

RELIANT ENERGY INC  
Form 10-Q  
November 08, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2007

OR

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

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

Commission file number: 1-16455

**Reliant Energy, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)  
1000 Main Street

76-0655566  
(I.R.S. Employer Identification No.)

Houston, Texas 77002

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(Address of Principal Executive Offices) (Zip Code)

(713) 497-3000

(Registrant's Telephone Number, Including Area Code)

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

Yes  No

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

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

Yes  No

As of October 31, 2007, the latest practicable date for determination, Reliant Energy, Inc. had 344,316,444 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, potential, should, will, expect, objective, projection, forecast, goal, guidance, outlook, effort, target and other similar words. The use 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, regulatory and/or market 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 September 30, |                     | Nine Months Ended September 30, |                     |
|--|----------------------------------|---------------------|---------------------------------|---------------------|
|  | 2007                             | 2006                | 2007                            | 2006                |
| <b>Revenues:</b>   |                                  |                     |                                 |                     |
| Revenues (including \$7,205, \$(14,579), \$10,927 and \$187,320 unrealized gains (losses)) (including \$39,805, \$0, \$39,805 and \$0 from affiliates)             | \$ 3,543,192                     | \$ 3,305,568        | \$ 8,555,708                    | \$ 8,533,156        |
| <b>Expenses:</b>   |                                  |                     |                                 |                     |
| Cost of sales (including \$(34,719), \$(340,886), \$157,443 and \$(467,288) unrealized gains (losses)) (including \$37,782, \$0, \$37,782 and \$0 from affiliates) | 2,838,950                        | 2,989,956           | 6,758,157                       | 7,473,913           |
| Operation and maintenance  | 209,374                          | 220,460             | 674,081                         | 635,990             |
| Selling, general and administrative  | 99,796                           | 116,465             | 290,477                         | 278,895             |
| Western states and similar settlements   |                                  | 35,000              | 22,000                          | 35,000              |
| Gains on sales of assets and emission allowances, net  | (16,769)                         | (3,457)             | (18,496)                        | (159,787)           |
| Depreciation and amortization  | 121,449                          | 108,256             | 324,021                         | 279,853             |
| Total operating expense  | 3,252,800                        | 3,466,680           | 8,050,240                       | 8,543,864           |
| <b>Operating Income (Loss)</b>   | <b>290,392</b>                   | <b>(161,112)</b>    | <b>505,468</b>                  | <b>(10,708)</b>     |
| <b>Other Income (Expense):</b>   |                                  |                     |                                 |                     |
| Income of equity investment, net   | 1,549                            | 1,268               | 4,075                           | 3,655               |
| Debt extinguishments   | (1,320)                          |                     | (72,589)                        |                     |
| Other, net   | 1,590                            | (163)               | 2,084                           | 666                 |
| Interest expense   | (74,235)                         | (100,840)           | (283,280)                       | (312,446)           |
| Interest income  | 5,777                            | 6,889               | 24,473                          | 22,784              |
| Total other expense  | (66,639)                         | (92,846)            | (325,237)                       | (285,341)           |
| <b>Income (Loss) from Continuing Operations Before Income Taxes</b>  | <b>223,753</b>                   | <b>(253,958)</b>    | <b>180,231</b>                  | <b>(296,049)</b>    |
| Income tax expense (benefit)   | 63,850                           | (100,135)           | 41,028                          | (25,886)            |
| <b>Income (Loss) from Continuing Operations</b>  | <b>159,903</b>                   | <b>(153,823)</b>    | <b>139,203</b>                  | <b>(270,163)</b>    |
| Income (loss) from discontinued operations   | 2,479                            | (1,340)             | (1,062)                         | (4,911)             |
| <b>Income (Loss) Before Cumulative Effect of Accounting Change</b>   | <b>162,382</b>                   | <b>(155,163)</b>    | <b>138,141</b>                  | <b>(275,074)</b>    |
| Cumulative effect of accounting change, net of tax   |                                  |                     |                                 | 968                 |
| <b>Net Income (Loss)</b>   | <b>\$ 162,382</b>                | <b>\$ (155,163)</b> | <b>\$ 138,141</b>               | <b>\$ (274,106)</b> |
| <b>Basic Earnings (Loss) per Share:</b>  |                                  |                     |                                 |                     |
| Income (loss) from continuing operations   | \$ 0.47                          | \$ (0.50)           | \$ 0.41                         | \$ (0.88)           |
| Income (loss) from discontinued operations   |                                  |                     | (0.01)                          | (0.01)              |
| Income (loss) before cumulative effect of accounting change  | 0.47                             | (0.50)              | 0.40                            | (0.89)              |
| Cumulative effect of accounting change, net of tax   |                                  |                     |                                 |                     |
| Net income (loss)  | \$ 0.47                          | \$ (0.50)           | \$ 0.40                         | \$ (0.89)           |

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**Diluted Earnings (Loss) per Share:**

|   |    |      |    |        |    |        |    |        |
|---|----|------|----|--------|----|--------|----|--------|
| Income (loss) from continuing operations                    | \$ | 0.45 | \$ | (0.50) | \$ | 0.40   | \$ | (0.88) |
| Income (loss) from discontinued operations                  |    | 0.01 |    |        |    | (0.01) |    | (0.01) |
| Income (loss) before cumulative effect of accounting change |    | 0.46 |    | (0.50) |    | 0.39   |    | (0.89) |
| Cumulative effect of accounting change, net of tax          |    |      |    |        |    |        |    |        |
| Net income (loss)   | \$ | 0.46 | \$ | (0.50) | \$ | 0.39   | \$ | (0.89) |

