illinois, Eastern Division. On June 4, 2007, the defendants filed a motion to dismiss the case.

On March 30, 2007, David Schafer, Tim Perry, Pat Martin and Michael Murray, individually and on behalf of an alleged class of similarly situated electric ratepayers in Illinois, filed a complaint in the Circuit Court of Cook County, Illinois, against Commonwealth Edison, Ameren, and all of the successful participants in the Illinois auction, including EMMT. EMMT has not been formally served in the case. The lawsuit alleges that the defendants, including EMMT, colluded and conspired to manipulate the auction results by price-fixing. The lawsuit seeks unspecified damages. On April 26, 2007, the defendants transferred the complaint to the U.S. District Court for the Northern District of Illinois, Eastern Division. On June 4, 2007, the defendants filed a motion to dismiss the case.

The Wexler case and the Schafer case have been consolidated into a single proceeding by the U.S. District Court for the Northern District of Illinois, Eastern Division. The defendants' motions to dismiss the case remain pending.

Midwest Generation believes that EMMT's actions in regard to the Illinois auction were appropriate and lawful and intends to defend vigorously both of the matters described above. However, at this time Midwest Generation cannot predict the outcome of these matters.

### *Potential Environmental Proceeding*

On July 31, 2007, the US EPA issued a NOV to Midwest Generation and Commonwealth Edison. In the NOV, the US EPA alleges that, beginning in the early 1990's and into 2003, Midwest Generation or Commonwealth Edison performed repair or replacement projects at six Illinois coal-fired electric generating stations in violation of the Prevention of Significant Deterioration requirements and of the New Source Performance Standards of the Clean Air Act, including alleged requirements to obtain a construction permit and to install Best Available Control Technology at the time of the projects. The US EPA also alleges that Midwest Generation and Commonwealth Edison violated certain operating permit requirements under Title V of the Clean Air Act. Finally, the US EPA alleges violations of certain opacity and particulate matter standards at the Illinois Plants. The NOV does not specify the penalties or other relief that the US EPA seeks for the alleged violations. Midwest Generation, the US EPA, and the DOJ are in talks designed to explore the possibility of a settlement. If the settlement talks fail and the DOJ files suit, litigation could take many years to resolve the issues alleged in the NOV. As a result, Midwest Generation is investigating the claims made by the US EPA in the NOV and has identified several defenses which it will raise if the government files suit. At this early stage in the process, Midwest Generation cannot predict the effect this matter may have on its facilities, its results of operations or financial position.

On August 13, 2007, Midwest Generation and Commonwealth Edison received a letter signed by several Chicago-based environmental action groups stating that, in light of the NOV, the groups are examining the possibility of filing a citizen suit against Midwest Generation and Commonwealth Edison based presumably on the same or similar theories advanced by the US EPA in the NOV.

By letter dated August 8, 2007, Commonwealth Edison advised Midwest Generation that Commonwealth Edison believes it is entitled to indemnification for all liabilities, costs, and expenses that it may be required to bear as a result of the NOV. By letter dated August 16, 2007, Commonwealth Edison tendered a request for indemnification to Midwest Generation for all liabilities,

costs, and expenses that Commonwealth Edison may be required to bear if the environmental groups were to file suit. Midwest Generation and Commonwealth Edison are cooperating with one another in responding to the NOV.

***Environmental Matters and Regulations***

The construction and operation of power plants are subject to environmental regulation by federal, state and local authorities. Midwest Generation believes that it is in substantial compliance with existing environmental regulatory requirements. Typically, environmental laws and regulations require a lengthy and complex process for obtaining licenses, permits and approvals prior to construction, operation or modification of a project or generating facility. Meeting all the necessary requirements can delay or sometimes prevent the completion of a proposed project, as well as require extensive modifications to existing projects, which may involve significant capital expenditures. If Midwest Generation fails to comply with applicable environmental laws, it may be subject to injunctive relief or penalties and fines imposed by regulatory authorities.

With respect to Midwest Generation’s potential liabilities arising under CERCLA or similar laws for the investigation and remediation of contaminated property, Midwest Generation accrues a liability to the extent the costs are probable and can be reasonably estimated. Midwest Generation had accrued approximately \$3.4 million at September 30, 2007 for estimated environmental investigation and remediation costs for the Illinois Plants. This estimate is based upon the number of sites, the scope of work and the estimated costs for environmental activity where such expenditures could be reasonably estimated. Future estimated costs may vary based on changes in regulations or requirements of federal, state, or local governmental agencies, changes in technology, and actual costs of disposal. In addition, future remediation costs will be affected by the nature and extent of contamination discovered at the sites that requires remediation. Given the prior history of the operations at its facilities, Midwest Generation cannot be certain that the existence or extent of all contamination at its sites has been fully identified. However, based on available information, management believes that future costs in excess of the amounts disclosed on all known and quantifiable environmental contingencies will not be material to Midwest Generation’s financial position. See “Note 10. Commitments and Contingencies—Environmental Matters and Regulations” in Midwest Generation’s financial statements included in its annual report on Form 10-K for the year ended December 31, 2006 for a more complete discussion of Midwest Generation’s environmental contingencies.

**Note 7. Supplemental Statements of Cash Flows Information**

	Nine Months Ended September 30	
	2007	2006
	(in thousands)	
Cash paid (received)		
Interest . . . . .	\$135,255	\$149,837
Income taxes . . . . .	(3,250)	—

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*This MD&A contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements reflect Midwest Generation's current expectations and projections about future events based on Midwest Generation's knowledge of present facts and circumstances and assumptions about future events and include any statement that does not directly relate to a historical or current fact. Other information distributed by Midwest Generation that is incorporated in this report, or that refers to or incorporates this report, may also contain forward-looking statements. In this quarterly report on Form 10-Q, the words "expects," "believes," "anticipates," "estimates," "projects," "intends," "plans," "probable," "may," "will," "could," "would," "should," and variations of such words and similar expressions, or discussions of strategy or plans, are intended to identify forward-looking statements. Such statements necessarily involve risks and uncertainties that could cause actual results to differ materially from those anticipated. Some of the risks, uncertainties and other important factors that could cause results to differ, or that otherwise could impact Midwest Generation or its subsidiaries, include but are not limited to:*

- supply and demand for electric capacity and energy, and the resulting prices and dispatch volumes, in the wholesale markets to which Midwest Generation's generating units have access;*
- the cost and availability of fuel and fuel transportation services;*
- market volatility and other market conditions that could increase Midwest Generation's obligations to post collateral beyond the amounts currently expected, and the potential effect of such conditions on the ability of Midwest Generation to provide sufficient collateral in support of its hedging activities and purchases of fuel;*
- the cost and availability of emission credits or allowances;*
- transmission congestion in and to each market area and the resulting differences in prices between delivery points;*
- governmental, statutory, regulatory or administrative changes or initiatives affecting Midwest Generation or the electricity industry generally, including market structure rules;*
- environmental regulations that could require additional expenditures or otherwise affect Midwest Generation's cost and manner of doing business;*
- the ability of Midwest Generation to borrow funds and access capital markets on favorable terms;*
- the extent of additional supplies of capacity, energy and ancillary services from current competitors or new market entrants, including the development of new generation facilities and technologies that may be able to produce electricity at a lower cost than Midwest Generation's generating facilities and/or increased access by competitors to Midwest Generation's markets as a result of transmission upgrades;*
- the difficulty of predicting wholesale prices, transmission congestion, energy demand, and other aspects of the complex and volatile markets in which Midwest Generation participates;*
- operating risks, including equipment failure, availability, heat rate, output and availability and cost of spare parts and repairs;*

- effects of legal proceedings, changes in or interpretations of tax laws, rates or policies, and changes in accounting standards;
- general political, economic and business conditions; and
- weather conditions, natural disasters and other unforeseen events.

Additional information about risks and uncertainties, including more detail about the factors described above, is contained throughout this MD&A and in the “Risk Factors” section included in Part I, Item 1A of Midwest Generation’s Annual Report on Form 10-K for the year ended December 31, 2006. Readers are urged to read this entire quarterly report on Form 10-Q and carefully consider the risks, uncertainties and other factors that affect Midwest Generation’s business. Forward-looking statements speak only as of the date they are made, and Midwest Generation is not obligated to publicly update or revise forward-looking statements. Readers should review future reports filed by Midwest Generation with the Securities and Exchange Commission.

This MD&A discusses material changes in the results of operations, financial condition and other developments of Midwest Generation since December 31, 2006, and as compared to the third quarter of 2006 and nine months ended September 30, 2006. This discussion presumes that the reader has read or has access to the MD&A included in Item 7 of Midwest Generation’s annual report on Form 10-K for the year ended December 31, 2006.

