RELIANT ENERGY INC
Form 10-Q
August 05, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

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 þ No o

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

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

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

As of July 25, 2008, the latest practicable date for determination, Reliant Energy, Inc. had 348,646,409 shares of common stock outstanding and no shares of treasury stock.

TABLE OF CONTENTS

PART II.
OTHER INFORMATION

Table of Contents

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, capital structure and other financial items, our plans and objectives for future operations or about our future economic performance, transactions and dispositions and financings and approvals related thereto. In many cases, you can identify forward-looking statements by terminology such as anticipate, estimate, believe, continue, could, intend, may, plan, po should, will, expect, objective, projection, forecast, goal, guidance, outlook, effort, target and However, the absence of these words does not mean that the statements are not forward-looking.

Actual results may differ materially from those expressed or implied by the forward-looking statements as a result of many factors or events, including, but not limited to, the following:

Demand and market prices for electricity, purchased power and fuel and emission allowances;

Limitations on our ability to set rates at market prices;

Legislative, regulatory and/or market developments;

Our ability to obtain adequate fuel supply and/or transmission and distribution services;

Interruption or breakdown of our generating equipment and processes;

Failure of third parties to perform contractual obligations;

Changes in environmental regulations that constrain our operations or increase our compliance costs;

Failure by transmission system operators to communicate operating and system information properly and timely;

Failure to meet our debt service, collateral postings and obligations related to our credit-enhanced retail structure;

Ineffective hedging and other risk management activities;

Changes in the wholesale energy market or in our evaluation of our generation assets;

The outcome of pending or threatened lawsuits, regulatory proceedings, tax proceedings and investigations;

Weather-related events or other events beyond our control;

The timing and extent of changes in commodity prices and interest rates;

Our ability to attract and retain retail customers and to adequately forecast their energy needs and usage;

Failure of our credit-enhanced retail structure; and

Financial market conditions and our access to capital.

Other factors that could cause our actual results to differ from our projected results are discussed or referred 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.

Table of Contents

PART I.
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

RELIANT ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(thousands of dollars, except per share amounts)			
Revenues:				
Revenues (including $5,627, $(10,848) $(6,957) and $3,722 unrealized gains (losses)) (including $145,592, $0, $253,001 and $0 from affiliates)	$ 3,423,535	$ 2,649,915	$ 6,238,959	$ 5,012,516
Expenses:				
Cost of sales (including $564,562, $(315,497) $1,135,445 and $192,162 unrealized gains (losses)) (including $121,134, $0, $200,130 and $0 from affiliates)	2,408,849	2,475,716	4,160,521	3,919,207
Operation and maintenance	229,423	233,966	441,901	464,707
Selling, general and administrative	85,414	103,084	161,064	190,681
Western states litigation and similar settlements			34,000	22,000
Gains on sales of assets and emission and exchange allowances, net	(22,312)	(1,727)	(22,923)	(1,727)
Depreciation and amortization	88,775	110,603	177,369	202,572
Total operating expense	2,790,149	2,921,642	4,951,932	4,797,440
Operating Income (Loss)	633,386	(271,727)	1,287,027	215,076
Other Income (Expense):				
Income of equity investment, net	988	1,366	1,195	2,526
Debt extinguishments		(71,269)	(423)	(71,269)
Other, net	90	(574)	26	494
Interest expense	(63,230)	(121,975)	(126,331)	(209,045)
Interest income	10,747	8,232	20,251	18,696
Total other expense	(51,405)	(184,220)	(105,282)	(258,598)
Income (Loss) from Continuing Operations Before Income Taxes	581,981	(455,947)	1,181,745	(43,522)
Income tax expense (benefit)	223,122	(174,884)	451,909	(22,822)
Income (Loss) from Continuing Operations	358,859	(281,063)	729,836	(20,700)
Income (loss) from discontinued operations	(171)	(1,889)	6,064	(3,541)

Net Income (Loss)	$ 358,688	$ (282,952)	$ 735,900	$ (24,241)
Basic Earnings (Loss) per Share:				
Income (loss) from continuing operations	$ 1.04	$ (0.82)	$ 2.11	$ (0.06)
Income (loss) from discontinued operations	(0.01)	(0.01)	0.02	(0.01)
Net income (loss)	$ 1.03	$ (0.83)	$ 2.13	$ (0.07)
Diluted Earnings (Loss) per Share:				
Income (loss) from continuing operations	$ 1.01	$ (0.82)	$ 2.06	$ (0.06)
Income (loss) from discontinued operations		(0.01)	0.02	(0.01)
Net income (loss)	$ 1.01	$ (0.83)	$ 2.08	$ (0.07)

