RELIANT ENERGY INC
Form 10-Q
August 02, 2007

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

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended June 30, 2007**

**OR**

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

**For the transition period from to**

**Commission file number: 1-16455**

# Reliant Energy, Inc.
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **Delaware** | **76-0655566** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

**1000 Main Street**
**Houston, Texas 77002**
(Address of Principal Executive Offices) (Zip Code)

**(713) 497-3000**
(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant 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 x Accelerated filer o Non-accelerated filer o

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

Yes o No x

As of July 25, 2007, the latest practicable date for determination, Reliant Energy, Inc. had 343,018,694 shares of common stock outstanding and no shares of treasury stock.

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**FORWARD-LOOKING INFORMATION**

**This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are statements that contain projections, assumptions or estimates about our revenues, income and other financial items, our plans and objectives for future operations or about our future economic performance, transactions and dispositions and financings related thereto. In many cases you can identify forward-looking statements by terminology such as anticipate, estimate, believe, continue, could, intend, may, plan, potent should, will, expect, objective, projection, forecast, goal, guidance, outlook, effort, target and other similar words. I of these words does not mean that the statements are not forward-looking.**

**Actual results may differ materially from those expressed or implied by forward-looking statements as a result of many factors or events, including, but not limited to, legislative and regulatory developments, the outcome of pending lawsuits, governmental proceedings and investigations, the effects of competition, financial market conditions, access to capital, the timing and extent of changes in commodity prices and interest rates, weather conditions and other factors we discuss or refer to in the Risk Factors section of our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission.**

**Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.**

**PART I.**

**FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**RELIANT ENERGY, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(Thousands of Dollars, Except Per Share Amounts)**
**(Unaudited)**

| | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Six Months Ended June 30, 2007 | Six Months Ended June 30, 2006 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Revenues (including $(10,848), $52,393, $3,722 and $201,899 unrealized gains (losses)) | $ 2,649,915 | $ 2,774,903 | $ 5,012,516 | $ 5,227,588 |
| **Expenses:** | | | | |
| Purchased power, fuel and cost of gas sold (including $(315,497), $(364), $192,162 and $(126,402) unrealized gains (losses)) | 2,475,716 | 2,233,908 | 3,919,207 | 4,483,957 |
| Operation and maintenance | 233,966 | 229,975 | 464,707 | 415,530 |
| Selling, general and administrative | 103,084 | 91,690 | 190,681 | 162,430 |
| Western states and similar settlements | | | 22,000 | |
| Gains on sales of assets and emission allowances, net | (1,727) | (4,854) | (1,727) | (156,330) |
| Depreciation and amortization | 110,603 | 91,092 | 202,572 | 171,597 |
| Total operating expense | 2,921,642 | 2,641,811 | 4,797,440 | 5,077,184 |
| **Operating Income (Loss)** | (271,727) | 133,092 | 215,076 | 150,404 |
| **Other Income (Expense):** | | | | |
| Income of equity investment, net | 1,366 | 2,061 | 2,526 | 2,387 |
| Debt extinguishment premium and consent fees | (71,269) | | (71,269) | |
| Other, net | (574) | 744 | 494 | 829 |
| Interest expense | (121,975) | (103,444) | (209,045) | (211,606) |
| Interest income | 8,232 | 6,877 | 18,696 | 15,895 |
| Total other expense | (184,220) | (93,762) | (258,598) | (192,495) |
| **Income (Loss) from Continuing Operations Before Income Taxes** | (455,947) | 39,330 | (43,522) | (42,091) |
| Income tax expense (benefit) | (174,884) | 16,603 | (22,822) | 74,249 |
| **Income (Loss) from Continuing Operations** | (281,063) | 22,727 | (20,700) | (116,340) |
| Loss from discontinued operations | (1,889) | (8,551) | (3,541) | (3,571) |
| **Income (Loss) Before Cumulative Effect of Accounting Change** | (282,952) | 14,176 | (24,241) | (119,911) |
| Cumulative effect of accounting change, net of tax | | | | 968 |
| **Net Income (Loss)** | $ (282,952) | $ 14,176 | $ (24,241) | $ (118,943) |
| | | | | |
| **Basic Earnings (Loss) per Share:** | | | | |
| Income (loss) from continuing operations | $ (0.82) | $ 0.07 | $ (0.06) | $ (0.38) |
| Loss from discontinued operations | (0.01) | (0.02) | (0.01) | (0.01) |
| Income (loss) before cumulative effect of accounting change | (0.83) | 0.05 | (0.07) | (0.39) |
| Cumulative effect of accounting change, net of tax | | | | |
| Net income (loss) | $ (0.83) | $ 0.05 | $ (0.07) | $ (0.39) |
| | | | | |
| **Diluted Earnings (Loss) per Share:** | | | | |
| Income (loss) from continuing operations | $ (0.82) | $ 0.07 | $ (0.06) | $ (0.38) |
| Loss from discontinued operations | (0.01) | (0.02) | (0.01) | (0.01) |
| Income (loss) before cumulative effect of accounting change | (0.83) | 0.05 | (0.07) | (0.39) |
| Cumulative effect of accounting change, net of tax | | | | |
| Net income (loss) | $ (0.83) | $ 0.05 | $ (0.07) | $ (0.39) |

**See Notes to our Unaudited Consolidated Interim Financial Statements**

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Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligati

**RELIANT ENERGY, INC. AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
**(Thousands of Dollars, Except Share and Per Share Amounts)**

| | June 30, 2007 (Unaudited) | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets:** | | |
| Cash and cash equivalents | $ 165,994 | $ 463,909 |
| Restricted cash | 5,334 | 24,980 |
| Accounts and notes receivable, principally customer, net of allowance of $31,894 and $33,332 | 1,288,726 | 1,043,637 |
| Inventory | 283,768 | 275,437 |
| Derivative assets | 320,847 | 489,726 |
| Margin deposits | 323,469 | 452,605 |
| Accumulated deferred income taxes | 262,979 | 279,479 |
| Prepayments and other current assets | 173,968 | 141,016 |
| Current assets of discontinued operations | | 2,460 |
| Total current assets | 2,825,085 | 3,173,249 |
| Property, plant and equipment, gross | 7,257,694 | 7,192,437 |
| Accumulated depreciation | (1,576,153) | (1,450,442) |
| **Property, Plant and Equipment, net** | 5,681,541 | 5,741,995 |
| **Other Assets:** | | |
| Goodwill | 379,644 | 381,594 |
| Other intangibles, net | 410,495 | 423,745 |
| Derivative assets | 180,256 | 203,857 |
| Accumulated deferred income taxes | 109,458 | 87,858 |
| Prepaid lease | 257,556 | 264,328 |
| Other | 239,138 | 290,507 |
| Total other assets | 1,576,547 | 1,651,889 |
| **Total Assets** | $ 10,083,173 | $ 10,567,133 |
| | | |
| **LIABILITIES AND EQUITY** | | |
| **Current Liabilities:** | | |
| Current portion of long-term debt and short-term borrowings | $ 381,011 | $ 355,264 |
| Accounts payable, principally trade | 845,316 | 664,630 |
| Derivative liabilities | 841,538 | 1,164,809 |
| Margin deposits | | 16,490 |
| Other | 405,462 | 488,764 |
| Current liabilities of discontinued operations | 1,828 | 3,286 |
| Total current liabilities | 2,475,155 | 2,693,243 |
| **Other Liabilities:** | | |
| Derivative liabilities | 282,945 | 420,534 |
| Other | 308,471 | 324,145 |
| Total other liabilities | 591,416 | 744,679 |
| **Long-term Debt** | 2,987,441 | 3,177,691 |
| **Commitments and Contingencies** | | |
| **Temporary Equity Stock-based Compensation** | 2,620 | 1,647 |
| **Stockholders Equity:** | | |
| Preferred stock; par value $0.001 per share (125,000,000 shares authorized; none outstanding) | | |
| Common stock; par value $0.001 per share (2,000,000,000 shares authorized; 342,425,141 and 337,623,392 issued) | 103 | 99 |
| Additional paid-in capital | 6,201,536 | 6,174,665 |
| Retained deficit | (2,024,874) | (2,026,316) |
| Accumulated other comprehensive loss | (150,224) | (198,575) |
| Total stockholders equity | 4,026,541 | 3,949,873 |
| **Total Liabilities and Equity** | $ 10,083,173 | $ 10,567,133 |