This MD&A is presented in four sections:

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Management’s Overview; Critical Accounting Policies . . . . .	16
Results of Operations . . . . .	19
Liquidity and Capital Resources . . . . .	22
Market Risk Exposures . . . . .	30

## **MANAGEMENT’S OVERVIEW; CRITICAL ACCOUNTING POLICIES**

### **Management’s Overview**

#### ***Introduction***

Midwest Generation is a Delaware limited liability company formed on July 12, 1999 for the purpose of owning or leasing, making improvements to, and operating and selling the capacity and energy of, the power generation assets it purchased from Commonwealth Edison, which are referred to as the Illinois Plants.

Midwest Generation is currently operating 5,918 MW of power plants consisting of:

- six coal-fired generating plants consisting of 5,613 MW, which include the Powerton, Joliet, Will County, Waukegan, Crawford and Fisk Stations; and
- the Fisk and Waukegan on-site generating peakers consisting of 305 MW, based on PJM installed capability.

Midwest Generation’s power plants are located in the control area managed by PJM. The energy and capacity from the Illinois Plants are sold under terms, including price and quantity, arranged by

EMMT, an EME subsidiary engaged in the power marketing and trading business, with customers through a combination of bilateral agreements, forward energy sales and spot market sales. See “Market Risk Exposures” for further discussion of forward market prices.

### ***Overview of Midwest Generation’s Operating Performance***

Midwest Generation’s net income for the quarter and nine months ended September 30, 2007 was \$135.3 million and \$220.5 million, respectively, compared to \$110.3 million and \$178.7 million, for the quarter and nine months ended September 30, 2006, respectively. The increase in third quarter earnings was primarily attributable to lower interest expense due to the repayment of debt in May 2007 and higher energy margin, partially offset by a \$7.5 million payment during the third quarter of 2007 related to the settlement agreement with the Illinois Attorney General. The increase in year-to-date earnings was primarily attributable to higher energy revenues resulting from higher generation and average realized prices, and lower interest expense. Partially offsetting these increases were higher planned maintenance costs and a \$7.5 million payment during the third quarter of 2007 as described above. Earnings for 2007 were also adversely affected due to the timing of unrealized gains and losses related to hedge contracts as described further in “Results of Operations—Operating Revenues.”

### ***PJM Reliability Pricing Model***

During 2007, PJM completed capacity auctions under the PJM RPM for periods through May 31, 2010. EMMT participated in each auction which sold forward significant capacity at prices from \$40.80 per MW-day to \$111.92 per MW-day. The increase in capacity prices determined through the PJM RPM reflected the auction design to encourage increased capacity resources to meet projected demand. As a result of these auctions, capacity revenues are expected to increase significantly through May 31, 2010 as compared to the amounts realized previously. For further discussion regarding the PJM and recent auctions, see “Market Risk Exposures—Commodity Price Risk—Capacity Price Risk.”

### ***Illinois Settlement***

On July 24, 2007, Midwest Generation and its affiliate EMMT, along with other power generation companies and utilities, entered into a settlement agreement with the Illinois Attorney General that subsequently resulted in legislation that was signed by the Governor of Illinois. The legislation established a new Illinois Power Agency to manage future power procurement for the Illinois regulated utilities, Commonwealth Edison and Ameren (beginning with the planning year June 1, 2009 through May 31, 2010). As part of the settlement, Midwest Generation has agreed to pay \$25 million over three years toward approximately \$1 billion in utility customer rate relief and startup costs of the new Illinois Power Agency. Also as part of the settlement, all auction-related complaints filed by the Illinois Attorney General at the FERC, the Illinois Commerce Commission and in the Illinois courts have been dismissed. See “Settlement with Illinois Attorney General” under “Liquidity and Capital Resources—Contractual Obligations and Contingencies—Contingencies” for further discussion.

### ***Financing Activities***

On May 7, 2007, EME completed a private offering of \$1.2 billion of its 7.00% senior notes due 2017, \$800 million of its 7.20% senior notes due 2019 and \$700 million of its 7.625% senior notes due 2027. EME used a portion of the net proceeds of the offering of the senior notes, together with cash on hand, to make an equity contribution (through intermediate holding companies) to Midwest Generation of approximately \$1.385 billion which enabled Midwest Generation to purchase \$999.8 million of its 8.75% second priority senior secured notes due 2034 and to repay the outstanding

amount (\$327.8 million) of its senior secured term loan facility. Midwest Generation recorded a pre-tax loss of \$128.3 million on early extinguishment of debt during the second quarter of 2007.

During the second quarter of 2007, Midwest Generation amended and restated its existing \$500 million senior secured working capital facility. The changes to the senior secured working capital facility included a reduction in the interest rate, a longer maturity date, and fewer restrictive covenants. Midwest Generation intends to use its secured working capital facility to provide credit support for its hedging activities and for general working capital purposes. Midwest Generation may also support its hedging activities by granting first or second priority liens to eligible hedge counterparties.

### **Critical Accounting Policies**

For a discussion of Midwest Generation's critical accounting policies, refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Estimates" of Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006.

## RESULTS OF OPERATIONS

### Summary

The table below summarizes total revenues as well as key performance measures related to coal-fired generation, which represents the majority of Midwest Generation's operations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
<b>Operating Revenues</b> (in millions) . . . . .	\$ 449	\$ 438	\$ 1,214	\$ 1,050
<b>Statistics – Coal-Fired Generation</b>				
Generation (in GWh)				
Energy only contracts . . . . .	6,298	8,429	17,441	21,167
Load requirements services contracts(1) . . . . .	2,115	—	5,728	—
Total . . . . .	8,413	8,429	23,169	21,167
Aggregate plant performance				
Equivalent availability(2) . . . . .	86.6%	89.6%	78.7%	80.9%
Capacity factor(3) . . . . .	67.9%	68.0%	63.0%	57.6%
Load factor(4) . . . . .	78.4%	75.9%	80.1%	71.2%
Forced outage rate(5) . . . . .	8.6%	7.0%	7.0%	5.7%
Average realized price/MWh				
Energy only contracts(6) . . . . .	\$ 48.15	\$ 50.06	\$ 48.73	\$ 47.53
Load requirements services contracts(7) . . . . .	\$ 65.27	\$ —	\$ 63.34	\$ —
Capacity revenue only (in millions) . . . . .	\$ 11	\$ 7	\$ 17	\$ 20
Average fuel costs/MWh . . . . .	\$ 13.88	\$ 14.12	\$ 13.40	\$ 13.53

- (1) Represents two load requirements services contracts, awarded as part of an Illinois auction, with Commonwealth Edison that commenced on January 1, 2007.
- (2) The equivalent availability factor is defined as the number of MWh the coal units are available to generate electricity divided by the product of the capacity of the coal units (in MW) and the number of hours in the period. Equivalent availability reflects the impact of the unit's inability to achieve full load, referred to as derating, as well as outages which result in a complete unit shutdown. The coal units are not available during periods of planned and unplanned maintenance.
- (3) The capacity factor is defined as the actual number of MWh generated by the coal plants divided by the product of the capacity of the coal plants (in MW) and the number of hours in the period.
- (4) The load factor is determined by dividing capacity factor by the equivalent availability factor.
- (5) Midwest Generation refers to unplanned maintenance as a forced outage.
- (6) The average realized energy price reflects the average price at which energy is sold into the market including the effects of hedges, real-time and day-ahead sales and PJM fees and ancillary services. It is determined by dividing (i) operating revenue less unrealized SFAS No. 133 gains (losses) and other non-energy related revenue by (ii) generation. Revenue related to capacity sales are excluded from the calculation of average realized energy price.
- (7) The average realized price reflects the contract price for sales to Commonwealth Edison under load requirements services contracts that include energy, capacity and ancillary services. It is determined by dividing (i) contract revenue less PJM operating and ancillary charges by (ii) generation.

## **Operating Revenues**

Operating revenues increased \$10.5 million and \$163.4 million for the third quarter of 2007 and nine months ended September 30, 2007, respectively, compared to the corresponding periods of 2006, primarily due to higher energy revenues. The increase in energy revenues was attributable to higher generation and higher average realized energy prices, partially offset by the timing of unrealized gains and losses related to hedge contracts as described below.

Included in operating revenues were unrealized gains (losses) of \$(7.8) million and \$5.1 million for the third quarters of 2007 and 2006, respectively, and \$(26.2) million and \$16.5 million for the nine months ended September 30, 2007 and 2006, respectively. Unrealized gains (losses) are primarily due to power contracts that did not qualify for hedge accounting under SFAS No. 133 (sometimes referred to as economic hedges). These energy contracts were entered into to hedge the price risk related to projected sales of power. During 2007, power prices increased, resulting in mark-to-market losses on economic hedges. At September 30, 2007, unrealized losses of \$18.7 million were recognized primarily from economic hedges and from the ineffective portion of cash flow hedges related to subsequent periods. The ineffective portion of hedge contracts at the Illinois Plants was primarily attributable to changes in the difference between energy prices at NiHub (the settlement point under forward contracts) and the energy prices at the Illinois Plants busbars (the delivery point where power generated by the Illinois Plants is delivered into the transmission system) resulting from marginal losses. See “Market Risk Exposures—Commodity Price Risk” for more information regarding forward market prices.