See Notes to our Unaudited Consolidated Interim Financial Statements

Table of Contents

RELIANT ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

		June 30, 2008		December 31, 2007
		(thousands of dollars, except per share amounts)		
ASSETS				
Current Assets:				
Cash and cash equivalents	$	797,223	$	754,962
Restricted cash		7,086		3,251
Accounts and notes receivable, principally customer, net of allowance of $19,497 and $36,724		1,504,054		1,082,746
Inventory		330,799		285,408
Derivative assets		3,896,022		663,049
Margin deposits		203,284		139,834
Investment in and receivables from Channelview, net		84,728		83,253
Prepayments and other current assets		129,332		218,873
Assets held for sale		452,857		
Current assets of discontinued operations				2,133
Total current assets		7,405,385		3,233,509
Property, plant and equipment, gross		6,507,625		6,852,170
Accumulated depreciation		(1,692,618)		(1,629,953)
Property, Plant and Equipment, net		4,815,007		5,222,217
Other Assets:				
Goodwill, net		351,634		379,644
Other intangibles, net		394,105		405,338
Derivative assets		1,406,213		376,535
Prepaid lease		262,489		270,133
Other		233,126		304,424
Total other assets		2,647,567		1,736,074
Total Assets	$	14,867,959	$	10,191,800
LIABILITIES AND EQUITY				
Current Liabilities:				
Current portion of long-term debt and short-term borrowings	$	24,467	$	52,546
Accounts payable, principally trade		1,188,571		687,046
Derivative liabilities		3,066,290		885,346
Margin deposits		9,100		250
Other		607,588		426,839
Liabilities held for sale		53,206		

Current liabilities of discontinued operations		4,766		
Total current liabilities		4,953,988		2,052,027
Other Liabilities:				
Derivative liabilities		1,385,211		473,516
Other		399,584		278,641
Long-term liabilities of discontinued operations		3,542		3,542
Total other liabilities		1,788,337		755,699
Long-term Debt		2,877,848		2,902,346
Commitments and Contingencies				
Temporary Equity Stock-based Compensation		5,603		4,694
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; 347,813,336 and 344,579,508 issued)		109		106
Additional paid-in capital		6,228,514		6,215,512
Accumulated deficit		(899,626)		(1,635,526)
Accumulated other comprehensive loss		(86,814)		(103,058)
Total stockholders equity		5,242,183		4,477,034
Total Liabilities and Equity	$	14,867,959	$	10,191,800

See Notes to our Unaudited Consolidated Interim Financial Statements

Table of Contents

RELIANT ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30, 2008	2007
	(thousands of dollars)	
Cash Flows from Operating Activities:		
Net income (loss)	$ 735,900	$ (24,241)
(Income) loss from discontinued operations	(6,064)	3,541
Net income (loss) from continuing operations	729,836	(20,700)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	177,369	202,572
Deferred income taxes	430,817	(30,116)
Net changes in energy derivatives	(1,105,625)	(166,400)
Amortization of deferred financing costs	4,376	45,443
Gains on sales of assets and emission and exchange allowances, net	(22,923)	(1,727)
Debt extinguishments	423	71,269
Western states litigation and similar settlements	34,000	
Other, net	(145)	6,364
Changes in other assets and liabilities:		
Accounts and notes receivable, net	(435,848)	(212,797)
Changes in notes with affiliate	(5,440)	
Inventory	(47,936)	(18,390)
Margin deposits, net	(54,600)	112,646
Net derivative assets and liabilities	(38,594)	(27,380)
Western states litigation and similar settlements payments		(35,000)
Accounts payable	487,656	206,017
Other current assets	(28,343)	(24,432)
Other assets	19,357	(2,980)
Taxes payable/receivable	22,749	(7,444)
Other current liabilities	15,575	(75,353)
Other liabilities	(1,174)	2,493
Net cash provided by continuing operations from operating activities	181,530	24,085
Net cash provided by (used in) discontinued operations from operating activities	9,332	(2,540)
Net cash provided by operating activities	190,862	21,545
Cash Flows from Investing Activities:		
Capital expenditures	(117,130)	(99,172)
Proceeds from sales of emission and exchange allowances	28,420	3,346
Purchases of emission allowances	(17,644)	(14,127)
Restricted cash	(3,835)	19,646
Other, net	1,435	2,130