See Notes to our Unaudited Consolidated Interim Financial Statements

**RELIANT ENERGY, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Thousands of Dollars)**
**(Unaudited)**

| | Six Months Ended June 30, 2007 | 2006 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Net loss | $ (24,241) | $ (118,943) |
| Loss from discontinued operations | 3,541 | 3,571 |
| Net loss from continuing operations and cumulative effect of accounting change | (20,700) | (115,372) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Cumulative effect of accounting change | | (968) |
| Depreciation and amortization | 202,572 | 171,597 |
| Deferred income taxes | (30,116) | 68,644 |
| Net changes in energy derivatives | (166,400) | (43,342) |
| Amortization of deferred financing costs | 45,443 | 7,982 |
| Gains on sales of assets and emission allowances, net | (1,727) | (156,330) |
| Debt extinguishment premium and consent fees | 71,269 | |
| Other, net | 6,364 | 4,611 |
| Changes in other assets and liabilities: | | |
| Accounts and notes receivable, net | (212,797) | (135,413) |
| Inventory | (18,390) | 6,269 |
| Margin deposits, net | 112,646 | 311,582 |
| Net derivative assets and liabilities | (27,380) | (137,484) |
| Western states and similar settlements payments | (35,000) | (159,319) |
| Accounts payable | 206,017 | 35,514 |
| Other current assets | (24,432) | 8,304 |
| Other assets | (2,980) | 14,663 |
| Taxes payable/receivable | (7,444) | (29,884) |
| Other current liabilities | (75,353) | 31,285 |
| Other liabilities | 2,493 | 2,845 |
| Net cash provided by (used in) continuing operations from operating activities | 24,085 | (114,816) |
| Net cash used in discontinued operations from operating activities | (2,540) | (36,997) |
| Net cash provided by (used in) operating activities | 21,545 | (151,813) |
| **Cash Flows from Investing Activities:** | | |
| Capital expenditures | (99,172) | (41,919) |
| Proceeds from sales of assets, net | 380 | 1,382 |
| Proceeds from sales of emission allowances | 3,346 | 197,201 |
| Purchases of emission allowances | (14,127) | (3,273) |
| Restricted cash | 19,646 | 17,033 |
| Other, net | 1,750 | 4,750 |
| Net cash provided by (used in) continuing operations from investing activities | (88,177) | 175,174 |
| Net cash provided by discontinued operations from investing activities | | 967,568 |
| Net cash provided by (used in) investing activities | (88,177) | 1,142,742 |
| **Cash Flows from Financing Activities:** | | |
| Payments of long-term debt | (1,465,891) | (326,201) |
| Proceeds from long-term debt | 1,300,000 | |
| Increase (decrease) in short-term borrowings and revolving credit facilities, net | 6,554 | (55,337) |
| Payments of financing costs | (29,634) | |
| Payments of debt extinguishment premium and consent fees | (71,269) | |
| Proceeds from issuances of stock | 28,957 | 10,031 |
| Net cash used in continuing operations from financing activities | (231,283) | (371,507) |
| Net cash used in discontinued operations from financing activities | | (638,000) |
| Net cash used in financing activities | (231,283) | (1,009,507) |
| **Net Change in Cash and Cash Equivalents** | (297,915) | (18,578) |
| **Cash and Cash Equivalents at Beginning of Period** | 463,909 | 88,397 |
| **Cash and Cash Equivalents at End of Period** | $ 165,994 | $ 69,819 |
| **Supplemental Disclosure of Cash Flow Information:** | | |

| | | |
|---|---|---|
| Cash Payments: | | |
| Interest paid (net of amounts capitalized) for continuing operations | $ 205,505 | $ 189,243 |
| Income taxes paid (net of income tax refunds received) for continuing operations | 14,738 | 34,937 |

See Notes to our Unaudited Consolidated Interim Financial Statements

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**RELIANT ENERGY, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

## (1) Background and Basis of Presentation

### *(a) Background.*

Reliant Energy refers to Reliant Energy, Inc. and we, us and our refer to Reliant Energy, Inc. and its consolidated subsidiaries. Our business consists primarily of two business segments, retail energy and wholesale energy. See note 12. Our consolidated interim financial statements and notes (interim financial statements) are unaudited, omit certain disclosures and should be read in conjunction with our audited consolidated financial statements and notes in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (Form 10-K).

### *(b) Basis of Presentation.*

*Estimates.* Management makes estimates and assumptions to prepare financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) that affect:

- the reported amount of assets, liabilities and equity,
- the reported amounts of revenues and expenses and
- our disclosure of contingent assets and liabilities as of the date of the financial statements.

*Adjustments and Reclassifications.* The interim financial statements reflect all normal recurring adjustments necessary, in management s opinion, to present fairly our financial position and results of operations for the reported periods. Amounts reported for interim periods, however, may not be indicative of a full year period due to seasonal fluctuations in demand for electricity and energy services, changes in commodity prices, changes in our retail revenue rates and changes in regulations, timing of maintenance and other expenditures, dispositions, changes in interest expense and other factors. We have reclassified certain immaterial amounts reported in this Form 10-Q from prior periods to conform to the 2007 presentation. These reclassifications had no impact on reported earnings/losses.

*Gross Receipts Taxes.* We record gross receipts taxes for our retail energy segment on a gross basis in revenues and operations and maintenance in our consolidated statements of operations. During the three months ended June 30, 2007 and 2006, our retail energy segment s revenues and operation and maintenance include gross receipts taxes of $24 million and $28 million, respectively, and during the six months ended June 30, 2007 and 2006, $45 million and $49 million, respectively.

*Sales Taxes.* We record sales taxes collected from our taxable retail energy segment customers and remitted to the various governmental entities on a net basis, thus there is no impact on our consolidated statements of operations.

*New Accounting Pronouncement Not Yet Adopted Fair Value.* The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. This statement is applicable for us beginning in 2008. It applies under other accounting pronouncements that require or permit fair value measurements. We are currently in the process of determining the effects of the adoption, which could have a significant impact on our consolidated financial statements.

*New Accounting Pronouncement Not Yet Adopted Offsetting of Amounts*. The FASB issued FSP FIN 39-1, an amendment of FASB Interpretation No. 39 (FIN 39), which addresses certain modifications to FIN 39 and whether a reporting entity that is a party to a master netting arrangement can offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments that have been offset under the same master netting arrangement. The effects of applying this interpretation are to be recognized as a change in accounting principle through retrospective application for all financial statements presented unless it is impracticable to do so.

Where derivative instruments are subject to a master netting arrangement and the accounting criteria to offset are met, we currently present our derivative assets and liabilities with the same counterparty on a net basis. However, we currently do not offset collateral (net margin deposits) related to these derivatives. See note 2(d) to our consolidated financial statements in our Form 10-K. Under FSP FIN 39-1, if we elect to continue to net our derivative assets and liabilities with the same counterparty (pursuant to master netting arrangements), we will be required to net such amounts against cash collateral amounts. However, if we choose to discontinue netting our derivative assets and liabilities and present our derivative assets and liabilities on a gross basis, cash collateral amounts will also be required to be presented on a gross basis. Upon adoption of this interpretation, we will be allowed to choose between either accounting policy to offset or not offset all fair value amounts recognized for derivative instruments under master netting arrangements.

This interpretation is applicable for us beginning in 2008. We are currently in the process of determining which method we will apply and the adoption could have a significant impact on our consolidated balance sheets.

## (2) Stock-based Compensation

Our pre-tax compensation expense for our stock-based incentive plans was:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Stock-based incentive plans compensation expense (pre-tax) | $ 13 | $ 10 | $ 20 | $ 17 |

During February 2007, the compensation committee of our board of directors granted stock-based compensation awards to 47 of our officers under the Reliant Energy, Inc. 2002 Long-Term Incentive Plan. The committee granted 429,221 time-based stock options (exercise price of $16.26 per share, which vest in three equal installments during February 2008, 2009 and 2010), 200,314 time-based restricted stock units (which vest during February 2010) and 345,358 performance-based cash units. Our common stock closed at $23 or higher for 20 consecutive trading days on June 1, 2007. Accordingly, all of the outstanding performance-based cash units (326,048) vested according to their terms and we recognized $8 million of expense during the three and six months ended June 30, 2007 related to these units. In addition, during February 2007, the committee granted 126,790 time-based restricted stock units and 126,790 time-based cash units to other employees under the Reliant Energy, Inc. 2002 Stock Plan. These awards vest in February 2010.

No tax benefits related to stock-based compensation were realized during the three and six months ended June 30, 2007 and 2006 due to our net operating loss carryforwards.

## (3) Comprehensive Income (Loss)

The components of total comprehensive income (loss) are:

| | Three Months Ended June 30, 2007 | 2006 | Six Months Ended June 30, 2007 | 2006 |
|---|---|---|---|---|
| | (in millions) | | | |
| Net income (loss) | $ (283 ) | $ 14 | $ (24 ) | $ (119 ) |
| Other comprehensive income (loss), net of tax: | | | | |
| Deferred income (loss) from cash flow hedges | | (15 ) | 3 | (111 ) |
| Reclassification of net deferred loss from cash flow hedges realized in net income/loss | 20 | 29 | 45 | 71 |
| Comprehensive income (loss) | $ (263 ) | $ 28 | $ 24 | $ (159 ) |

## (4) Goodwill

*2007 Annual Goodwill Impairment Tests*. We completed our annual goodwill impairment tests for our wholesale energy and retail energy reporting units effective April 1, 2007. No impairments occurred.

*Estimation of Our Wholesale Energy Reporting Unit s Fair Value.* We updated a number of subjective factors and significant assumptions to estimate fair value in our April 2007 test as compared to our April 2006 test, including (a) appropriate weighting of valuation approaches (income approach, market approach and comparable public company approach); (b) projections about future power generation margins; (c) estimates of our future cost structure; (d) environmental assumptions; (e) discount rates for estimated cash flows, which changed from 9% to 9.5% primarily due to capital structure changes of peer companies; (f) required level of working capital and (g) assumed EBITDA (earnings before interest, taxes, depreciation and amortization) multiple for terminal values, which changed from 7.5 to 8.0 primarily due to market factors affecting peer company comparisons. See note 4(a) to our consolidated financial statements in our Form 10-K.