### *Seasonal Disclosure*

Due to higher electric demand resulting from warmer weather during the summer months and cold weather during the winter months, electric revenues from the Illinois Plants vary substantially on a seasonal basis. In addition, maintenance outages generally are scheduled during periods of lower projected electric demand (spring and fall) further reducing generation and increasing major maintenance costs which are recorded as an expense when incurred. Accordingly, earnings from the Illinois Plants are seasonal and have significant variability from quarter to quarter. Seasonal fluctuations may also be affected by changes in market prices. See “Market Risk Exposures—Commodity Price Risk—Energy Price Risk” for further discussion regarding market prices.

## **Operating Expenses**

Operating expenses increased \$4.8 million and \$33.3 million for the third quarter of 2007 and nine months ended September 30, 2007, respectively, compared to the corresponding periods of 2006. Operating expenses consist of fuel, gain on the sale of emission allowances, plant operations, depreciation and amortization, gain (loss) from disposal of assets, and administrative and general expenses. The change in the components of operating expenses is discussed below.

Fuel expenses decreased \$4.3 million and increased \$23.0 million for the third quarter of 2007 and nine months ended September 30, 2007, respectively, compared to the corresponding periods of 2006. The third quarter decrease was attributable to lower NO<sub>x</sub> emission allowance costs, as compared to 2006. The year-to-date increase was primarily attributable to higher coal consumption in 2007, as compared to 2006, resulting from higher generation.

Gain on the sale of emission allowances was \$4.1 million and \$12.1 million for the third quarter of 2007 and nine months ended September 30, 2007. Midwest Generation sold excess SO<sub>2</sub> emission allowances to an affiliate during the second and third quarters of 2007. During 2006, Midwest Generation did not sell

its excess SO<sub>2</sub> emission allowances to its affiliate until the fourth quarter, which resulted in gains of \$14.3 million.

Plant operations expenses increased \$9.6 million and \$29.6 million for the third quarter of 2007 and nine months ended September 30, 2007, respectively, compared to the corresponding periods of 2006. The third quarter increase was primarily attributable to the \$7.5 million payment made related to the settlement agreement with the Illinois Attorney General. The year-to-date increase was primarily attributable to higher overhaul and planned maintenance costs in 2007, as compared to 2006.

Loss from disposal of assets was \$5.1 million and \$5.6 million for the third quarter of 2007 and nine months ended September 30, 2007, respectively. The losses were primarily due to the write-off of the net book value of certain equipment at the Powerton and Joliet Stations. Loss from disposal of assets was \$8.8 million for the nine months ended September 30, 2006, which was primarily due to the \$10.9 million write-off of the estimated net book value of some major components that were replaced during the second quarter of 2006.

### Other Income (Expense)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in thousands)			
Interest and other income . . . . .	\$ 2,362	\$ 824	\$ 5,465	\$ 2,407
Interest income from affiliates . . . . .	28,859	29,346	86,355	85,817
Interest expense . . . . .	(18,160)	(51,227)	(97,205)	(153,408)
Loss on early extinguishment of debt . . . . .	—	—	(128,271)	—
Total other expense . . . . .	<u>\$ 13,061</u>	<u>\$(21,057)</u>	<u>\$(133,656)</u>	<u>\$ (65,184)</u>

Interest expense decreased \$33.1 million and \$56.2 million for the third quarter of 2006 and nine months ended September 30, 2007, respectively, compared to the corresponding periods of 2006, primarily due to repayment of debt in May 2007.

Loss on early extinguishment of debt for the nine months ended September 30, 2007 related to the early repayment of Midwest Generation's 8.75% second priority senior secured notes due May 1, 2034.

### Provision For Income Taxes

Midwest Generation had an effective income tax provision rate of 37.8% and 38.9% during the first nine months of 2007 and 2006, respectively. Midwest Generation's effective income tax rate varies from the federal statutory rate of 35% primarily due to state income taxes, and estimated benefits from a federal deduction related to qualified domestic production activities under Section 199 of the Internal Revenue Code.

### New Accounting Pronouncements

For a discussion of new accounting pronouncements affecting Midwest Generation, see "Midwest Generation, LLC and Subsidiaries Notes to Consolidated Financial Statements—Note 1. Summary of Significant Accounting Policies—New Accounting Pronouncements."

## LIQUIDITY AND CAPITAL RESOURCES

### Introduction

The following discussion of liquidity and capital resources is organized in the following sections:

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For a complete discussion of these issues, read this quarterly report on Form 10-Q in conjunction with Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006.

### Consolidated Cash Flow

At September 30, 2007, Midwest Generation had cash and cash equivalents of \$111.8 million, compared to \$170.8 million at December 31, 2006. Net working capital at September 30, 2007 was \$101.0 million, compared to \$237.4 million at December 31, 2006. The decline in working capital was primarily the result of a decrease in net derivative assets, largely driven by an increase in forward prices, a decrease in net receivables from affiliates, including loans for margin deposits, and a decrease in cash and cash equivalents. Partially offsetting these decreases were an increase in net deferred tax assets and a decrease in interest payable.

Net cash provided by operating activities decreased \$152.3 million in the first nine months of 2007, compared to the first nine months of 2006. The decrease was primarily due to the timing of cash receipts and disbursements related to working capital items as described above, partially offset by higher net income in 2007.

Net cash used in financing activities increased \$12.8 million in the first nine months of 2007, compared to the first nine months of 2006. In the first nine months of 2007, Midwest Generation received a \$1.4 billion contribution from its parent which was used to repay \$1.3 billion of long-term debt and tender premiums and related fees of \$106.8 million. In addition, Midwest Generation made distributions of \$475.2 million to its parent from cash generated from operations. In the first nine months of 2006, Midwest Generation made a \$380.1 million distribution to its parent, repaid \$537.6 million of long-term debt and borrowed \$395 million under its working capital facility.

Net cash used in investing activities decreased \$4.9 million in the first nine months of 2007, compared to the first nine months of 2006. The decrease was primarily due to an increase in proceeds from the sale of emission allowances, offset by an increase in capital expenditures.

Midwest Generation's principal sources of liquidity are cash on hand, a \$500 million working capital facility, payments by EME under the intercompany notes issued in connection with the Powerton-Joliet facilities sale-leaseback and future cash flow from operations. As of September 30, 2007, \$2.6 million had been utilized under the working capital facility.

## Capital Expenditures

At September 30, 2007, the estimated capital expenditures by Midwest Generation for October through December 2007 and for 2008 and 2009 were as follows:

	October through December 2007	2008	2009
	(in millions)		
Plant capital expenditures . . . . .	\$ 11.6	\$ 44.5	\$ 26.4
Environmental expenditures . . . . .	18.8	38.6	66.5
Total . . . . .	<u>\$ 30.4</u>	<u>\$ 83.1</u>	<u>\$ 92.9</u>

Plant capital expenditures relate to non-environmental projects such as upgrades to dust collection/mitigation systems and mill inerting projects. Environmental expenditures relate to various projects to achieve specified emissions reductions such as installation of mercury controls. Midwest Generation plans to finance these expenditures with its working capital facility, cash on hand or cash generated from operations. See further discussion regarding these and possible additional capital expenditures under “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Environmental Matters and Regulations—Air Quality Regulation” of Midwest Generation’s annual report on Form 10-K for the year ended December 31, 2006.

## Credit Facility and Other Covenants

Midwest Generation is bound by the covenants in its credit agreement and certain covenants under the Powerton-Joliet lease documents with respect to Midwest Generation making payments under the leases. These covenants include restrictions on the ability to, among other things, incur debt, create liens on its property, merge or consolidate, sell assets, make investments, engage in transactions with affiliates, make distributions, make capital expenditures, enter into agreements restricting its ability to make distributions, engage in other lines of business or engage in transactions for any speculative purpose. In order for Midwest Generation to make a distribution, it must be in compliance with the covenants specified under its credit agreement, including maintaining a debt to capitalization ratio of no greater than 0.60 to 1. At September 30, 2007, the debt to capitalization ratio was 0.23 to 1. During the nine months ended September 30, 2007, Midwest Generation made distributions totaling \$475.2 million. In October 2007, Midwest Generation made an additional distribution of \$115 million.

## Powerton-Joliet Lease Payments

As part of the sale-leaseback of the Powerton and Joliet Stations, Midwest Generation loaned the proceeds (in the original amount of \$1.367 billion) to EME in exchange for promissory notes in the same aggregate amount. EME’s obligations under the promissory notes payable to Midwest Generation are general corporate obligations of EME and are not contingent upon receiving distributions from its subsidiaries. There is no assurance that EME will have sufficient cash flow to meet these obligations. Furthermore, EME has guaranteed Midwest Generation’s lease obligations under these leases. If EME fails to pay under its guarantee, including payments due under the Powerton-Joliet leases in the event that Midwest Generation could not make such payments, this would result in an event of default under the Powerton and Joliet leases. This event would have a material adverse effect on Midwest Generation.