Net cash used in investing activities	(108,754)	(88,177)
Cash Flows from Financing Activities:		
Payments of long-term debt	(45,193)	(1,465,891)
Proceeds from long-term debt		1,300,000
Increase in short-term borrowings and revolving credit facilities, net		6,554
Payments of financing costs		(29,634)
Payments of debt extinguishments	(423)	(71,269)
Proceeds from issuances of stock	5,769	28,957
Net cash used in financing activities	(39,847)	(231,283)
Net Change in Cash and Cash Equivalents	42,261	(297,915)
Cash and Cash Equivalents at Beginning of Period	754,962	463,909
Cash and Cash Equivalents at End of Period	$ 797,223	$ 165,994
Supplemental Disclosure of Cash Flow Information:		
Cash Payments:		
Interest paid (net of amounts capitalized) for continuing operations	$ 127,795	$ 205,505
Income taxes paid (net of income tax refunds) for continuing operations	2,687	14,738

See Notes to our Unaudited Consolidated Interim Financial Statements

Table of Contents

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 13. 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 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 at 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 changed the presentation of our December 31, 2007 consolidated balance sheet due to the adoption of FSP FIN 39-1, Amendment of FASB Interpretation No. 39 (FIN 39-1). See below.

Deconsolidation of Channelview. On August 20, 2007, four of our wholly-owned subsidiaries, Reliant Energy Channelview LP (Channelview LP), Reliant Energy Channelview (Texas) LLC, Reliant Energy Channelview (Delaware) LLC and Reliant Energy Services Channelview LLC (collectively, Channelview), filed for reorganization under Chapter 11 of the Bankruptcy Code. As Channelview is currently subject to the supervision of the bankruptcy court, we deconsolidated Channelview s financial results beginning August 20, 2007 and began reporting our investment in Channelview using the cost method.

The Channelview plant was sold on July 1, 2008. See note 14 for further discussion of Channelview.

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, 2008 and 2007, our retail energy segment s revenues and operation and maintenance include gross receipts taxes of $27 million and $24 million, respectively, and during the six months ended June 30, 2008 and 2007, $48 million and $45 million, respectively.

New Accounting Pronouncement Adopted Offsetting of Amounts. FIN 39-1 was applicable for us beginning January 1, 2008. This interpretation allows either (a) offsetting assets and liabilities for derivative instruments under a master netting arrangement only if the fair value amounts recognized for any related cash collateral are also offset or (b) presenting these amounts gross.

Effective January 1, 2008, we discontinued netting our derivative assets and liabilities (with the same counterparty pursuant to a master netting arrangement) and present them on a gross basis. Cash collateral amounts remain presented on a gross basis. This change has significantly increased our derivative assets and liabilities retrospectively for all financial statements presented and is accounted for as a change in accounting principle.

Table of Contents

The effect to our December 31, 2007 consolidated balance sheet was as follows: (Note only line items impacted are shown.)

	December 31, 2007	
	As Previously Reported in the Form 10-K	Upon Adoption of FIN 39-1
	(in millions)	
Current derivative assets	$ 214	$ 663
Total current assets	2,784	3,233
Noncurrent derivative assets	90	376
Total other assets	1,450	1,736
Total assets	9,457	10,192
Current derivative liabilities	437	885
Total current liabilities	1,602	2,050
Noncurrent derivative liabilities	187	474
Total other liabilities	470	757
Total liabilities and stockholders equity	9,457	10,192

New Accounting Pronouncement Not Yet Adopted Disclosures about Derivatives and Hedging Activities. Statement of Financial Accounting Standards (SFAS) No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161) is an amendment of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and is intended to enhance the related qualitative and quantitative disclosures, including information about objectives, strategies, volume and credit-risk-related contingent features. SFAS No. 161 must be adopted by January 1, 2009.