## (5) Derivative Instruments

For discussion of our derivative activities, see notes 2(d) and 5 to our consolidated financial statements in our Form 10-K. The income (loss) of our energy and interest rate derivative instruments is:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| | **(in millions)** | | | |
| Energy derivatives: | | | | |
| Hedge ineffectiveness | $ (1) | $ (21) | $ 2 | $ (70) |
| Other net unrealized gains (losses) | (325) | 73 | 194 | 145 |
| Interest rate derivatives: | | | | |
| Hedge ineffectiveness | | | | |
| Other net unrealized losses | (2) | (2) | (5) | (5) |
| Total(1)(2) | $ (328) | $ 50 | $ 191 | $ 70 |

(1) No component of the derivatives gain or loss was excluded from the assessment of effectiveness.

(2) During the three months ended June 30, 2007 and 2006, $0 and during the six months ended June 30, 2007 and 2006, $0 and $3 million loss, respectively, were recognized in our results of continuing operations as a result of the discontinuance of cash flow hedges because it was probable that the forecasted transaction would not occur.

As of December 31, 2006, the maximum length of time we were hedging our exposure to the variability in future cash flows that may result from changes in commodity prices was six years. During the first quarter of 2007, we de-designated our remaining cash flow hedges; therefore, as of June 30, 2007, we have no cash flow hedges.

Amounts included in accumulated other comprehensive loss:

| | June 30, 2007 | |
|---|---|---|
| | **At the End of the Period (in millions)** | **Expected to be Reclassified into Results of Operations in Next 12 Months** |
| Designated cash flow hedges | $ | $ |
| De-designated cash flow hedges | (124) | (60) |
| | $ (124) | $ (60) |

Although we discontinued our proprietary trading business in March 2003, we have legacy positions, which will be closed as economically feasible or in accordance with their terms. The income (loss) associated with these transactions are:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Revenues | $ | $ | $ | $ |
| Purchased power, fuel and cost of gas sold | | | | 10 |
| Total | $ | $ | $ | $ 10 |

## (6) Debt

### *(a) Overview.*

Our outstanding debt is:

| | June 30, 2007 Weighted Average Stated Interest Rate(1) | Long-term | Current | December 31, 2006 Weighted Average Stated Interest Rate(1) | Long-term | Current |
|---|---|---|---|---|---|---|
| | (in millions, except interest rates) | | | | | |
| **Banking or Credit Facilities, Bonds and Notes:** | | | | | | |
| **Reliant Energy:** | | | | | | |
| Senior secured revolver due 2012 | 7.11 % | $ | $ | | $ | $ |
| Senior secured term loans (B) | | | | 7.73 | 397 | 3 |
| Senior unsecured notes due 2010(2) | 9.25 | | 29 (2) | 9.25 | 550 | |
| Senior unsecured notes due 2013(3) | 9.50 | 13 | | 9.50 | 550 | |
| Senior secured notes due 2014 | 6.75 | 750 | | 6.75 | 750 | |
| Senior unsecured notes due 2014 | 7.625 | 575 | | | | |
| Senior unsecured notes due 2017 | 7.875 | 725 | | | | |
| Convertible senior subordinated notes due 2010 (unsecured) | 5.00 | 2 | | 5.00 | 2 | |
| **Subsidiary Obligations:** | | | | | | |
| Orion Power Holdings, Inc. senior notes due 2010 (unsecured) | 12.00 | 400 | | 12.00 | 400 | |
| Reliant Energy Seward, LLC PEDFA(4) fixed-rate bonds due 2036 | 6.75 | 500 | | 6.75 | 500 | |
| Reliant Energy Channelview LP (Channelview): | | | | | | |
| Term loans and revolving working capital facility: | | | | | | |
| Floating rate debt due 2007 to 2024 | 6.95 | | 267 | 6.95 | | 267 |
| Fixed rate debt due 2014 to 2024 | 9.55 | | 75 | 9.55 | | 75 |
| Reliant Energy Power Supply, LLC working capital facility due 2012 | 5.77 | | | 5.80 | | |
| Total facilities, bonds and notes | | 2,965 | 371 | | 3,149 | 345 |
| **Other:** | | | | | | |
| Adjustment to fair value of debt(5) | | 22 | 10 | | 29 | 10 |
| Total other debt | | 22 | 10 | | 29 | 10 |
| Total debt | | $ 2,987 | $ 381 | | $ 3,178 | $ 355 |

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(1) The weighted average stated interest rates are as of June 30, 2007 or December 31, 2006.

(2) These notes became unsecured in June 2007 and we called them in July 2007. See below.

(3) These notes became unsecured in June 2007. See below.

(4) PEDFA is the Pennsylvania Economic Development Financing Authority.

(5) Debt acquired in the Orion Power acquisition was adjusted to fair value as of the acquisition date. Included in interest expense is amortization for valuation adjustments for debt of $4 million and $2 million during the three months ended June 30, 2007 and 2006, respectively, and $7 million and $4 million during the six months ended June 30, 2007 and 2006, respectively.

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Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligati

Amounts borrowed and available for borrowing under our revolving credit agreements as of June 30, 2007 are:

| | Total Committed Credit (in millions) | Drawn Amount | Letters of Credit | Unused Amount |
|---|---|---|---|---|
| Reliant Energy senior secured revolver due 2012 | $ 500 | $ | $ 213 | $ 287 |
| Letter of credit facility due 2014 | 250 | | 249 | 1 |
| Retail working capital facility due 2012 | 300 | | | 300 |
| Channelview revolving working capital facility due 2007(1) | 14 | 14 | | |
| | $ 1,064 | $ 14 | $ 462 | $ 588 |

(1) See below.

### *(b) Financing Activity.*

*2007 Financing Activity.* We completed a refinancing in June 2007, the components of which included:

- Downsize of:
- $700 million to $500 million senior secured revolver and extension of maturity from 2009 to 2012, and
- $300 million to $250 million senior secured letter of credit facility and extension of maturity from 2010 to 2014;
- Issuance of:
- $575 million 7.625% senior unsecured notes due 2014, and
- $725 million 7.875% senior unsecured notes due 2017;
- Repayment of:
- $521 million 9.25% senior secured notes due 2010,
- $537 million 9.50% senior secured notes due 2013, and
- $400 million senior secured term loan due 2010.

*Senior Secured Revolver and Letter of Credit Facility (the June 2007 credit facilities).* We entered into the June 2007 credit facilities, which replaced the December 2006 credit facilities. The senior secured revolver bears interest at the London Inter Bank Offering Rate (LIBOR) plus 1.75% or a base rate plus 0.75%. Our revolving credit facility and letter of credit facility provide for the issuance of up to $500 million and $250 million of letters of credit, respectively.

The June 2007 credit facilities restrict our ability to, among other actions, (a) encumber our assets, (b) enter into business combinations or divest our assets, (c) incur additional debt or engage in sale and leaseback transactions, (d) pay dividends or pay subordinated debt, (e) make investments or acquisitions, (f) enter into transactions with affiliates, (g) materially change our business, (h) repurchase capital stock or (i) utilize proceeds from asset sales. When there are any revolving loans or revolving letters of credit outstanding under our June 2007 credit facilities, we are required to achieve specified levels for the ratio of consolidated secured debt to adjusted net earnings (loss) before interest expense, interest income, income taxes, depreciation and amortization (consolidated secured leverage ratio).

The June 2007 credit facilities are (a) guaranteed by some of our subsidiaries and (b) secured by the assets and stock of those subsidiaries, as well as the stock of RERH Holdings, LLC, REMA LLC and Orion Power Holdings, Inc. See note 11.

*Senior Unsecured 7.625% and 7.875% Notes.* In June 2007, we issued $575 million of 7.625% senior unsecured notes due 2014 and $725 million of 7.875% senior unsecured notes due 2017. These notes are unsecured obligations and not guaranteed. The unsecured notes restrict our ability to encumber our assets. Upon a change of control, the notes require, as do the 6.75% senior secured notes and the PEDFA guarantee, that an offer to purchase the notes be made at a purchase price of 101% of the principal amount. The proceeds of this issuance were used to repay the tendered 9.25% and 9.50% senior secured notes and a portion of the senior secured term loan.

*Senior Unsecured 9.25% and 9.50% Notes.* In June 2007, we completed a tender offer to purchase for cash any and all of the outstanding 9.25% senior secured notes due 2010 and 9.50% senior secured notes due 2013. We also solicited consents to (a) amend the applicable indentures governing the notes to eliminate substantially all of the restrictive covenants, (b) amend certain events of default, (c) modify other provisions contained in the indentures and (d) release the collateral securing the notes. Approximately 94.81% of the 2010 note holders and 97.73% of the 2013 note holders accepted the tender offer and agreed to the consents. We paid a cash premium of $50 million and a consent solicitation fee of $21 million to the note holders who tendered during the three months ended June 30, 2007.

In July 2007, we called the remaining $29 million of our 2010 notes that were outstanding as of June 30, 2007. We used cash on hand to pay the $29 million and a $1 million call premium.