## Credit Ratings

### Overview

Credit ratings for EME, Midwest Generation and EMMT, at September 30, 2007, were as follows:

	<u>Moody's Rating</u>	<u>S&amp;P Rating</u>	<u>Fitch Rating</u>
EME . . . . .	B1	BB-	BB-
Midwest Generation . . . . .	Baa3	BB+	BBB-
EMMT . . . . .	Not Rated	BB-	Not Rated

Midwest Generation cannot provide assurance that the credit ratings above will remain in effect for any given period of time or that one or more of these ratings will not be lowered. Midwest Generation notes that these credit ratings are not recommendations to buy, sell or hold securities and may be revised at any time by a rating agency.

### Credit Rating of EMMT

Midwest Generation sells merchant energy and capacity and purchases its natural gas through EMMT, which currently has a below investment grade credit rating. Midwest Generation is expected to have cash on hand and has a \$500 million working capital facility that can be used to provide credit support for hedging contracts entered into by EMMT related to the Illinois Plants. As of September 30, 2007, \$2.6 million was utilized under this facility.

As of September 30, 2007, Midwest Generation had \$27.8 million in loans receivable from EMMT. EMMT borrows under its revolving credit agreement with Midwest Generation to provide credit support for futures and forward contracts. Loans provided under this revolving credit agreement are repaid by EMMT upon the return of the funds under the terms of the related forward contracts. The amount repaid includes interest earned, if any, under margining agreements supporting such contracts.

Midwest Generation anticipates that sales of its power through EMMT may require additional credit support, depending upon market conditions and the strategies adopted for the sale of this power. Changes in forward market prices and margining requirements and increases in merchant sales could further increase the need for credit support related to hedging activities. Midwest Generation is able to provide collateral to support bilateral contracts for power and fuel to the extent that any such transactions relate to its merchant energy operations. Depending on market conditions and the volume and duration of forward sales, there is no assurance that Midwest Generation will be able to provide sufficient credit support to EMMT.

## Contractual Obligations and Contingencies

### Contractual Obligations

#### Capital Improvements

At September 30, 2007, Midwest Generation had firm commitments to spend approximately \$25.9 million on capital expenditures during the remainder of 2007 and \$10.1 million in 2008, primarily related to environmental improvements. These capital expenditures are planned to be financed by cash generated from operations.

### *Fuel Supply Contracts*

Midwest Generation has entered into additional fuel purchase commitments during the first nine months of 2007. These additional commitments are currently estimated to be \$14.9 million for the remainder of 2007, \$105.8 million in 2008, \$73.5 million in 2009, and \$76.5 million in 2010.

### *Coal Transportation Agreements*

Midwest Generation has contractual agreements for the transport of coal to its facilities. The primary contract is with Union Pacific Railroad (and various delivering carriers), which extends through 2011. Midwest Generation's commitments under this contract are based on actual coal purchases from the PRB. Accordingly, contractual obligations for transportation are based on coal volumes set forth in fuel supply contracts. The increase in transportation commitments entered into during the first nine months of 2007 relates to additional volumes of fuel purchases using the terms of existing transportation agreements. These additional commitments are currently estimated to be \$17.6 million for the remainder of 2007, \$111.0 million for 2008, \$75.6 million for 2009, and \$77.1 million for 2010.

### *Contingencies*

#### *FERC Notice Regarding Investigatory Proceeding against EMMT*

In October 2006, EMMT was advised by the enforcement staff at the FERC that it is prepared to recommend that the FERC initiate a formal investigatory proceeding and seek monetary sanctions against EMMT for alleged violation of the Energy Policy Act of 2005 and the FERC's rules regarding market behavior, all with respect to certain bidding practices previously employed by EMMT. EMMT is engaged in discussions with the staff to explore the possibility of resolution of this matter. Discussions to date have been constructive and may lead to a settlement agreement acceptable to both parties. Should these discussions not result in a settlement and a formal proceeding commenced, EMMT will be entitled to contest any alleged violations before the FERC and an appropriate court. EMMT has advised Midwest Generation that EMMT believes that it has complied with all applicable laws and regulations and intends to contest vigorously any allegation of violation.

#### *Challenges of Illinois Power Procurement Auction Results*

EMMT participated successfully in the first Illinois power procurement auction, held in September 2006 according to rules approved by the Illinois Commerce Commission, and entered into two load requirements services contracts through which it is delivering electricity, capacity and specified ancillary, transmission and load following services necessary to serve a portion of Commonwealth Edison's residential and small commercial customer load, using contracted supply from Midwest Generation.

#### *Settlement with Illinois Attorney General—*

On March 16, 2007, the Office of the Attorney General for the State of Illinois filed a complaint at the FERC alleging that the prices resulting from the Illinois auction resulted in unjust and unreasonable rates under the Federal Power Act and that participating wholesale sellers in the Illinois auction had colluded and manipulated the results of the auction. All successful participants in the Illinois auction, including EMMT, were named as respondents. The Office of the Attorney General asked the FERC to order refunds and to revoke the respondents' market-based rate pricing authority.

On July 24, 2007, Midwest Generation and EMMT, along with other power generation companies and utilities, entered into a settlement agreement with the Illinois Attorney General. The settlement

was subject to the passage of legislation which will, among other things, establish a new Illinois Power Agency to manage future power procurement for the Illinois regulated utilities, Commonwealth Edison and Ameren (beginning with the planning year June 1, 2009 through May 31, 2010). The settlement legislation was passed by the Illinois legislature on July 26, 2007, and was signed by the Governor of Illinois on August 28, 2007.

As part of the settlement, Midwest Generation has agreed to pay \$25 million over three years toward approximately \$1 billion in utility customer rate relief and startup costs of the new Illinois Power Agency. The remainder is to be funded by subsidiaries of Exelon Corporation, subsidiaries of Ameren, Dynegy Holdings Inc., and Mid-American Energy Company. Also as part of the settlement, all auction-related complaints filed by the Illinois Attorney General at the FERC, the Illinois Commerce Commission and in the Illinois courts have been dismissed. The private class action lawsuits described below remain pending.

Midwest Generation made a payment of \$7.5 million in September 2007 and is obligated to make monthly payments of \$750,000 beginning in January 2008 and continuing until the total commitment has been funded. These payments are non-refundable; however, Midwest Generation's obligations to make the monthly payments will cease if, at any time prior to December 2009, Illinois imposes an electric rate freeze or an additional tax on generators.

#### Class Action Lawsuits—

On April 4, 2007, EMMT was served with a complaint filed in the Circuit Court of Cook County, Illinois, by Saul R. Wexler, individually and on behalf of an alleged class of similarly situated electric ratepayers in Illinois against Commonwealth Edison, Ameren, and all of the successful participants in the Illinois auction, including EMMT. The lawsuit alleges that the defendants, including EMMT, colluded and conspired to manipulate the auction results by price-fixing. The lawsuit seeks unspecified damages. On April 26, 2007, the defendants transferred the complaint to the U.S. District Court for the Northern District of Illinois, Eastern Division. On June 4, 2007, the defendants filed a motion to dismiss the case.

On March 30, 2007, David Schafer, Tim Perry, Pat Martin and Michael Murray, individually and on behalf of an alleged class of similarly situated electric ratepayers in Illinois, filed a complaint in the Circuit Court of Cook County, Illinois, against Commonwealth Edison, Ameren, and all of the successful participants in the Illinois auction, including EMMT. EMMT has not been formally served in the case. The lawsuit alleges that the defendants, including EMMT, colluded and conspired to manipulate the auction results by price-fixing. The lawsuit seeks unspecified damages. On April 26, 2007, the defendants transferred the complaint to the U.S. District Court for the Northern District of Illinois, Eastern Division. On June 4, 2007, the defendants filed a motion to dismiss the case.

The Wexler case and the Schafer case have been consolidated into a single proceeding by the U.S. District Court for the Northern District of Illinois, Eastern Division. The defendants' motions to dismiss the case remain pending.

Midwest Generation believes that EMMT's actions in regard to the Illinois auction were appropriate and lawful and intends to defend vigorously both of the matters described above. However, at this time Midwest Generation cannot predict the outcome of these matters.

### *Potential Environmental Proceeding*

On July 31, 2007, the US EPA issued a NOV to Midwest Generation and Commonwealth Edison. In the NOV, the US EPA alleges that, beginning in the early 1990's and into 2003, Midwest Generation or Commonwealth Edison performed repair or replacement projects at six Illinois coal-fired electric generating stations in violation of the Prevention of Significant Deterioration requirements and of the New Source Performance Standards of the Clean Air Act, including alleged requirements to obtain a construction permit and to install Best Available Control Technology at the time of the projects. The US EPA also alleges that Midwest Generation and Commonwealth Edison violated certain operating permit requirements under Title V of the Clean Air Act. Finally, the US EPA alleges violations of certain opacity and particulate matter standards at the Illinois Plants. The NOV does not specify the penalties or other relief that the US EPA seeks for the alleged violations. Midwest Generation, the US EPA, and the DOJ are in talks designed to explore the possibility of a settlement. If the settlement talks fail and the DOJ files suit, litigation could take many years to resolve the issues alleged in the NOV. As a result, Midwest Generation is investigating the claims made by the US EPA in the NOV and has identified several defenses which it will raise if the government files suit. At this early stage in the process, Midwest Generation cannot predict the effect this matter may have on its facilities, its results of operations or financial position.