(2) Stock-based Compensation

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Stock-based incentive plans compensation expense (pre-tax)	$ 4	$ 13	$ 8	$ 20

During February 2008, 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 461,824 time-based stock options (exercise price of $23.38 per share, which vest in three equal installments during February 2009, 2010 and 2011), 215,527 time-based restricted stock units (which vest during February 2011) and 371,586 market-based cash units (each payable into a cash amount equal to the market value of one share of our common stock if our common stock closes at $32 or higher for 20 consecutive trading days before February 19, 2011). In addition, during February 2008, the committee granted 95,574 time-based restricted stock units and 95,574 time-based cash units to other employees under the Reliant Energy, Inc. 2002 Stock Plan. These awards will vest during February 2011.

No tax benefits related to stock-based compensation were realized during the six months ended June 30, 2008 and 2007 due to our net operating loss carryforwards.

5

(3) Fair Value Measurements

Summary. Effective January 1, 2008, we adopted SFAS No. 157, Fair Value Measurements (SFAS No. 157) on a prospective basis for our derivative assets and liabilities. In connection with the adoption, no cumulative effect of an accounting change was recognized. For non-financial assets and liabilities, the adoption of SFAS No. 157 has been deferred until January 1, 2009.

Fair Value Hierarchy and Valuation Techniques. We apply recurring fair value measurements to our derivative assets and liabilities. In determining fair value, we generally use the market approach and incorporate assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation techniques. These inputs can be readily observable, market corroborated, or generally unobservable internally-developed inputs. Based on the observability of the inputs used in our valuation techniques, our derivative assets and liabilities are classified as follows:

Level 1: Level 1 represents unadjusted quoted market prices in active markets for identical assets or liabilities that are accessible at the measurement date. This category includes our energy derivative instruments that are exchange-traded or that are cleared and settled through the exchange.

Level 2: Level 2 represents quoted market prices for similar assets or liabilities in active markets, quoted market prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data. This category includes emission allowances futures that are exchange-traded and over-the-counter (OTC) derivative instruments such as generic swaps and forwards.

Level 3: This category includes our energy derivative instruments whose fair value is estimated based on internally developed models and methodologies utilizing significant inputs that are generally less readily observable from objective sources (such as market heat rates, implied volatilities and correlations). Our OTC, complex or structured derivative instruments that are transacted in less liquid markets with limited pricing information are included in Level 3. Examples are structured power supply contracts, coal contracts, longer term natural gas contracts and options.

We value some of our OTC, complex or structured derivative instruments using valuation models, which utilize inputs that may not be corroborated by market data. When such inputs are significant to the fair value measurement, the derivative assets or liabilities are classified as Level 3 when we do not have corroborating market evidence to support significant valuation model inputs and cannot verify the model to market transactions. We believe the transaction price is the best estimate of fair value at inception under the exit price methodology. Accordingly, when a pricing model is used to value such an instrument, the resulting value is adjusted so the model value at inception equals the transaction price. Valuation models are typically impacted by Level 1 or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Subsequent to initial recognition, we update Level 1 and Level 2 inputs to reflect observable market changes. Level 3 inputs are updated when corroborated by available market evidence. In the absence of such evidence, management s best estimate is used.

Fair Value of Derivative Instruments. Fair value measurements of our derivative assets and liabilities are as follows:

	June 30, 2008				
	Level 1	Level 2	Level 3	Reclassifications[1]	Total Fair Value
	(in millions)				
Total derivative assets	$ 962	$ 3,519	$ 861	$ (40)	$ 5,302
Total derivative liabilities	1,095	3,017	379	(40)	4,451

(1) Reclassifications are required to reconcile to FIN 39-1 consolidated

balance sheet
presentation.

Table of Contents

The following is a reconciliation of changes in fair value of net derivative assets and liabilities classified as Level 3:

	Three Months Ended June 30, 2008 Net Derivatives (in millions)	Six Months Ended June 30, 2008 Net Derivatives (in millions)
Balance, beginning of period	$ 326	$ 121
Total gains or losses (realized/unrealized):		
Included in earnings	278(1)	398(1)
Purchases, issuances and settlements (net)	(124)	(36)
Transfers in and/or out of Level 3 (net)	2(2)	(1)(3)
Balance, June 30, 2008	$ 482	$ 482
Changes in unrealized gains/losses relating to derivative assets and liabilities still held at June 30, 2008	224(4)	261(5)

(1) Recorded in revenues and cost of sales.