*Deferred Financing Costs.* We incur costs, which are deferred and amortized over the life of the debt, in connection with obtaining financings.

| | Six Months Ended June 30, 2007 (in millions) | |
|---|---|---|
| Balance, January 1, 2007 | $ 92 | |
| Capitalized | 30 | |
| Amortized | (6 | ) |
| Accelerated amortization/write-offs due to early extinguishments | (39 | ) |
| Balance, June 30, 2007 | $ 77 | |

***(c) Channelview.***

We are considering various strategic alternatives with respect to our interest in Channelview, including selling our equity interests to a third party, refinancing all or a portion of Channelview s debt or placing Channelview in bankruptcy. There can be no assurances regarding the outcome of this process. As of June 30, 2007, Channelview s net property, plant and equipment is $362 million and its debt is $342 million. As of June 30, 2007, our net investment in the Channelview companies, before considering any income tax impacts, is approximately $60 million. Under Channelview s credit agreement, the partnership is required to maintain a working capital requirement of $14 million. This covenant is currently met by the commitments of the $14 million revolving working capital facility that matures by August 15, 2007. The lenders have not agreed to extend the commitments and we do not know whether the working capital requirement will be met. Failure to maintain the working capital requirement would constitute an event of default allowing Channelview s lenders to demand immediate payment. Due to these factors, we have classified the Channelview debt as a current liability as of June 30, 2007. Channelview s debt is non-recourse to Reliant Energy.

## (7) Earnings Per Share

Reconciliations of the amounts used in the basic and diluted earnings (loss) per common share computations are:

| | Three Months Ended June 30, 2007 (in millions) | | 2006 | Six Months Ended June 30, 2007 | | 2006 | |
|---|---|---|---|---|---|---|---|
| Income (loss) from continuing operations (basic) | $ (281 | ) | $ 23 | $ (21 | ) | $ (116 | ) |
| Plus: Interest expense on 5.00% convertible senior subordinated notes, net of tax | | (1) | 2 | | (1) | | (1) |
| Income (loss) from continuing operations (diluted) | $ (281 | ) | $ 25 | $ (21 | ) | $ (116 | ) |

(1) As we incurred a loss from continuing operations for this period, diluted loss per share is calculated the same as basic loss per share.

Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligati

| | Three Months Ended June 30, 2007 | 2006 | Six Months Ended June 30, 2007 | 2006 |
|---|---|---|---|---|
| | (shares in thousands) | | | |
| Diluted Weighted Average Shares Calculation: | | | | |
| Weighted average shares outstanding (basic) | 342,074 | 306,780 | 340,717 | 306,208 |
| Plus: Incremental shares from assumed conversions: | | | | |
| Stock options | (1) | 2,309 | (1) | (1) |
| Restricted stock | (1) | 604 | (1) | (1) |
| Employee stock purchase plan | (1) | 81 | (1) | (1) |
| 5.00% convertible senior subordinated notes | (1) | 28,823 | (1) | (1) |
| Warrants | (1) | 3,995 | (1) | (1) |
| Weighted average shares outstanding assuming conversion (diluted) | 342,074 | 342,592 | 340,717 | 306,208 |

(1) See note (1) above regarding diluted loss per share.

We excluded the following items from diluted earnings (loss) per common share due to the anti-dilutive effect:

| | Three Months Ended June 30, 2007 | 2006 | Six Months Ended June 30, 2007 | 2006 |
|---|---|---|---|---|
| | (shares in thousands, dollars in millions) | | | |
| Shares excluded from the calculation of diluted earnings (loss) per share | 11,196 (1) | | 10,653 (1) | 35,657 (1) |
| Shares excluded from the calculation of diluted earnings (loss) per share because the exercise price exceeded the average market price | 2,112 (2) | 3,159 (2) | 2,138 (2) | 5,233 (2) |
| Interest expense that would be added to income if 5.00% convertible senior subordinated notes were dilutive | $ (3) | $ | $ (3) | $ 4 |

(1) Potential shares excluded consist of convertible senior subordinated notes, warrants, stock options, restricted stock, performance-based shares and shares related to employee stock purchase plan.

(2) Includes stock options.

(3) In December 2006, we converted 99.2% of our convertible senior subordinated notes to common stock.

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## (8) Income Taxes

### *(a) Tax Rate Reconciliation.*

A reconciliation of the federal statutory income tax rate to the effective income tax rate is:

| | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Six Months Ended June 30, 2007 | Six Months Ended June 30, 2006 |
|---|---|---|---|---|
| Federal statutory rate | 35 % | 35 % | 35 % | 35 % |
| Additions (reductions) resulting from: | | | | |
| Federal tax uncertainties | 1 | | 14 | (1 ) |
| Federal valuation allowance(1) | | 52 | (7 ) | (214 ) |
| State income taxes, net of federal income taxes | 2 | (46 )(2) | 8 | 10 (2) |
| Other, net | | 1 | 2 | (6 ) |
| Effective rate | 38 % | 42 % | 52 % | (176 )% |

(1) Our changes to the federal valuation allowance are recorded at Reliant Energy, Inc.

(2) During the three and six months ended June 30, 2006, we recorded a deferred state tax benefit of $19 million to reflect the estimated cumulative change to deferred tax items as a result of the Texas law change. See note 11(f) to our consolidated financial statements in our Form 10-K.

### *(b) Valuation Allowances.*

We assess quarterly our future ability to use federal, state and foreign net operating loss carryforwards, capital loss carryforwards and other deferred tax assets. These assessments include an evaluation of our recent history of earnings and losses, future reversals of temporary differences and identification of other sources of future taxable income, including the identification of tax planning strategies in certain situations.

Our valuation allowances are:

| | Federal (in millions) | State | Capital, Foreign and Other, Net |
|---|---|---|---|
| As of December 31, 2006 | $ 60 | $ 85 | $ 18 |
| Changes in valuation allowance | 1 | 4 | |
| As of March 31, 2007 | 61 | 89 | 18 |
| Changes in valuation allowance | 21 (1) | (10 ) | |
| As of June 30, 2007 | $ 82 | $ 79 | $ 18 |

(1) During 2007, we submitted a revision to taxable income to the Internal Revenue Service filed in our 2003 federal income tax return, which resulted in an increase in our net deferred tax assets related to our net operating losses, which was offset by an increase in our valuation allowance of $19 million during the three and six months ended June 30, 2007.

### *(c) Adoption of FIN 48 and Tax Uncertainties.*

Effective January 1, 2007, we adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48). This interpretation addresses whether (and when) tax benefits claimed in our tax returns should be recorded in our financial statements. Pursuant to FIN 48, we may only recognize the tax benefit from an uncertain tax position when it is more-likely-than-not that, based on the technical merits, the position will be sustained by taxing authorities or the courts. The recognized tax benefits are measured as the largest benefit having a greater than fifty percent likelihood of being sustained upon settlement. FIN 48 also provides guidance for derecognition, classification, interest and penalties, disclosures and related matters. We classify accrued interest and penalties related to uncertain income tax positions in income tax expense/benefit.

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Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligati

In connection with the adoption, we recognized the following in our consolidated financial statements:

| | Adoption Effect on January 1, 2007 Increase (Decrease) (in millions) |
|---|---|
| Goodwill | $ (2) |
| Other long-term liabilities | (27) |
| Retained deficit | (25) |

As of January 1, 2007, immediately after adoption, our consolidated balance sheet reflected $4 million for income tax uncertainties in long-term liabilities. Of the $4 million, $1 million relates to income taxes, $2 million relates to penalties and $1 million relates to interest. As of June 30, 2007, we have accrued $1 million for uncertain income tax positions (relating to income taxes) included in long-term liabilities.

Our income tax returns for the 1997 to 2005 tax reporting periods are under audit by federal and state taxing authorities. These audits may result in additional taxes, interest and penalties or revisions of the timing of tax payments. We do not currently estimate that our unrecognized tax benefits will change significantly within the next 12 months.

## (9) Guarantees and Indemnifications

We have guaranteed some non-qualified benefits of CenterPoint s existing retirees at September 20, 2002. The estimated maximum potential amount of future payments under the guarantee was approximately $56 million as of June 30, 2007 and no liability is recorded in our consolidated balance sheets for this item.

In addition, we are also required to indemnify CenterPoint for certain liabilities relating to the initial public offering of our common stock.

We also guarantee the $500 million PEDFA bonds, which are included in our consolidated balance sheet as outstanding debt. Our guarantees are secured by guarantees from all of our subsidiaries that guarantee the June 2007 credit facilities. The guarantees require us to comply with covenants substantially identical to those in the 6.75% senior secured notes indenture. The PEDFA bonds will become secured by certain assets of our Seward power plant if the collateral supporting both the 6.75% senior secured notes and our guarantee is released. Our maximum potential obligation under the guarantee is for payment of the principal of $500 million and related interest charges at a fixed rate of 6.75%.

We have guaranteed payments to a third party relating to energy sales from El Dorado Energy, LLC, a former investment. The estimated maximum potential amount of future payments under this guarantee was approximately $21 million as of June 30, 2007 and no liability is recorded in our consolidated balance sheets for this item.

We enter into contracts that include indemnification and guarantee provisions. In general, we enter into contracts with indemnities for matters such as breaches of representations and warranties and covenants contained in the contract and/or against certain specified liabilities. Examples of these contracts include asset sales agreements, retail supply agreements, service agreements and procurement agreements.

In our debt agreements, we typically indemnify against liabilities that arise from the preparation, entry into, administration or enforcement of the agreement.

We are unable to estimate our maximum potential exposure under these provisions until an event triggering payment under these provisions occurs. We do not expect to make any material payments under these provisions.

## (10) Contingencies

We are party to many legal proceedings, some of which may involve substantial amounts. Unless otherwise noted, we cannot predict the outcome of the matters described below. Other than as described below and in note 10 to our consolidated interim financial statements in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, there have been no significant developments regarding the contingencies disclosed in note 13 to our consolidated financial statements in our Form 10-K.