On August 13, 2007, Midwest Generation and Commonwealth Edison received a letter signed by several Chicago-based environmental action groups stating that, in light of the NOV, the groups are examining the possibility of filing a citizen suit against Midwest Generation and Commonwealth Edison based presumably on the same or similar theories advanced by the US EPA in the NOV.

By letter dated August 8, 2007, Commonwealth Edison advised Midwest Generation that Commonwealth Edison believes it is entitled to indemnification for all liabilities, costs, and expenses that it may be required to bear as a result of the NOV. By letter dated August 16, 2007, Commonwealth Edison tendered a request for indemnification to Midwest Generation for all liabilities, costs, and expenses that Commonwealth Edison may be required to bear if the environmental groups were to file suit. Midwest Generation and Commonwealth Edison are cooperating with one another in responding to the NOV.

### **Off-Balance Sheet Transactions**

For a discussion of Midwest Generation's off-balance sheet transactions, refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Off-Balance Sheet Transactions" of Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006. There have been no significant developments with respect to Midwest Generation's off-balance sheet transactions that affect disclosures presented in Midwest Generation's annual report.

### **Environmental Matters and Regulations**

For a discussion of Midwest Generation's environmental matters, refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Environmental Matters and Regulations" of Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006 and the notes to the Consolidated Financial Statements set forth therein. There have been no other significant developments with respect to

environmental matters specifically affecting Midwest Generation since the filing of Midwest Generation's annual report, except as follows:

### ***Air Quality Regulation***

#### ***Clean Air Act***

On December 11, 2006, Midwest Generation entered into an agreement with the Illinois EPA to reduce mercury, NO<sub>x</sub> and SO<sub>2</sub> emissions at the Illinois Plants. The agreement has been embodied in rule language, called the CPS, and Midwest Generation's obligations under the agreement were conditioned upon the formal adoption of the CPS as an Illinois rule. On January 5, 2007, the Illinois EPA and Midwest Generation jointly filed the CPS in the pending state rulemaking related to the Illinois SIP for the CAIR. The CPS was approved by the Joint Committee on Administrative Rules on August 14, 2007, and became final upon publication in the Illinois Register, which took place on September 7, 2007. It is now pending approval by the US EPA as part of the SIP. Midwest Generation believes that the CPS will provide greater predictability of the timing and amount of emissions reductions which will be required of the Illinois Plants for these pollutants through 2018.

#### ***Potential Environmental Proceeding***

On July 31, 2007, the US EPA issued a NOV to Midwest Generation and Commonwealth Edison with respect to alleged violations of the Clean Air Act and certain opacity and particulate matter standards. See “—Contractual Obligations and Contingencies—Contingencies—Potential Environmental Proceeding” for further discussion.

### ***Water Quality Regulation***

On July 9, 2007, the US EPA published in the Federal Register a notice immediately suspending the requirements for cooling water intake structures, pending further rulemaking. The US EPA is expected to begin another rulemaking process by the end of 2008. EME had begun to collect impingement and entrainment data at its potentially affected Midwest Generation facilities in Illinois to begin the process of determining what corrective actions might need to be taken under the previous rule, and those activities are continuing. Although the rule to be generated in the new rulemaking process could have a material impact on Midwest Generation's operations, its compliance criteria have not yet been finalized, and Midwest Generation cannot reasonably determine the financial impact at this time.

On October 26, 2007, the Illinois Environmental Protection Agency filed a proposed rule with the Illinois Pollution Control Board (PCB) that would establish new, more stringent thermal and effluent water quality standards for the Chicago Area Waterway System and Lower Des Plaines River. Midwest Generation's Fisk, Crawford, Joliet and Will County stations all use water from the affected waterways for cooling purposes and the rule is expected to affect the manner in which those stations use water for station cooling.

The proposed rule will be the subject of an administrative proceeding before the Illinois PCB and must be approved by the Illinois PCB and the Illinois Joint Committee on Administrative Rules. Following state adoption and approval, the US EPA also must approve the rule. Midwest Generation intends to participate as a party in those proceedings and in any subsequent appellate proceedings. At this time, it is not possible to predict the final form of the rule, how it would impact the operation of the affected stations, or the possible compliance costs or liability.

### ***Climate Change***

On April 2, 2007, the United States Supreme Court issued an opinion in *Massachusetts et. al. v. Environmental Protection Agency, et. al.*, ruling that the US EPA has the authority to regulate greenhouse gas emissions of new motor vehicles under the Clean Air Act and that it has a duty to (i) determine whether greenhouse gas emissions of new motor vehicles contribute to climate change or

(ii) offer a reasoned explanation for its failure to make such a determination when presented with a request for a rulemaking on the issue by the state claimants. The Court ruled that the US EPA's failure to make the necessary determination or offer a reasonable explanation for its refusal to do so was impermissible. While this case hinged on a provision of the Clean Air Act related to emissions of motor vehicles, a parallel provision of the Clean Air Act applies to stationary sources such as electric generators. The US EPA has recently announced that it plans to propose regulations to address carbon dioxide emissions as part of the Clean Air Act's New Source Review program. Even in the absence of federal regulation, states may begin to take into account carbon dioxide emissions when considering permits to construct or modify significant sources of such emissions. Midwest Generation also believes that the Court's *Massachusetts* decision may spur additional congressional action to require reductions of greenhouse gas emissions by all material sources, including electric generators.

## MARKET RISK EXPOSURES

### Introduction

Midwest Generation sells all its energy into wholesale power markets. Midwest Generation's primary market risk exposures arise from fluctuations in electricity, capacity and fuel prices, emission allowances, and transmission rights. Additionally, Midwest Generation's financial results can be affected by fluctuations in interest rates. Midwest Generation manages these risks in part by using derivative financial instruments in accordance with established policies and procedures.

This section discusses these market risk exposures under the following headings:

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Accounting for Energy Contracts . . . . .	36
Derivative Financial Instruments . . . . .	37
Credit Risk . . . . .	37
Interest Rate Risk . . . . .	39
Regulatory Matters . . . . .	39

For a complete discussion of these issues, read this quarterly report on Form 10-Q in conjunction with Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006.

### Commodity Price Risk

#### *Overview*

Midwest Generation's revenues and results of operations of its merchant power plants will depend upon prevailing market prices for capacity, energy, ancillary services, emission allowances or credits, coal, natural gas and fuel oil, and associated transportation costs in PJM. Among the factors that influence the price of energy, capacity and ancillary services in PJM are:

- prevailing market prices for coal, natural gas and fuel oil, and associated transportation;
- the extent of additional supplies of capacity, energy and ancillary services from current competitors or new market entrants, including the development of new generation facilities and/or technologies that may be able to produce electricity at a lower cost than the Illinois Plants and/or increased access by competitors to Midwest Generation's markets as a result of transmission upgrades;
- transmission congestion in and to each market area and the resulting differences in prices between delivery points;
- the market structure rules to be established for, and regulatory developments affecting, PJM, including any price limitations and other mechanisms adopted to address volatility or illiquidity in these markets or the physical stability of the system;
- the cost and availability of emission credits or allowances;

- the availability, reliability and operation of competing power generation facilities, including nuclear generating plants where applicable, and the extended operation of such facilities beyond their presently expected dates of decommissioning;
- weather conditions prevailing in surrounding areas from time to time; and
- changes in the demand for electricity or in patterns of electricity usage as a result of factors such as regional economic conditions and the implementation of conservation programs.

A discussion of commodity price risk for the Illinois Plants is set forth below.

### ***Introduction***

Midwest Generation sells all its energy and capacity into wholesale power markets through EMMT. EMMT enters into forward contracts for Midwest Generation's electric output in order to provide more predictable earnings and cash flow. When appropriate, EMMT manages the spread between electric prices and fuel prices through the use of forward contracts, swaps, futures, or options contracts. There is no assurance that contracts to hedge changes in market prices will be effective.

Midwest Generation's operations expose it to commodity price risk, which represents the potential loss that can be caused by a change in the market value of a particular commodity. Commodity price risks are actively monitored by a risk management committee to ensure compliance with Midwest Generation's risk management policies through EMMT. Policies are in place which define risk management processes, and procedures exist which allow for monitoring of all commitments and positions with regular reviews by a risk management committee. Despite this, there can be no assurance that all risks have been accurately identified, measured and/or mitigated.

In addition to prevailing market prices, Midwest Generation's ability to derive profits from the sale of electricity will be affected by the cost of production, including costs incurred to comply with environmental regulations. The costs of production of the units vary and, accordingly, depending on market conditions, the amount of generation that will be sold from the units is expected to vary.