(2) Represents fair value as of March 31, 2008.

(3) Represents fair value as of December 31, 2007.

(4) Includes $(2) million recorded in revenues and $226 million recorded in cost of sales.

(5) Includes $(1) million recorded in revenues and $262 million recorded in cost of sales.

See notes 2(d) and 5 to our consolidated financial statements in our Form 10-K for additional information about our derivatives.

(4) Comprehensive Income (Loss)

The components of total comprehensive income (loss) are:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Net income (loss)	$ 359	$ (283)	$ 736	$ (24)
Other comprehensive income, net of tax:				
Deferred income from cash flow hedges				3
Reclassification of net deferred loss from cash flow hedges realized in net income/loss	6	20	16	45
Comprehensive income (loss)	$ 365	$ (263)	$ 752	$ 24

(5) Goodwill

2008 Annual Goodwill Impairment Tests. We are in the process of performing our annual goodwill impairment tests for our wholesale energy and retail energy reporting units effective April 1, 2008.

Estimation of Our Wholesale Energy Reporting Unit s Fair Value. We anticipate using substantially the same subjective factors and significant assumptions to estimate fair value in our 2008 test as we used in our April 2007 test. See note 4(a) to our consolidated financial statements in our Form 10-K.

Table of Contents

(6) 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,	
	2008	2007	2008	2007
	(in millions)			
Energy derivatives:				
Hedge ineffectiveness gains (losses)	$ 1[(1)]	$ (1)[(1)]	$ [(1)]	$ 2[(1)]
Other net unrealized gains (losses)	569	(325)	1,128	194
Interest rate derivatives:				
Other net unrealized losses		(2)		(5)
Total[(2)(3)]	$ 570	$ (328)	$ 1,128	$ 191

(1) During 2007, we de-designated our remaining cash flow hedges; the amount reflected here subsequent to that time relates to previously measured ineffectiveness reversing due to settlement of the derivative contracts.

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

(3) During the three and six months ended June 30, 2008 and 2007,

$0 was recognized in our results of operations as a result of the discontinuance of cash flow hedges because it was probable that the forecasted transaction would not occur.

Amounts included in accumulated other comprehensive loss:

	June 30, 2008			
	At the End of the Period		Expected to be Reclassified into Results of Operations in Next 12 Months	
	(in millions)			
De-designated cash flow hedges	$	64	$	23

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 is:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008		2007		2008		2007	
	(in millions)							
Revenues	$		$		$		$	
Cost of sales		(13)				(17)		
Total	$	(13)	$		$	(17)	$	

8

Table of Contents

(7) Debt
Our outstanding debt:

	June 30, 2008			December 31, 2007		
	Weighted Average Stated Interest Rate[1]	Long-term	Current	Weighted Average Stated Interest Rate[1]	Long-term	Current
	(in millions, except interest rates)					
Facilities, Bonds and Notes:						
Reliant Energy:						
Senior secured revolver due 2012	4.53%	$	$	6.45%	$	$
Senior secured notes due 2014[2]	6.75	667		6.75	671	41
Senior unsecured notes due 2013	9.50		13(3)	9.50	13	
Senior unsecured notes due 2014	7.625	575		7.625	575	
Senior unsecured notes due 2017	7.875	725		7.875	725	
Convertible senior subordinated notes due 2010 (unsecured)[4]	5.00			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[5] fixed-rate bonds due 2036	6.75	500		6.75	500	
Reliant Energy Power Supply, LLC working capital facility due 2012	2.93			5.30		
Total facilities, bonds and notes		2,867	13		2,886	41
Other:						
Adjustment to fair value of debt[6]		11	11		17	11
Total other debt		11	11		17	11
Total debt		$ 2,878	$ 24		$ 2,903	$ 52

(1) The weighted average stated interest rates are as of June 30, 2008 or December 31, 2007.

(2)

We repurchased $45 million during the six months ended June 30, 2008 and incurred an insignificant amount of debt extinguishment expenses.

(3) In July 2008, we called the remaining $13 million.

(4) In April 2008, nearly all of these outstanding notes were converted to common stock.

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

(6) Debt acquired in the acquisition of Orion Power Holdings, Inc. and subsidiaries was adjusted to fair value as of the acquisition date. Included in interest expense is amortization for valuation adjustments for debt of $3 million and $4 million during the three months ended June 30, 2008 and 2007,

respectively, and $6 million and $7 million during the six months ended June 30, 2008 and 2007, respectively.