### *(a) Legal Proceedings.*

***Pending Electricity and Natural Gas Litigation***

The following proceedings relate to alleged conduct in the electricity and natural gas markets. In 2005 and 2006, we settled a number of proceedings that were pending in California and other Western states; however, a number of other proceedings remain pending.

*Electricity Actions*. We are party to one remaining lawsuit relating to our participation in alleged conduct to increase electricity prices in violation of antitrust laws, unfair competition laws and similar laws. The lawsuit seeks treble damages, restitution and expenses. The lawsuit is on appeal from an order of the United States District Court, District of Oregon that dismissed this case in our favor. We do not believe the appeal will materially impact the underlying 2005 settlement or other electricity lawsuits.

*Natural Gas Actions.* We are party to 27 lawsuits, several of which are class action lawsuits, in state and federal courts in California, Colorado, Kansas, Missouri and Wisconsin. These lawsuits relate to alleged conduct to increase natural gas prices in violation of antitrust and similar laws. The lawsuits seek treble damages, restitution and/or expenses. The lawsuits also name a number of unaffiliated energy companies as parties. In July 2007, the cases pending in California were stayed pending a ruling by the Ninth Circuit Court of Appeals in related cases on appeal.

One of the natural gas cases is a case filed by the Los Angeles Department of Water and Power (LADWP) in the California Superior Court in 2004. The lawsuit alleges that we conspired to manipulate natural gas prices in breach of our supply contract with LADWP and in violation of California s antitrust laws and the California False Claims Act. The lawsuit seeks treble damages for the alleged overcharges (estimated to be $218 million) for gas purchased by LADWP, interest and legal costs. The lawsuit also seeks (a) a determination that an extension of the contract with LADWP was invalid in that the required municipal approvals for the extension were allegedly not obtained and (b) a return of all money paid by LADWP during that period (estimated to be $681 million).

***PUCT Cases***

There are various proceedings pending before the state district court in Travis County, Texas, seeking reviews of the Public Utility Commission of Texas (PUCT) orders relating to the fuel factor component used in our price-to-beat tariff. These proceedings pertain to the same issues affirmed by a district court in Travis County and later by the Travis County Court of Appeals in 2004 in a separate proceeding.

***Settlements***

*Criminal Proceeding Reliant Energy Services*. In March 2007, Reliant Energy Services, Inc. entered into a Deferred Prosecution Agreement in resolution of its April 2004 indictment for alleged violations of the Commodity Exchange Act, wire fraud and conspiracy charges. As part of the agreement, Reliant Energy Services, Inc. paid and expensed a $22 million penalty in March 2007. The agreement has a term of two years.

### *(b) Environmental Matters.*

*New Source Review Matters.* The United States Environmental Protection Agency (EPA) and various states are investigating compliance of coal-fueled electric generating stations with the New Source Review requirements of the Clean Air Act. The EPA has agreed to share information relating to its investigations with state environmental agencies. We are unable to predict the ultimate outcome of the EPA s investigation. In November 2005, we received a notice of intent to sue pursuant to the Clean Air Act from the state of New Jersey relating to one of our power plants located in Pennsylvania.  The allegations relate to conduct that occurred prior to our ownership of the power plant.  If the state of New Jersey sues us and is successful, we could incur significant capital expenditures associated with the implementation of emissions reductions on an accelerated basis and possible penalties. In February 2007, the state of New Jersey filed suit against the EPA to force a ruling on the petition filed by the state of New Jersey relating to renewal of an air permit for our plant. In June 2007, the EPA issued a ruling that denied New Jersey s petition and the New Jersey complaint was dismissed.

*Ash Disposal Site Closures.* We are responsible for environmental costs related to the future closures of seven ash disposal sites. Based on our evaluations with assistance from third-party consultants and engineers, we recorded the estimated discounted costs associated with these environmental liabilities as part of our asset retirement obligations. See note 2(p) to our consolidated financial statements in our Form 10-K.

*Remediation Obligations*. We are responsible for environmental costs related to site contamination investigations and remediation requirements at four power plants in New Jersey. Based on our evaluations with assistance from third-party consultants and engineers, we recorded the estimated liability for the remediation costs of $6 million and $7 million as of June 30, 2007 and December 31, 2006, respectively.

*New Castle Notice of Violation*. In December 2006, we received a Notice of Violation from the Pennsylvania Department of Environmental Protection (PADEP) regarding the elevation of the permitted coal ash landfill at our generating site in New Castle, Pennsylvania. In July 2007, we agreed to pay a penalty of $120,000 to the PADEP in settlement of this matter.

*Avon Lake Emission Violation.* In early 2007, we notified the EPA and the Ohio EPA that the nitrogen oxide level at one of our Avon Lake units exceeded the 2006 annual emission limit. In July 2007, we paid the EPA $268,000 in settlement of this matter. No monetary sanctions are due to the Ohio EPA.

*Conemaugh Actions.* In April 2007, the PADEP filed suit against us in the Court of Common Pleas of Indiana County, Pennsylvania. In addition, in April 2007, PennEnvironment and the Sierra Club filed a citizens suit against us in the United States District Court, Western District of Pennsylvania. Each suit alleges that the Conemaugh plant is in violation of its water discharge permit and related state and federal laws and seeks civil penalties, remediation and/or to enjoin violations. The Conemaugh plant is jointly owned by us and seven other companies and is governed by a consent order agreement with the PADEP. We are confident that the Conemaugh plant has operated and will continue to operate in material compliance with the consent order agreement, its water discharge permit and related state and federal laws. However, if PADEP or PennEnvironment and the Sierra Club are successful, we could incur significant capital expenditures associated with the implementation of discharge reductions on an accelerated basis and possible penalties.

*Water Quality.* In July 2007, the EPA suspended its regulations relating to cooling water intake structures at large existing power plants pending further rulemaking. This action was in response to the Second Circuit Court of Appeals January 2007 remand of the regulations. In issuing the suspension, the EPA retained interim requirements that associated intakes employ best technology available controls as determined on a plant-by-plant, best professional judgment basis.

***(c) Other.***

*PUCT Complaint.* A market participant has filed a complaint at the PUCT relating to the Electric Reliability Council of Texas s (ERCOT s) procedure for allocating replacement reserve charges for 2006. We, along with other parties opposing complainant s request for relief, filed a joint motion to dismiss the complaint. If the motion to dismiss is not granted and if the PUCT orders resettlement of the charges and depending on the method of resettlement, our share of the resettlement charges could be up to $25 million.

*CenterPoint Indemnity.* We have agreed to indemnify CenterPoint against certain losses relating to the lawsuits described in note 10(a) under Pending Electricity and Natural Gas Litigation Natural Gas Actions. We have also agreed to indemnify CenterPoint against losses relating to an alleged breach of fiduciary duties in violation of the Employee Retirement Income Security Act in a class action lawsuit in the United States District Court for the Southern District of Texas. The lawsuit seeks monetary damages and restitution. In January 2006, the court granted CenterPoint s motion for summary judgment and dismissed the case with prejudice. The court s decision is on appeal to the United States Court of Appeals for the Fifth Circuit.

*Texas Franchise Audit*. The state of Texas has issued preliminary audit findings indicating an estimated tax liability of approximately $75 million (excluding any interest and penalties) relating primarily to the sourcing of receipts for 2000 through 2005. We plan to contest any proposed audit assessment related to this issue. We cannot predict an outcome at this time.

*Sales Tax Contingencies.* We have some estimated sales tax exposure related to disputed tax-exempt customers. As of June 30, 2007, we have $29 million accrued in current and long-term liabilities relating to these contingencies.

## (11) Supplemental Guarantor Information

Our wholly-owned subsidiaries are either (a) full and unconditional guarantors, jointly and severally, or (b) non-guarantors of the senior secured notes. Effective with the December 2006 refinancing and the credit-enhanced retail structure, RERH Holdings, LLC and its subsidiaries, which comprise our Texas retail energy business, became non-guarantors. We have retrospectively adjusted the information presented for the three and six months ended June 30, 2006 to be comparable to 2007.

*Condensed Consolidating Statements of Operations.*

| | Three Months Ended June 30, 2007 Reliant Energy (in millions) | Guarantors | Non-Guarantors | Adjustments (1) | Consolidated |
|---|---|---|---|---|---|
| Revenues | $ | $ 860 | $ 2,377 | $ (587 ) | $ 2,650 |
| Purchased power, fuel and cost of gas sold | | 736 | 2,324 | (584 ) | 2,476 |
| Operation and maintenance | | 48 | 188 | (3 ) | 233 |
| Selling, general and administrative | | 7 | 98 | | 105 |
| (Gains) losses on sales of assets and emission allowances, net | | 5 | (7 ) | | (2 ) |
| Depreciation and amortization | | 38 | 72 | | 110 |
| Total | | 834 | 2,675 | (587 ) | 2,922 |
| Operating income (loss) | | 26 | (298 ) | | (272 ) |
| Income of equity investment, net | | 2 | | | 2 |
| Income of equity investments of consolidated subsidiaries | (221 ) | (42 ) | | 263 | |
| Debt extinguishment premium and consent fees | (71 ) | | | | (71 ) |
| Other, net | (1 ) | | | | (1 ) |
| Interest expense | (93 ) | (9 ) | (20 ) | | (122 ) |
| Interest income | 2 | 2 | 4 | | 8 |
| Interest income (expense) affiliated companies, net | 93 | (69 ) | (24 ) | | |
| Total other expense | (291 ) | (116 ) | (40 ) | 263 | (184 ) |
| Loss from continuing operations before income taxes | (291 ) | (90 ) | (338 ) | 263 | (456 ) |
| Income tax benefit | (8 ) | (47 ) | (120 ) | | (175 ) |
| Loss from continuing operations | (283 ) | (43 ) | (218 ) | 263 | (281 ) |
| Loss from discontinued operations | | | (2 ) | | (2 ) |
| Net loss | $ (283 ) | $ (43 ) | $ (220 ) | $ 263 | $ (283 ) |