EMMT uses "value at risk" to identify, measure, monitor and control Midwest Generation's overall market risk exposure. The use of value at risk allows management to aggregate overall commodity risk, compare risk on a consistent basis and identify the risk factors. Value at risk measures the possible loss over a given time interval, under normal market conditions, at a given confidence level. Given the inherent limitations of value at risk and relying on a single risk measurement tool, EMMT supplements this approach with the use of stress testing and worst-case scenario analysis for key risk factors, as well as stop-loss limits and counterparty credit exposure limits.

### ***Hedging Strategy***

To reduce its exposure to market risk, Midwest Generation hedges a portion of its merchant portfolio risk through EMMT. To the extent that Midwest Generation does not hedge its merchant portfolio, the unhedged portion will be subject to the risks and benefits of spot market price movements. Hedge transactions are primarily implemented through:

- the use of contracts cleared on the Intercontinental Trading Exchange and the New York Mercantile Exchange,

- forward sales transactions entered into on a bilateral basis with third parties, including electric utilities and power marketing companies,
- full requirements services contracts or load requirements services contracts for the procurement of power for electric utilities' customers, with such services including the delivery of a bundled product including, but not limited to, energy, capacity and ancillary services, generally for a fixed unit price, and
- participation in capacity auctions.

The extent to which Midwest Generation hedges its market price risk depends on several factors. First, Midwest Generation evaluates over-the-counter market prices to determine whether the types of hedge transactions set forth above at forward market prices are sufficiently attractive compared to assuming the risk associated with fluctuating spot market sales. Second, Midwest Generation's ability to enter into hedging transactions depends upon its and EMMT's credit capacity and upon the forward sales markets having sufficient liquidity to enable Midwest Generation to identify appropriate counterparties for hedging transactions.

Midwest Generation is permitted to use its working capital facility and cash on hand to provide credit support for hedging transactions related to the Illinois Plants entered into by EMMT. Utilization of this credit facility in support of these hedging transactions provides additional liquidity support for implementation of Midwest Generation's contracting strategy for the Illinois Plants. In addition, Midwest Generation is permitted to grant liens on its property in support of hedging transactions associated with the Illinois Plants. See "—Credit Risk" below.

### ***Energy Price Risk***

All the energy and capacity from the Illinois Plants is sold under terms, including price and quantity, arranged by EMMT with customers through a combination of bilateral agreements (resulting from negotiations or from auctions), forward energy sales and spot market sales. As discussed further below, power generated at the Illinois Plants is generally sold into the PJM market.

Midwest Generation sells its power into PJM at spot prices based upon locational marginal pricing. Hedging transactions related to the generation of the Illinois Plants are generally entered into at the Northern Illinois Hub in PJM, and may also be entered into at other trading hubs, including the AEP/Dayton Hub in PJM and the Cinergy Hub in the MISO. These trading hubs have been the most liquid locations for hedging purposes. However, hedging transactions which settle at points other than the Northern Illinois Hub are subject to the possibility of basis risk. See "—Basis Risk" below for further discussion.

PJM has a short-term market, which establishes an hourly clearing price. The Illinois Plants are situated in the PJM control area and are physically connected to high-voltage transmission lines serving this market.

The following table depicts the average historical market prices for energy per megawatt-hour during the first nine months of 2007 and 2006.

	<b>24-Hour Northern Illinois Hub Historical Energy Prices(1)</b>	
	<u>2007</u>	<u>2006</u>
January . . . . .	\$ 35.75	\$ 42.27
February . . . . .	56.64	42.66
March . . . . .	42.04	42.50
April . . . . .	48.91	43.16
May . . . . .	44.49	39.96
June . . . . .	39.76	34.80
July . . . . .	43.40	51.82
August . . . . .	57.97	54.76
September . . . . .	39.68	31.87
Nine-Month Average . . . . .	<u>\$ 45.40</u>	<u>\$ 42.64</u>

(1) Energy prices were calculated at the Northern Illinois Hub delivery point using hourly real-time prices as published by PJM.

Forward market prices at the Northern Illinois Hub fluctuate as a result of a number of factors, including natural gas prices, transmission congestion, changes in market rules, electricity demand (which in turn is affected by weather, economic growth, and other factors), plant outages in the region, and the amount of existing and planned power plant capacity. The actual spot prices for electricity delivered by the Illinois Plants into these markets may vary materially from the forward market prices set forth in the table below.

The following table sets forth the forward market prices for energy per megawatt-hour as quoted for sales into the Northern Illinois Hub at September 30, 2007:

	<b>24-Hour Northern Illinois Hub Forward Energy Prices(1)</b>
<b>2007</b>	
October . . . . .	\$ 37.76
November . . . . .	36.60
December . . . . .	42.36
<b>2008 Calendar “strip”(2)</b> . . . . .	\$ 46.80
<b>2009 Calendar “strip”(2)</b> . . . . .	\$ 48.70

(1) Energy prices were determined by obtaining broker quotes and information from other public sources relating to the Northern Illinois Hub delivery point.

(2) Market price for energy purchases for the entire calendar year, as quoted for sales into the Northern Illinois Hub.

The following table summarizes Midwest Generation's hedge position (primarily based on prices at the Northern Illinois Hub) at September 30, 2007:

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Energy Only Contracts(1)				
MWh . . . . .	4,131,750	10,837,600	7,487,490	3,471,950
Average price/MWh(2) . . . . .	\$ 48.18	\$ 61.36	\$ 62.28	\$ 62.62
Load Requirements Services Contracts				
Estimated MWh(3) . . . . .	1,862,231	5,613,433	1,631,859	—
Average price/MWh(4) . . . . .	\$ 63.63	\$ 64.01	\$ 63.65	\$ —
Total estimated MWh . . . . .	5,993,981	16,451,033	9,119,349	3,471,950

(1) Primarily at Northern Illinois Hub.

(2) The energy only contracts include forward contracts for the sale of power and futures contracts during different periods of the year and the day. Market prices tend to be higher during on-peak periods and during summer months, although there is significant variability of power prices during different periods of time. Accordingly, the above hedge position at September 30, 2007 is not directly comparable to the 24-hour Northern Illinois Hub prices set forth above.

(3) Under a load requirements services contract, the amount of power sold is a portion of the retail load of the purchasing utility and thus can vary significantly with variations in that retail load. Retail load depends upon a number of factors, including the time of day, the time of the year and the utility's number of new and continuing customers. Estimated MWh have been forecast based on historical patterns and on assumptions regarding the factors that may affect retail loads in the future. The actual load will vary from that used for the above estimate, and the amount of variation may be material.

(4) The average price per MWh under a load requirements services contract (which is subject to a seasonal price adjustment) represents the sale of a bundled product that includes, but is not limited to, energy, capacity and ancillary services. Furthermore, as a supplier of a portion of a utility's load, Midwest Generation will incur charges from PJM as a load-serving entity. For these reasons, the average price per MWh under a load requirements services contract is not comparable to the sale of power under an energy only contract. The average price per MWh under a load requirements services contract represents the sale of the bundled product based on an estimated customer load profile.

### **Capacity Price Risk**

On June 1, 2007, PJM implemented the RPM for capacity. The purpose of the RPM is to provide a long-term pricing signal for capacity resources. The RPM allows PJM to satisfy the region's need for generation capacity, which is then allocated among the load-serving entities through a locational reliability charge.

The first RPM auction took place in April 2007 and resulted in a fixed price for Midwest Generation's capacity sold into the auction (included in PJM as "rest of market" location) of \$40.80/MW per day for the period from June 1, 2007 through May 31, 2008. The second auction took place in July 2007 and resulted in a fixed price for Midwest Generation's capacity sold into the auction of \$111.92/MW per day for the period from June 1, 2008 through May 31, 2009. In October 2007, the third auction took place for the period from June 1, 2009 through May 31, 2010 and resulted in a fixed price for Midwest Generation's net capacity sold of 4,614 MW into the auction of \$102.04/MW per day. A subsequent auction will be conducted in January 2008 to auction capacity for the period from June 1, 2010 through May 31, 2011.

Midwest Generation entered into hedge transactions in advance of the RPM auctions with counterparties that are settled through PJM. In October 2007, Midwest Generation sold 715 MW of capacity at a fixed price of \$71.46/MW per day for the period from June 1, 2009 through May 31, 2010. In addition, the load service requirements contracts entered into by Midwest Generation with

Commonwealth Edison include energy, capacity and ancillary services (sometimes referred to as a “bundled product”). Under PJM’s business rules, Midwest Generation sells all of its available capacity (unit capacity less forced outages) into the RPM and is subject to a locational reliability charge for the load under these contracts. This means that the locational reliability charge generally offsets the related amounts sold in the RPM, which Midwest Generation presents net in the table below.