Amounts borrowed and available for borrowing under our revolving credit agreements as of June 30, 2008:

	Total Committed Credit	Drawn Amount	Letters of Credit	Unused Amount
		(in millions)		
Reliant Energy senior secured revolver due 2012	$ 500	$	$ 223	$ 277
Reliant Energy letter of credit facility due 2014	250		250	
Retail working capital facility due 2012	300			300
	$ 1,050	$	$ 473	$ 577

Table of Contents

(8) 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,				Six Months Ended June 30,			
	2008		2007		2008		2007	
	(in millions)							
Income (loss) from continuing operations (basic)	$	359	$	(281)	$	730	$	(21)
Plus: Interest expense on 5.00% convertible senior subordinated notes, net of tax		(1)		(2)		(1)		(2)
Income (loss) from continuing operations (diluted)	$	359	$	(281)	$	730	$	(21)

(1) In December 2006 and April 2008, nearly all of these outstanding notes were converted to common stock.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(shares in thousands)			
Diluted Weighted Average Shares Calculation:				
Weighted average shares outstanding (basic)	346,616	342,074	346,017	340,717
Plus: Incremental shares from assumed conversions:				
Stock options	4,317	(1)	4,285	(1)

Restricted stock	575	(1)	559	(1)
Employee stock purchase plan	47	(1)	23	(1)
5.00% convertible senior subordinated notes	18	(1)	115	(1)
Warrants	2,481	(1)	3,079	(1)
Weighted average shares outstanding assuming conversion (diluted)	354,054	342,074	354,078	340,717

(1) See note (2) 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, 2008	2007	Six Months Ended June 30, 2008	2007
	(shares in thousands, dollars in millions)			
Shares excluded from the calculation of diluted earnings (loss) per share	N/A	11,196(1)	N/A	10,653(1)
Shares excluded from the calculation of diluted earnings (loss) per share because the exercise price exceeded the average market price	1,833(2)	2,112(2)	1,849(2)	2,138(2)
Interest expense that would be added to income if 5.00% convertible senior subordinated notes were dilutive	N/A	$ (3)	N/A	$ (3)

(1) Potential shares excluded consist of convertible senior subordinated notes, warrants, stock options, restricted stock and shares related to the 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.

(9) 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,		Six Months Ended June 30,	
	2008	2007	2008	2007
Federal statutory rate	35%	35%	35%	35%
Additions (reductions) resulting from:				
Federal tax uncertainties		1		14
Federal valuation allowance				(7)
State income taxes, net of federal income taxes	3	2	3	8
Other, net				2
Effective rate	38%	38%	38%	52%

(b) Valuation Allowances.

We assess our future ability to use federal, state and foreign net operating loss carryforwards, capital loss carryforwards and other deferred tax assets using the more-likely-than-not criteria. 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 for deferred tax assets are:

	Federal	State (in millions)	Capital, Foreign and Other, Net
As of December 31, 2007	$ 14	$ 67	$ 22
Changes in valuation allowances		5	(1)
As of March 31, 2008	14	72	21
Changes in valuation allowances		2	
As of June 30, 2008	$ 14	$ 74	$ 21

(c) Adoption of FIN 48 and Tax Uncertainties.

Effective January 1, 2007, we adopted FIN 48, Accounting for Uncertainty in Income Taxes . 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 for financial reporting purposes 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 realized upon settlement with a taxing authority. FIN 48 also provides guidance for derecognition, classification, interest and penalties, disclosures, transition rules and related matters. We classify accrued interest and penalties related to uncertain income tax positions in income tax expense/benefit.

We expect to continue discussions with taxing authorities regarding tax positions related to the following, and believe it is reasonably possible some of these matters could be resolved in the next 12 months; however, we cannot estimate the range of changes that might occur:

$177 million payment to CenterPoint during 2004 related to our residential customers;

$351 million charge during 2005 to settle certain civil litigation and claims relating to the Western states energy crisis (see note 14(a) to our consolidated financial statements in our Form 10-K); and

the timing of tax deductions as a result of negotiations with respect to California-related revenue, depreciation, emission allowances and certain employee benefits.