| | Three Months Ended June 30, 2006 Reliant Energy (in millions) | Guarantors | Non-Guarantors | Adjustments (1) | Consolidated |
|---|---|---|---|---|---|
| Revenues | $ | $ 2,422 | $ 2,306 | $ (1,953 ) | $ 2,775 |
| Purchased power, fuel and cost of gas sold | | 2,349 | 1,838 | (1,953 ) | 2,234 |
| Operation and maintenance | | 51 | 180 | | 231 |
| Selling, general and administrative | | 3 | 89 | | 92 |
| (Gain) loss on sales of receivables | | 2 | (2 ) | | |
| Gains on sales of assets and emission allowances, net | | | (5 ) | | (5 ) |
| Depreciation and amortization | | 38 | 53 | | 91 |
| Total | | 2,443 | 2,153 | (1,953 ) | 2,643 |
| Operating income (loss) | | (21 ) | 153 | | 132 |
| Income of equity investment, net | | 2 | | | 2 |
| Other, net | | 1 | | | 1 |
| | 44 | (15 ) | 2 | (31 ) | |

| | | | | | |
|---|---|---|---|---|---|
| Income (loss) of equity investments of consolidated subsidiaries | | | | | |
| Interest expense | (72) | (8) | (23) | | (103) |
| Interest income | | 7 | | | 7 |
| Interest income (expense) affiliated companies, net | 56 | (76) | 20 | | |
| Total other income (expense) | 28 | (89) | (1) | (31) | (93) |
| Income (loss) from continuing operations before income taxes | 28 | (110) | 152 | (31) | 39 |
| Income tax expense (benefit) | 14 | (55) | 57 | | 16 |
| Income (loss) from continuing operations | 14 | (55) | 95 | (31) | 23 |
| Loss from discontinued operations | | (1) | (8) | | (9) |
| Net income (loss) | $ 14 | $ (56) | $ 87 | $ (31) | $ 14 |

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| | Six Months Ended June 30, 2007<br>Reliant Energy<br>(in millions) | Guarantors | Non-Guarantors | Adjustments (1) | Consolidated |
|---|---|---|---|---|---|
| Revenues | $ | $ 1,682 | $ 4,448 | $ (1,118) | $ 5,012 |
| Purchased power, fuel and cost of gas sold | | 1,605 | 3,426 | (1,112) | 3,919 |
| Operation and maintenance | | 107 | 363 | (6) | 464 |
| Selling, general and administrative | | 11 | 181 | | 192 |
| Western states and similar settlements | | 22 | | | 22 |
| (Gains) losses on sales of assets and emission allowances, net | | 8 | (10) | | (2) |
| Depreciation and amortization | | 86 | 116 | | 202 |
| Total | | 1,839 | 4,076 | (1,118) | 4,797 |
| Operating income (loss) | | (157) | 372 | | 215 |
| Income of equity investment, net | | 3 | | | 3 |
| Income of equity investments of consolidated subsidiaries | (5) | (42) | | 47 | |
| Debt extinguishment premium and consent fees | (71) | | | | (71) |
| Interest expense | (149) | (17) | (43) | | (209) |
| Interest income | 6 | 5 | 7 | | 18 |
| Interest income (expense) affiliated companies, net | 184 | (142) | (42) | | |
| Total other expense | (35) | (193) | (78) | 47 | (259) |
| Income (loss) from continuing operations before income taxes | (35) | (350) | 294 | 47 | (44) |
| Income tax expense (benefit) | (11) | (121) | 109 | | (23) |
| Income (loss) from continuing operations | (24) | (229) | 185 | 47 | (21) |
| Loss from discontinued operations | | | (3) | | (3) |
| Net income (loss) | $ (24) | $ (229) | $ 182 | $ 47 | $ (24) |

| | Six Months Ended June 30, 2006<br>Reliant Energy<br>(in millions) | Guarantors | Non-Guarantors | Adjustments (1) | Consolidated |
|---|---|---|---|---|---|
| Revenues | $ | $ 4,659 | $ 4,162 | $ (3,593) | $ 5,228 |
| Purchased power, fuel and cost of gas sold | | 4,582 | 3,495 | (3,593) | 4,484 |
| Operation and maintenance | | 93 | 323 | | 416 |
| Selling, general and administrative | | 1 | 161 | | 162 |
| (Gain) loss on sales of receivables | | 5 | (5) | | |
| Gains on sales of assets and emission allowances, net | | (18) | (138) | | (156) |
| Depreciation and amortization | | 77 | 95 | | 172 |
| Total | | 4,740 | 3,931 | (3,593) | 5,078 |
| Operating income (loss) | | (81) | 231 | | 150 |
| Income of equity investment, net | | 2 | | | 2 |
| Other, net | | 1 | | | 1 |

| | | | | | |
|---|---|---|---|---|---|
| Income of equity investments of consolidated subsidiaries | 1 | 7 | 2 | (10) | |
| Interest expense | (148) | (17) | (46) | | (211) |
| Interest income | | 14 | 2 | | 16 |
| Interest income (expense) affiliated companies, net | 112 | (147) | 35 | | |
| Total other expense | (35) | (140) | (7) | (10) | (192) |
| Income (loss) from continuing operations before income taxes | (35) | (221) | 224 | (10) | (42) |
| Income tax expense (benefit) | 80 | (97) | 91 | | 74 |
| Income (loss) from continuing operations | (115) | (124) | 133 | (10) | (116) |
| Income (loss) from discontinued operations | (4) | (4) | 4 | | (4) |
| Cumulative effect of accounting change, net of tax | | 1 | | | 1 |
| Net income (loss) | $ (119) | $ (127) | $ 137 | $ (10) | $ (119) |

(1) These amounts relate to either (a) eliminations and adjustments recorded in the normal consolidation process or (b) reclassifications recorded due to differences in classifications at the subsidiary levels compared to the consolidated level.

*Condensed Consolidating Balance Sheets.*

| June 30, 2007 | Reliant Energy (in millions) | Guarantors | Non-Guarantors | Adjustments (1) | Consolidated |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current Assets:** | | | | | |
| Cash and cash equivalents | $ 75 | $ 2 | $ 89 | $ | $ 166 |
| Restricted cash | | 1 | 4 | | 5 |
| Accounts and notes receivable, principally customer, net | 15 | 325 | 962 | (13) | 1,289 |
| Accounts and notes receivable affiliated companies | 1,989 | 408 | 287 | (2,684) | |
| Inventory | | 144 | 140 | | 284 |
| Derivative assets | | 62 | 259 | | 321 |
| Other current assets | | 368 | 362 | 30 | 760 |
| Total current assets | 2,079 | 1,310 | 2,103 | (2,667) | 2,825 |
| **Property, Plant and Equipment, net** | | 2,982 | 2,700 | | 5,682 |
| **Other Assets:** | | | | | |
| Goodwill | | 51 | 210 | 119 | 380 |
| Other intangibles, net | | 131 | 279 | | 410 |
| Notes receivable affiliated companies | 2,661 | 763 | 91 | (3,515) | |
| Equity investments of consolidated subsidiaries | 1,966 | 291 | | (2,257) | |
| Derivative assets | | 48 | 132 | | 180 |
| Other long-term assets | 59 | 890 | 355 | (698) | 606 |
| Total other assets | 4,686 | 2,174 | 1,067 | (6,351) | 1,576 |
| Total Assets | $ 6,765 | $ 6,466 | $ 5,870 | $ (9,018) | $ 10,083 |
| | | | | | |
| **LIABILITIES AND EQUITY** | | | | | |
| **Current Liabilities:** | | | | | |
| Current portion of long-term debt and short-term borrowings | $ 29 | $ | $ 352 | $ | $ 381 |
| Accounts payable, principally trade | | 187 | 662 | (4) | 845 |
| Accounts and notes payable affiliated companies | | 2,270 | 414 | (2,684) | |
| Derivative liabilities | | 194 | 648 | | 842 |
| Other current liabilities | 16 | 111 | 316 | (38) | 405 |
| Current liabilities of discontinued operations | | | 2 | | 2 |
| Total current liabilities | 45 | 2,762 | 2,394 | (2,726) | 2,475 |
| **Other Liabilities:** | | | | | |
| Notes payable affiliated companies | | 2,484 | 1,031 | (3,515) | |
| Derivative liabilities | | 51 | 231 | | 282 |
| Other long-term liabilities | 625 | 168 | 214 | (698) | 309 |
| Total other liabilities | 625 | 2,703 | 1,476 | (4,213) | 591 |
| **Long-term Debt** | 2,065 | 500 | 422 | | 2,987 |
| **Commitments and Contingencies** | | | | | |
| **Temporary Equity Stock-based Compensation** | 3 | | | | 3 |
| **Total Stockholders Equity (Deficit)** | 4,027 | 501 | 1,578 | (2,079) | 4,027 |
| **Total Liabilities and Equity** | $ 6,765 | $ 6,466 | $ 5,870 | $ (9,018) | $ 10,083 |