The following table summarizes the status of capacity sales for Midwest Generation at September 30, 2007:

	<u>October 1, 2007 to May 31, 2008</u>	<u>June 1, 2008 to May 31, 2009</u>
<b>Fixed Price Capacity Sales</b>		
Through RPM Auction, Net		
MW . . . . .	2,596	3,283
Price per MW-day . . . . .	\$ 40.80	\$ 111.92
Non-unit Specific Capacity Sales		
MW . . . . .	500	880
Price per MW-day . . . . .	\$ 21.31	\$ 64.35

Revenues from the sale of capacity from Midwest Generation beyond the periods set forth above will depend upon the amount of capacity available and future market prices either in PJM or nearby markets if Midwest Generation has an opportunity to capture a higher value associated with those markets. Under PJM’s RPM system, the market price for capacity is generally determined by aggregate market-based supply conditions and an administratively set aggregate demand curve. Among the factors influencing the supply of capacity in any particular market are plant forced outage rates, plant closings, plant delistings (due to plants being removed as capacity resources and/or to export capacity to other markets), capacity imports from other markets, and new entry.

***Basis Risk***

Sales made from the Illinois Plants in the real-time or day-ahead market receive the actual spot prices or day-ahead prices, as the case may be, at the busbars (delivery points) of the individual plants. In order to mitigate price risk from changes in spot prices at the individual plant busbars, Midwest Generation may enter into cash settled futures contracts as well as forward contracts with counterparties for energy to be delivered in future periods. Currently, a liquid market for entering into these contracts at the individual plant busbars does not exist. A liquid market does exist for a settlement point at the Northern Illinois Hub. Midwest Generation’s hedging activities use this settlement point (and, to a lesser extent, other similar trading hubs) to enter into hedging contracts. Midwest Generation’s revenues with respect to such forward contracts include:

- sales of actual generation in the amounts covered by the forward contracts with reference to PJM spot prices at the busbar of the plant involved, plus,
- sales to third parties at the price under such hedging contracts at designated settlement points (generally the Northern Illinois Hub) less the cost of power at spot prices at the same designated settlement points.

Under PJM’s market design, locational marginal pricing, which establishes market prices at specific locations throughout PJM by considering factors including generator bids, load requirements, transmission congestion and losses, can cause the price of a specific delivery point to be higher or lower relative to other locations depending on how the point is affected by transmission constraints.

Effective June 1, 2007, PJM implemented marginal losses which adjusts the algorithm that calculates locational marginal prices to include a component for marginal transmission losses in addition to the component included for congestion. To the extent that, on the settlement date of a hedge contract, spot prices at the relevant busbar are lower than spot prices at the settlement point, the proceeds actually realized from the related hedge contract are effectively reduced by the difference. This is referred to as “basis risk.” During the past 12 months, the prices at the Northern Illinois Hub were substantially the same as those at the individual busbars of the Illinois Plants, although the implementation of marginal losses on June 1, 2007 has lowered energy prices at the Illinois Plants busbars.

***Coal and Transportation Price Risk***

The Illinois Plants purchase coal primarily obtained from the Southern PRB of Wyoming. Coal purchases are made under a variety of supply agreements extending through 2010. The following table summarizes the amount of coal under contract at September 30, 2007 for the remainder of 2007 and the following three years.

	<u>October through December 2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Amount of coal under contract in millions of tons(1) . . . . .	5.0	14.6	11.7	11.7

(1) The amount of coal under contract in tons is calculated based on contracted tons and applying an 8,800 Btu equivalent.

Midwest Generation is subject to price risk for purchases of coal that are not under contract. The price of PRB coal (with 8,800 Btu per pound heat content and 0.8 pounds of SO<sub>2</sub> per MMBtu sulfur content) purchased for the Illinois Plants increased to \$10.55 per ton at September 28, 2007 from \$9.90 per ton at December 15, 2006, as reported by the Energy Information Administration. The 2007 fluctuations in PRB coal prices were in line with normal market price volatility.

Midwest Generation has contractual agreements for the transport of coal to its facilities. The primary contract is with Union Pacific Railroad (and various delivering carriers), which extends through 2011. Midwest Generation is exposed to price risk related to higher transportation rates after the expiration of its existing transportation contracts. Current transportation rates for PRB coal are higher than the existing rates under contract (transportation costs are more than 50% of the delivered cost of PRB coal to the Illinois Plants).

**Accounting for Energy Contracts**

Midwest Generation uses a number of energy contracts to manage exposure from changes in the price of electricity, including forward sales and purchases of physical power and forward price swaps which settle only on a financial basis (including futures contracts). Midwest Generation follows SFAS No. 133, and under this Standard these energy contracts are generally defined as derivative financial instruments. Importantly, SFAS No. 133 requires changes in the fair value of each derivative financial instrument to be recognized in earnings at the end of each accounting period unless the instrument qualifies for hedge accounting under the terms of SFAS No. 133. For derivatives that do qualify for cash flow hedge accounting, changes in their fair value are recognized in other comprehensive income until the hedged item settles and is recognized in earnings. However, the ineffective portion of a derivative that qualifies for cash flow hedge accounting is recognized currently in earnings. For further discussion of derivative financial instruments, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Management’s Overview; Critical Accounting Estimates—Critical Accounting Estimates—Derivative Financial Instruments and Hedging Activities” of Midwest Generation’s annual report on Form 10-K for the year ended December 31, 2006.

SFAS No. 133 affects the timing of income recognition, but has no effect on cash flow. To the extent that income varies under SFAS No. 133 from accrual accounting (i.e., revenue recognition based on settlement of transactions), Midwest Generation records unrealized gains or losses. Midwest Generation classifies unrealized gains and losses from energy contracts as part of operating revenues. The results of derivative activities are recorded as part of cash flows from operating activities in the consolidated statements of cash flows. The following table summarizes unrealized gains (losses) for the third quarters of 2007 and 2006 and nine months ended September 30, 2007 and 2006:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in millions)			
Non-qualifying hedges . . . . .	\$ (0.4)	\$ 3.9	\$ (18.3)	\$ 14.6
Ineffective portion of cash flow hedges . . . . .	(7.4)	1.2	(7.9)	1.9
Total unrealized gains (losses) . . . . .	<u>\$ (7.8)</u>	<u>\$ 5.1</u>	<u>\$ (26.2)</u>	<u>\$ 16.5</u>

### Derivative Financial Instruments

The following table summarizes the fair values for outstanding financial instruments used for hedging activities. The decrease in fair value of electricity contracts at September 30, 2007 as compared to December 31, 2006 is attributable to an increase in the average market prices for power as compared to contracted prices at September 30, 2007, which is the valuation date.

	September 30, 2007	December 31, 2006
	(in thousands)	
Commodity price:		
Electricity . . . . .	<u>\$ (37,170)</u>	<u>\$ 93,983</u>

In assessing the fair value of Midwest Generation's derivative financial instruments, EMMT uses a variety of methods and assumptions based on the market conditions and associated risks existing at each balance sheet date. The fair value of commodity price contracts takes into account quoted market prices, time value of money, volatility of the underlying commodities and other factors. The following table summarizes the maturities and the related fair value, based on actively traded prices, of Midwest Generation's commodity derivative assets and liabilities as of September 30, 2007 (in thousands):

	Total Fair Value	Maturity <1 year	Maturity 1 to 3 years	Maturity 4 to 5 years	Maturity >5 years
Prices actively quoted . . . . .	<u>\$(37,170)</u>	<u>\$(22,649)</u>	<u>\$(14,521)</u>	<u>\$ —</u>	<u>\$ —</u>

### Credit Risk

In conducting Midwest Generation's hedging activities, EMMT contracts with a number of utilities, energy companies, financial institutions, and other companies, collectively referred to as counterparties. In the event a counterparty were to default on its trade obligation, Midwest Generation would be exposed to the risk of possible loss associated with re-contracting the product at a price different from the original contracted price if the non-performing counterparty were unable to pay the resulting liquidated damages owed to Midwest Generation. Midwest Generation's agreement with EMMT transfers the risk of non-payment of accounts receivable from counterparties to EMMT. Notwithstanding the foregoing, Midwest Generation will not be in default under the credit agreement if

it fails to enforce payment from EMMT in the case of nonpayment of an account receivable from a counterparty, so long as the counterparty is rated investment grade.

The obligations of Midwest Generation under the credit agreement are secured by, among other things, an account of EMMT in which EMMT will deposit funds received from third-party counterparties for sales of energy and capacity from the Illinois Plants. For further discussion, refer to “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations—Related Party Transactions—EMMT Agreements” of Midwest Generation’s annual report on Form 10-K for the year ended December 31, 2006.

To manage credit risk, EMMT looks at the risk of a potential default by counterparties. Credit risk is measured by the loss that would be incurred if counterparties failed to perform pursuant to the terms of their contractual obligations. EMMT measures, monitors and mitigates credit risk to the extent possible. To mitigate credit risk from counterparties, master netting agreements are used whenever possible and counterparties may be required to pledge collateral when deemed necessary. EMMT also takes other appropriate steps to limit or lower credit exposure. Processes have also been established to determine and monitor the creditworthiness of counterparties. EMMT manages the credit risk on the portfolio based on credit ratings using published ratings of counterparties and other publicly disclosed information, such as financial statements, regulatory filings, and press releases, to guide it in the process of setting credit levels, risk limits and contractual arrangements, including master netting agreements. A risk management committee regularly reviews the credit quality of EMMT’s counterparties. Despite this, there can be no assurance that these efforts will be wholly successful in mitigating credit risk or that collateral pledged will be adequate.