Table of Contents
(10) 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 $55 million as of June 30, 2008 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 some of our subsidiaries. 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 guarantees are released. Our maximum potential obligation under the guarantees 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, 2008 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.
Except as otherwise noted, we are unable to estimate our maximum potential exposure under these agreements until an event triggering payment occurs. We do not expect to make any material payments under these agreements.
(11) 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.
(a) Pending Natural Gas Litigation.
The following proceedings relate to alleged conduct in the 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.
We are party to approximately 30 lawsuits, several of which are class action lawsuits, in state and federal courts in California, Colorado, Kansas, Missouri, Nevada, Tennessee and Wisconsin. These lawsuits relate to alleged conduct to increase natural gas prices in violation of antitrust and similar laws. The lawsuits seek treble or punitive damages, restitution and/or expenses. The lawsuits also name a number of unaffiliated energy companies as parties.

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).

Recent developments in these cases include:

In May 2008, we signed a memorandum of understanding to settle the 16 cases comprising the California-based gas index litigation, including the case filed by LADWP. The settlement is subject to definitive documentation that has not been completed. The charges anticipated to be incurred in connection with the settlement were expensed during the first quarter of 2008.

In September 2007, the Ninth Circuit Court of Appeals issued decisions in a number of the other gas cases in which we are a defendant. The Ninth Circuit Court of Appeals reversed a series of lower court decisions holding that the filed rate doctrine barred the plaintiffs claims in those cases. As a result of the Ninth Circuit Court of Appeals rulings, these cases have been remanded for further proceedings at the trial court level.

(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 pre-construction permitting requirements of the Clean Air Act known as New Source Review. In 2000 and 2001, we responded to the EPA s information requests related to five of our stations, and in December 2007, we received supplemental requests for two of those stations. The EPA has agreed to share information relating to its investigations with state environmental agencies.

In December 2007, the New Jersey Department of Environmental Protection (NJDEP) filed suit against us in the United States District Court in Pennsylvania, alleging that New Source Review violations occurred at one of our power plants located in Pennsylvania. The suit seeks installation of best available control technologies for each pollutant, to enjoin us from operating the plant if it is not in compliance with the Clean Air Act and civil penalties. The allegations are based on projects occurring prior to our ownership of the facility and the suit names three past owners of the plant as defendants. We believe we are indemnified by or have the right to seek indemnification from the prior owners for losses and expenses that we may incur.

We are unable to predict the ultimate outcome of the EPA s investigation or the NJDEP s suit, but a final finding that we violated the New Source Review requirements could result in significant capital expenditures associated with the implementation of emissions reductions on an accelerated basis and possible penalties.

Ash Disposal Landfill Closures. We are responsible for environmental costs related to the future closures of seven ash disposal landfills. We recorded the estimated discounted costs associated with these environmental liabilities as part of our asset retirement obligations. See note 2(o) 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. We recorded the estimated liability for the remediation costs of $8 million as of June 30, 2008 and December 31, 2007.

Conemaugh Actions. In April 2007, the Pennsylvania Department of Environmental Protection (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 to enjoin violations. The Conemaugh plant is jointly leased 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.

Global Warming. In February 2008, the Native Village of Kivalina and the City of Kivalina filed a suit in the United States District Court for the Northern District of California against us and 23 other electric generating and oil and gas companies. The lawsuit seeks damages of up to $400 million for the cost of relocating the village allegedly because of global warming caused by the greenhouse gas emissions of the defendants.

(c) Other.

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.

CenterPoint Indemnity. We have agreed to indemnify CenterPoint against certain losses relating to the lawsuits described in note 11(a) under Pending Natural Gas Litigation.

Texas Franchise Audit. The state of Texas has issued assessment orders indicating an estimated tax liability of approximately $53 million (including interest and penalties of $16 million) relating primarily to the sourcing of receipts for 2000 through 2005. We are contesting the audit assessments related to this issue.

Sales Tax Contingencies. Some of our sales tax computations are subject to challenge under audit. As of June 30, 2008 and December 31, 2007, we have $22 million and $19 million, respectively, accrued in current and noncurrent liabilities relating to these contingencies.

Table of Contents

(12) 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.

Condensed Consolidating Statements of Operations.

Three Months Ended June 30, 2008			
Reliant Energy	Guarantors	Non-Guarantors	Adjustments