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| December 31, 2006 Reliant Energy (in millions) | | Guarantors | Non-Guarantors | Adjustments (1) | Consolidated |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current Assets:** | | | | | |
| Cash and cash equivalents | $ 286 | $ 24 | $ 154 | $ | $ 464 |
| Restricted cash | | | 25 | | 25 |
| Accounts and notes receivable, principally customer, net | 10 | 264 | 779 | (9 ) | 1,044 |
| Accounts and notes receivable affiliated companies | 1,737 | 418 | 259 | (2,414 ) | |
| Inventory | | 144 | 131 | | 275 |
| Derivative assets | | 61 | 429 | | 490 |
| Other current assets | 7 | 529 | 354 | (17 ) | 873 |
| Current assets of discontinued operations | | | 2 | | 2 |
| Total current assets | 2,040 | 1,440 | 2,133 | (2,440 ) | 3,173 |
| **Property, Plant and Equipment, net** | | 3,044 | 2,698 | | 5,742 |
| **Other Assets:** | | | | | |
| Goodwill | | 51 | 212 | 119 | 382 |
| Other intangibles, net | | 131 | 293 | | 424 |
| Notes receivable affiliated companies | 3,249 | 789 | 94 | (4,132 ) | |
| Equity investments of consolidated subsidiaries | 1,377 | 328 | 5 | (1,710 ) | |
| Derivative assets | | 77 | 127 | | 204 |
| Other long-term assets | 76 | 730 | 400 | (564 ) | 642 |
| Total other assets | 4,702 | 2,106 | 1,131 | (6,287 ) | 1,652 |
| **Total Assets** | $ 6,742 | $ 6,590 | $ 5,962 | $ (8,727 ) | $ 10,567 |
| **LIABILITIES AND EQUITY** | | | | | |
| **Current Liabilities:** | | | | | |
| Current portion of long-term debt and short-term borrowings | $ 3 | $ | $ 352 | $ | $ 355 |
| Accounts payable, principally trade | | 224 | 444 | (3 ) | 665 |
| Accounts and notes payable affiliated companies | | 2,021 | 393 | (2,414 ) | |
| Derivative liabilities | | 238 | 927 | | 1,165 |
| Other current liabilities | 55 | 159 | 313 | (23 ) | 504 |
| Current liabilities of discontinued operations | | | 3 | | 3 |
| Total current liabilities | 58 | 2,642 | 2,432 | (2,440 ) | 2,692 |
| **Other Liabilities:** | | | | | |
| Notes payable affiliated companies | | 3,251 | 881 | (4,132 ) | |
| Derivative liabilities | | 77 | 344 | | 421 |
| Other long-term liabilities | 484 | 167 | 237 | (564 ) | 324 |
| Total other liabilities | 484 | 3,495 | 1,462 | (4,696 ) | 745 |
| **Long-term Debt** | 2,248 | 501 | 429 | | 3,178 |
| **Commitments and Contingencies** | | | | | |
| **Temporary Equity Stock-based Compensation** | 2 | | | | 2 |
| **Total Stockholders Equity (Deficit)** | 3,950 | (48 ) | 1,639 | (1,591 ) | 3,950 |
| **Total Liabilities and Equity** | $ 6,742 | $ 6,590 | $ 5,962 | $ (8,727 ) | $ 10,567 |

(1) These amounts relate to either (a) eliminations and adjustments recorded in the normal consolidation process or (b) reclassifications recorded due to differences in classifications at the subsidiary levels compared to the consolidated level.

Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligati

*Condensed Consolidating Statements of Cash Flows.*

| | Six Months Ended June 30, 2007<br>Reliant Energy<br>(in millions) | Guarantors | Non-Guarantors | Adjustments(1) | Consolidated |
|---|---|---|---|---|---|
| **Cash Flows from Operating Activities:** | | | | | |
| Net cash provided by (used in) continuing operations from operating activities | $ 60 | $ (237) | $ 201 | $ | $ 24 |
| Net cash used in discontinued operations from operating activities | | | (3) | | (3) |
| Net cash provided by (used in) operating activities | 60 | (237) | 198 | | 21 |
| **Cash Flows from Investing Activities:** | | | | | |
| Capital expenditures | | (12) | (87) | | (99) |
| Investments in, advances to and from and distributions from subsidiaries, net (2)(3) | (40) | | (259) | 299 | |
| Net purchases of emission allowances | | (3) | (8) | | (11) |
| Restricted cash | | (1) | 21 | | 20 |
| Other, net | | 3 | (1) | | 2 |
| Net cash used in investing activities | (40) | (13) | (334) | 299 | (88) |
| **Cash Flows from Financing Activities:** | | | | | |
| Payments of long-term debt | (1,458) | | (7) | | (1,465) |
| Proceeds from long-term debt | 1,300 | | | | 1,300 |
| Increase in short-term borrowings and revolving credit facilities, net | | | 7 | | 7 |
| Changes in notes with affiliated companies, net (3)(4) | | 228 | 71 | (299) | |
| Payments of financing costs | (30) | | | | (30) |
| Payments of debt extinguishment premium and consent fees | (71) | | | | (71) |
| Proceeds from issuances of stock | 29 | | | | 29 |
| Other, net | (1) | | | | (1) |
| Net cash provided by (used in) financing activities | (231) | 228 | 71 | (299) | (231) |
| **Net Change in Cash and Cash Equivalents** | (211) | (22) | (65) | | (298) |
| **Cash and Cash Equivalents at Beginning of Period** | 286 | 24 | 154 | | 464 |
| **Cash and Cash Equivalents at End of Period** | $ 75 | $ 2 | $ 89 | $ | $ 166 |

| | Six Months Ended June 30, 2006<br>Reliant Energy<br>(in millions) | Guarantors | Non-Guarantors | Adjustments(1) | Consolidated |
|---|---|---|---|---|---|
| **Cash Flows from Operating Activities:** | | | | | |
| Net cash provided by (used in) continuing operations from operating activities | $ (3) | $ (314) | $ 202 | $ | $ (115) |
| Net cash provided by (used in) discontinued operations from operating activities | 3 | (8) | (32) | | (37) |
| Net cash provided by (used in) operating activities | | (322) | 170 | | (152) |
| **Cash Flows from Investing Activities:** | | | | | |
| Capital expenditures | | (16) | (26) | | (42) |
| Investments in, advances to and from and distributions from subsidiaries, net (2) | 295 | | (210) | (85) | |
| Proceeds from sales of assets, net | | | 1 | | 1 |
| Net sales of emission allowances | | 89 | 105 | | 194 |
| Restricted cash | | | 18 | (1) | 17 |
| Other, net | | 5 | | | 5 |
| Net cash provided by (used in) continuing operations from investing activities | 295 | 78 | (112) | (86) | 175 |
| Net cash provided by discontinued operations from investing activities | 712 | | 968 | (712) | 968 |
| Net cash provided by investing activities | 1,007 | 78 | 856 | (798) | 1,143 |
| **Cash Flows from Financing Activities:** | | | | | |
| Payments of long-term debt | (319) | | (7) | | (326) |
| Increase (decrease) in short-term borrowings and revolving credit facilities, net | (60) | | 5 | | (55) |
| Changes in notes with affiliated companies, net (4) | | 233 | (318) | 85 | |
| Proceeds from issuances of stock | 10 | | | | 10 |
| Net cash provided by (used in) continuing operations from financing activities | (369) | 233 | (320) | 85 | (371) |
| Net cash used in discontinued operations from financing activities | (638) | | (712) | 712 | (638) |
| Net cash provided by (used in) financing activities | (1,007) | 233 | (1,032) | 797 | (1,009) |
| **Net Change in Cash and Cash Equivalents** | | (11) | (6) | (1) | (18) |
| **Cash and Cash Equivalents at Beginning of Period** | 3 | 36 | 49 | | 88 |
| **Cash and Cash Equivalents at End of Period** | $ 3 | $ 25 | $ 43 | $ (1) | $ 70 |

(1) These amounts relate to either (a) eliminations and adjustments recorded in the normal consolidation process or (b) reclassifications recorded due to differences in classifications at the subsidiary levels compared to the consolidated level.

(2) Net investments in, advances to and from and distributions from subsidiaries are classified as investing activities.

(3) Reliant Energy converted intercompany notes payable of a guarantor subsidiary of $753 million to equity during 2007.

(4) Net changes in notes with affiliated companies are classified as financing activities for subsidiaries of Reliant Energy and as investing activities for Reliant Energy.