In addition, coal for the Illinois Plants is purchased from suppliers under contracts which may be for multiple years. A number of the coal suppliers to the Illinois Plants do not currently have an investment grade credit rating and, accordingly, Midwest Generation may have limited recourse to collect damages in the event of default by a supplier. Midwest Generation seeks to mitigate this risk through diversification of its coal suppliers and through guarantees and other collateral arrangements when available. Despite this, there can be no assurance that these efforts will be successful in mitigating credit risk from coal suppliers.

Midwest Generation derives a significant source of its operating revenues from electric power sold into the PJM market by EMMT. Sales into PJM accounted for approximately 47% of Midwest Generation’s consolidated operating revenues for the nine months ended September 30, 2007. Moody’s rates PJM’s senior unsecured debt Aa3. PJM, an ISO with over 300 member companies, maintains its own credit risk policies and does not extend unsecured credit to non-investment grade companies. Any losses due to a PJM member default are shared by all other members based upon a predetermined formula.

Beginning in January 2007, Midwest Generation also derived a significant source of its revenues from the sale of energy, capacity and ancillary services generated at the Illinois Plants to Commonwealth Edison under load requirements services contracts. Sales under these contracts accounted for 30% of Midwest Generation’s consolidated operating revenues during the nine months ended September 30, 2007. Commonwealth Edison’s senior unsecured debt rating was downgraded below investment grade by S&P in October 2006 and by Moody’s in March 2007. For the nine months ended September 30, 2007, a third customer accounted for 10% of Midwest Generation’s consolidated operating revenues.

## **Interest Rate Risk**

Interest rate changes can affect earnings and the cost of capital for capital improvements. Midwest Generation has a \$500 million working capital facility, maturing in 2012, which exposes Midwest Generation to the risk of earnings loss resulting from changes in interest rates from any borrowings outstanding.

## **Regulatory Matters**

For a discussion of Midwest Generation's regulatory matters, refer to "Item 1. Business—Description of the Industry—Power Markets" of Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006 and "Item 1. Business—Regulatory Matters" of Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006. There have been no significant developments with respect to regulatory matters specifically affecting Midwest Generation since the filing of its annual report on Form 10-K for the year ended December 31, 2006, except as follows:

### ***Illinois Auction Challenges***

Legal actions, including a complaint at the FERC by the Illinois Attorney General and two class action lawsuits, have been instituted against successful participants in the 2006 Illinois power procurement auction, including EMMT. On July 24, 2007, Midwest Generation and EMMT, along with other power generation companies and utilities, entered into a settlement with the Illinois Attorney General. Enacting legislation for the settlement was signed on August 28, 2007. As part of the settlement, all auction-related complaints filed by the Illinois Attorney General at the FERC, the Illinois Commerce Commission and in the Illinois courts have been dismissed. The class actions have been consolidated and motions to dismiss are pending. For further discussion, see "Liquidity and Capital Resources—Contractual Obligations and Contingencies—Contingencies—Challenges of Illinois Power Procurement Auction Results."

### ***PJM Matters***

On December 22, 2006, the FERC issued an order conditionally approving the RPM settlement subject to PJM making certain compliance filings. The compliance filings were made by PJM on January 22, 2007 and February 20, 2007, and accepted by the FERC on June 25, 2007 and July 11, 2007, respectively. On June 1, 2007, PJM implemented marginal losses for transmission for its competitive wholesale electric market. For further discussion regarding the RPM and recent auctions, see "—Commodity Price Risk—Capacity Price Risk." Midwest Generation is still evaluating the impact that marginal loss pricing in PJM will have on its results of operations, but continues to believe that it may reduce locational marginal prices for some of the Illinois Plants relative to the locational marginal prices for the benchmark location of Northern Illinois Hub.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For a discussion of market risk sensitive instruments, refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Market Risk Exposures" of Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006. Refer to "Market Risk Exposures" in Item 2 of this quarterly report on Form 10-Q for an update to that disclosure.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

Midwest Generation's management, under the supervision and with the participation of the company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Midwest Generation's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period, Midwest Generation's disclosure controls and procedures are effective.

### **Changes in Internal Control Over Financial Reporting**

There were changes as described below in Midwest Generation's internal control over financial reporting (as that term is defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act) during the quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, Midwest Generation's internal control over financial reporting.

During the third quarter of 2007, Midwest Generation implemented a series of SAP ERP modules, including a new general ledger and chart of accounts and new consolidation, reporting, and accounts payable. In addition, procurement and materials management systems were implemented for the Illinois Plants. Midwest Generation's human resources module will be implemented in 2008 as part of Edison International's ERP implementation. The introduction of these ERP modules and the related workflow capabilities resulted in changes to Midwest Generation's financial reporting controls and procedures, with such changes identified during the implementation of the ERP modules. Therefore, as appropriate, Midwest Generation is modifying the design and documentation of internal control process and procedures relating to the new system to supplement and complement existing internal controls over financial reporting. The system changes were undertaken to integrate systems and consolidate information, and were not undertaken in response to any actual or perceived deficiencies in Midwest Generation's internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

#### **Potential Environmental Proceeding**

On July 31, 2007, the US EPA issued a NOV to Midwest Generation and Commonwealth Edison. In the NOV, the US EPA alleges that, beginning in the early 1990's and into 2003, Midwest Generation or Commonwealth Edison performed repair or replacement projects at six Illinois coal-fired electric generating stations in violation of the Prevention of Significant Deterioration requirements and of the New Source Performance Standards of the Clean Air Act, including alleged requirements to obtain a construction permit and to install Best Available Control Technology at the time of the projects. The US EPA also alleges that Midwest Generation and Commonwealth Edison violated certain operating permit requirements under Title V of the Clean Air Act. Finally, the US EPA alleges violations of certain opacity and particulate matter standards at the Illinois Plants. The NOV does not specify the penalties or other relief that the US EPA seeks for the alleged violations. Midwest Generation, the US EPA, and the DOJ are in talks designed to explore the possibility of a settlement. If the settlement talks fail and the DOJ files suit, litigation could take many years to resolve the issues alleged in the NOV. As a result, Midwest Generation is investigating the claims made by the US EPA in the NOV and has identified several defenses which it will raise if the government files suit. At this early stage in the process, Midwest Generation cannot predict the effect this matter may have on its facilities, its results of operations or financial position.

On August 13, 2007, Midwest Generation and Commonwealth Edison received a letter signed by several Chicago-based environmental action groups stating that, in light of the NOV, the groups are examining the possibility of filing a citizen suit against Midwest Generation and Commonwealth Edison based presumably on the same or similar theories advanced by the US EPA in the NOV.

By letter dated August 8, 2007, Commonwealth Edison advised Midwest Generation that Commonwealth Edison believes it is entitled to indemnification for all liabilities, costs, and expenses that it may be required to bear as a result of the NOV. By letter dated August 16, 2007, Commonwealth Edison tendered a request for indemnification to Midwest Generation for all liabilities, costs, and expenses that Commonwealth Edison may be required to bear if the environmental groups were to file suit. Midwest Generation and Commonwealth Edison are cooperating with one another in responding to the NOV.

#### **FERC Notice Regarding Investigatory Proceeding against EMMT**

In October 2006, EMMT was advised by the enforcement staff at the FERC that it is prepared to recommend that the FERC initiate a formal investigatory proceeding and seek monetary sanctions against EMMT for alleged violation of the Energy Policy Act of 2005 and the FERC's rules regarding market behavior, all with respect to certain bidding practices previously employed by EMMT. EMMT is engaged in discussions with the staff to explore the possibility of resolution of this matter. Discussions to date have been constructive and may lead to a settlement agreement acceptable to both parties. Should these discussions not result in a settlement and a formal proceeding commenced, EMMT will be entitled to contest any alleged violations before the FERC and an appropriate court. EMMT has advised Midwest Generation that EMMT believes that it has complied with all applicable laws and regulations and intends to contest vigorously any allegation of violation.

## **ITEM 1A. RISK FACTORS**

For a discussion of the risks, uncertainties, and other important factors which could materially affect Midwest Generation's business, financial condition, or future results, refer to "Item 1A. Risk Factors" of Midwest Generation's annual report on Form 10-K for the year ended December 31, 2006. The risks described in Midwest Generation's annual report on Form 10-K are not the only risks facing Midwest Generation. Additional risks and uncertainties that are not currently known, or that are currently deemed to be immaterial, also may materially adversely affect Midwest Generation's business, financial condition or future results.

## **ITEM 6. EXHIBITS**

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
32	Statement Pursuant to 18 U.S.C. Section 1350.