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Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligati

## (12) Reportable Segments

Financial data for our segments are as follows:

| | Retail Energy (in millions) | Wholesale Energy | Other Operations | Eliminations | Consolidated |
|---|---|---|---|---|---|
| **Three months ended June 30, 2007:** | | | | | |
| Revenues from external customers | $ 1,994 | $ 656 | $ | $ | $ 2,650 |
| Intersegment revenues | | 141 | 4 | (145) | |
| Contribution margin, including unrealized gains/losses on energy derivatives (1) | (234) | 122 | 4 | (2) | (110) |
| | | | | | |
| **Three months ended June 30, 2006:** | | | | | |
| Revenues from external customers | $ 2,217 | $ 558 (2) | $ | $ | $ 2,775 |
| Intersegment revenues | | 140 | | (140) | |
| Contribution margin, including unrealized gains/losses on energy derivatives (1) | 271 | (13) | | | 258 |
| | | | | | |
| **Six months ended June 30, 2007 (except as denoted):** | | | | | |
| Revenues from external customers | $ 3,695 | $ 1,317 | $ | $ | $ 5,012 |
| Intersegment revenues | | 228 | 7 | (235) | |
| Contribution margin, including unrealized gains/losses on energy derivatives (1) | 450 | 80 | 6 | (4) | 532 |
| Total assets as of June 30, 2007 | 1,849 | 8,160 | 632 | (558) | 10,083 |
| | | | | | |
| **Six months ended June 30, 2006 (except as denoted):** | | | | | |
| Revenues from external customers | $ 3,904 | $ 1,323 (3) | $ 1 | $ | $ 5,228 |
| Intersegment revenues | | 286 | | (286) | |
| Contribution margin, including unrealized gains/losses on energy derivatives (1) | 175 | 65 | 1 | | 241 |
| Total assets as of December 31, 2006 | 1,984 | 8,402 | 848 (4) | (667) | 10,567 |

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(1) Revenues less (a) purchased power, fuel and cost of gas sold, (b) operation and maintenance, (c) selling and marketing and (d) bad debt expense.

(2) Includes $382 million in revenues from a single counterparty, which represented 14% of our consolidated revenues and 68% of our wholesale energy segment revenues.

(3) Includes $655 million in revenues from a single counterparty, which represented 13% of our consolidated revenues and 50% of our wholesale energy segment revenues.

(4) Other operations include discontinued operations of $2 million.

| | Three Months Ended June 30, 2007 (in millions) | 2006 | Six Months Ended June 30, 2007 | 2006 |
|---|---|---|---|---|
| Contribution margin, including unrealized gains/losses on energy derivatives | $ (110) | $ 258 | $ 532 | $ 241 |
| Other general and administrative | 54 | 40 | 95 | 75 |
| Western states and similar settlements | | | 22 | |
| Gains on sales of assets and emission allowances, net | (2) | (5) | (2) | (156) |
| Depreciation | 86 | 77 | 173 | 151 |
| Amortization | 24 | 14 | 29 | 21 |
| Operating income (loss) | (272) | 132 | 215 | 150 |
| Income of equity investment, net | 2 | 2 | 3 | 2 |
| Debt extinguishment premium and consent fees | (71) | | (71) | |
| Other, net | (1) | 1 | | 1 |
| Interest expense | (122) | (103) | (209) | (211) |
| Interest income | 8 | 7 | 18 | 16 |
| Income (loss) from continuing operations before income taxes | (456) | 39 | (44) | (42) |
| Income tax expense (benefit) | (175) | 16 | (23) | 74 |
| Income (loss) from continuing operations | (281) | 23 | (21) | (116) |
| Loss from discontinued operations | (2) | (9) | (3) | (4) |
| Income (loss) before cumulative effect of accounting change | (283) | 14 | (24) | (120) |
| Cumulative effect of accounting change, net of tax | | | | 1 |
| Net income (loss) | $ (283) | $ 14 | $ (24) | $ (119) |

## (13) Discontinued Operations

***New York Plants.***

*General.* In February 2006, we closed on the sale of our three remaining New York plants with an aggregate net generating capacity of approximately 2,100 megawatts (MW) for $979 million. During the third quarter of 2005, we began to report the results of the New York plants as discontinued operations. These plants were a part of our wholesale energy segment.

*Use of Proceeds.* We applied $952 million of cash proceeds, which is net of estimated city, state and transfer taxes and transaction costs, to pay down our senior secured term loans.

*Assumptions Related to Debt, Deferred Financing Costs and Interest Expense on Discontinued Operations.* Based on our contractual obligation (at the time the purchase and sale agreement was executed) to utilize a portion of the net proceeds from the sale to prepay debt, we classified $638 million of debt as discontinued operations as of December 31, 2005 and through the date of sale. We also classified as discontinued operations the related deferred financing costs and interest expense on this debt. We allocated $15 million of related interest expense during the three months ended March 31, 2006 to discontinued operations. No interest was allocated to discontinued operations subsequent to the closing.

The following summarizes certain financial information of our New York plants discontinued operations:

| | Six Months Ended June 30, 2006 (in millions) |
|---|---|
| Revenues | $ 111 |
| Loss before income tax expense/benefit | (4) |

Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligati

Subsequent to the sale of our New York plants in February 2006, we continue to have insignificant settlements with the independent system operator. These amounts are classified as discontinued operations in our results of operations. In addition, we have some amounts on our consolidated balance sheets classified as discontinued operations relating to these settlements and other insignificant items.

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

The following discussion should be read in conjunction with our Form 10-K. This includes non-GAAP financial measures, which are not standardized; therefore, it may not be possible to compare these financial measures with other companies non-GAAP financial measures having the same or similar names. We strongly encourage investors to review our consolidated financial statements and publicly filed reports in their entirety and not rely on any single financial measure.

**Business Overview**

We provide electricity and energy services to retail and wholesale customers through two business segments.

- *Retail energy* provides electricity and energy services to approximately 1.9 million retail electricity customers in Texas, including residential and small business customers and commercial, industrial and governmental/institutional customers. Our next largest market is the PJM Market, where we serve commercial, industrial and governmental/institutional customers. We regularly evaluate entering other markets.

- *Wholesale energy* provides electricity and energy services in the competitive wholesale energy markets in the United States through our ownership and operation or contracting for power generation capacity. As of June 30, 2007, we had approximately 16,000 MW of power generation capacity.

*Key Earnings Drivers.*

*Retail Energy.* The retail energy segment is a low capital investment electricity resale business with relatively stable earnings (excluding unrealized gains/losses on energy derivatives). The key earnings drivers in the retail energy segment are the volume of electricity we sell to customers, the unit margins received on those sales and the cost of acquiring and serving those customers. We earn a margin by selling electricity to end-use customers and simultaneously acquiring supply. Short-term earnings in this business are impacted by local weather patterns and the competitive tactics of other retailers in the market. The longer-term earnings drivers of the business are the level of competitive intensity and our ability to retain and grow market share by having a strong brand and excellent customer service.

*Wholesale Energy.* The wholesale energy segment is a capital-intensive, cyclical business. Earnings are significantly impacted by the level of natural gas prices, spark spreads and capacity prices. The key earnings drivers are the amount of electricity we generate and the margin we earn for each unit of electricity sold. We do not control those factors that have the most significant impact on our earnings levels. The factor that we have the most control over is the percentage of time that our generating assets are available to run when it is economical for them to do so. Short-term earnings in our wholesale business are impacted by weather and commodity price volatility. Longer-term earnings are driven by the level of commodity prices and regional supply and demand fundamentals.

**Recent Events**

In this section, we present recent and potential events that have impacted or could in the future impact our results of operations, financial condition or liquidity. In addition to the events described below, a number of other factors could affect our future results of operations, financial condition or liquidity, including changes in natural gas prices, plant availability, retail energy customer growth, weather and other factors (see Risk Factors in Item 1A of our Form 10-K).

We completed a refinancing in June 2007 as an initial step towards creating a capital structure that gives us increased flexibility to direct cash flow and additional capital to those alternatives that we believe will create the greatest stockholder value. The 2007 refinancing included a tender offer and consent solicitation for our 9.25% and 9.50% senior secured notes totaling $1.1 billion. We (a) issued $1.3 billion of senior unsecured notes with 7- and 10-year maturities and (b) used cash on hand along with proceeds from senior unsecured notes to (i) fund the tender offer and consent solicitation, (ii) retire our $400 million term loan and (iii) call in July 2007 the 9.25% notes not tendered. In addition, we replaced our existing revolving credit facility and letter of credit facilities with a new $500 million revolving credit facility and $250 million letter of credit facility. For further discussion of the June 2007 refinancing, see note 6(b) to our interim financial statements.

We are evaluating various alternatives to address restrictions remaining in our 6.75% senior secured notes and our tax-exempt PEDFA bonds.

We believe the results of the Reliability Pricing Model (RPM) capacity auctions in 2007 support our view of tightening supply and demand in the wholesale energy business. RPM is a model utilized by the PJM Interconnection, LLC to meet load serving entities forecasted capacity obligations via a forward-looking commitment of capacity resources.

**Other**

There were no major legislative changes to the Texas regulatory model coming out of the 2007 legislative session. The minor legislation concerning electricity related matters that was passed during the 2007 session is not expected to have a material impact on our future results of operations.

## Consolidated Results of Operations

**Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006**

We reported $(283) million consolidated net loss, or $(0.83) loss per share, for the three months ended June 30, 2007 compared to $14 million consolidated net income, or $0.05 earnings per diluted share, for the same period in 2006.

| | Three Months Ended June 30, 2007 (in millions) | 2006 | Change |
|---|---|---|---|
| Retail energy contribution margin, including unrealized gains/losses on energy derivatives | $ (234) | $ 271 | $ (505) |
| Wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | 122 | (13) | 135 |
| Other contribution margin | 2 | | 2 |
| Other general and administrative | (54) | (40) | (14) |
| Gains on sales of assets and emission allowances, net | 2 | 5 | (3) |
| Depreciation and amortization | (110) | (91) | (19) |
| Income of equity investment, net | 2 | 2 | |
| Debt extinguishment premium and consent fees | (71) | | (71) |
| Other, net | (1) | 1 | (2) |
| Interest expense | (122) | (103) | (19) |
| Interest income | 8 | 7 | 1 |