See Notes to our Unaudited Consolidated Interim Financial Statements

## RELIANT ENERGY, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(Thousands of Dollars, Except Share and Per Share Amounts)

|  | September 30, 2007<br>(Unaudited) | December 31, 2006    |
|--|-----------------------------------|----------------------|
| <b>ASSETS</b>  |                                   |                      |
| <b>Current Assets:</b>   |                                   |                      |
| Cash and cash equivalents  | \$ 396,402                        | \$ 463,909           |
| Restricted cash  | 5,209                             | 24,980               |
| Accounts and notes receivable, principally customer, net of allowance of \$49,207 and \$33,332 | 1,427,389                         | 1,043,637            |
| Inventory  | 269,800                           | 275,437              |
| Derivative assets  | 313,422                           | 489,726              |
| Margin deposits  | 235,187                           | 452,605              |
| Accumulated deferred income taxes  | 217,479                           | 279,479              |
| Investment in and receivables from Channelview, net  | 74,400                            |                      |
| Prepayments and other current assets   | 144,206                           | 141,016              |
| Current assets of discontinued operations  | 656                               | 2,460                |
| <b>Total current assets</b>  | <b>3,084,150</b>                  | <b>3,173,249</b>     |
| Property, plant and equipment, gross   | 6,834,749                         | 7,192,437            |
| Accumulated depreciation   | (1,564,501)                       | (1,450,442)          |
| <b>Property, Plant and Equipment, net</b>  | <b>5,270,248</b>                  | <b>5,741,995</b>     |
| <b>Other Assets:</b>   |                                   |                      |
| Goodwill   | 379,644                           | 381,594              |
| Other intangibles, net   | 410,063                           | 423,745              |
| Derivative assets  | 67,207                            | 203,857              |
| Accumulated deferred income taxes  | 75,158                            | 87,858               |
| Prepaid lease  | 284,891                           | 264,328              |
| Other  | 229,317                           | 290,507              |
| <b>Total other assets</b>  | <b>1,446,280</b>                  | <b>1,651,889</b>     |
| <b>Total Assets</b>  | <b>\$ 9,800,678</b>               | <b>\$ 10,567,133</b> |
| <b>LIABILITIES AND EQUITY</b>  |                                   |                      |
| <b>Current Liabilities:</b>  |                                   |                      |
| Current portion of long-term debt and short-term borrowings                                    | \$ 10,874                         | \$ 355,264           |
| Accounts payable, principally trade  | 805,930                           | 664,630              |
| Derivative liabilities   | 715,465                           | 1,164,809            |
| Margin deposits  |                                   | 16,490               |
| Other  | 488,216                           | 488,764              |
| Current liabilities of discontinued operations   |                                   | 3,286                |
| <b>Total current liabilities</b>   | <b>2,020,485</b>                  | <b>2,693,243</b>     |
| <b>Other Liabilities:</b>  |                                   |                      |
| Derivative liabilities   | 283,893                           | 420,534              |
| Other  | 282,403                           | 324,145              |
| <b>Total other liabilities</b>   | <b>566,296</b>                    | <b>744,679</b>       |
| <b>Long-term Debt</b>  | <b>2,984,694</b>                  | <b>3,177,691</b>     |
| <b>Commitments and Contingencies</b>   |                                   |                      |
| <b>Temporary Equity Stock-based Compensation</b>   | <b>3,639</b>                      | <b>1,647</b>         |
| <b>Stockholders Equity:</b>  |                                   |                      |
| Preferred stock; par value \$0.001 per share (125,000,000 shares authorized; none outstanding) |                                   |                      |
|  | 105                               | 99                   |

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|  |  |              |               |
|--|--|--------------|---------------|
| Common stock; par value \$0.001 per share (2,000,000,000 shares authorized;<br>344,286,922 and 337,623,392 issued) |  |              |               |
| Additional paid-in capital   |  | 6,212,511    | 6,174,665     |
| Retained deficit   |  | (1,862,492)  | (2,026,316)   |
| Accumulated other comprehensive loss   |  | (124,560)    | (198,575)     |
| Total stockholders' equity   |  | 4,225,564    | 3,949,873     |
| <b>Total Liabilities and Equity</b>  |  | \$ 9,800,678 | \$ 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)

|  | Nine Months Ended September 30, |              |
|--|---------------------------------|--------------|
|  | 2007                            | 2006         |
| <b>Cash Flows from Operating Activities:</b>   |                                 |              |
| Net income (loss)  | \$ 138,141                      | \$ (274,106) |
| Loss from discontinued operations  | 1,062                           | 4,911        |
| Net income (loss) from continuing operations and cumulative effect of accounting change            | 139,203                         | (269,195)    |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                                 |              |
| Cumulative effect of accounting change   |                                 | (968)        |
| Deferred income taxes  | 25,246                          | (58,324)     |
| Western states and similar settlements   |                                 | 35,000       |
| Gains on sales of assets and emission allowances, net  | (18,496)                        | (159,787)    |
| Depreciation and amortization  | 324,021                         | 279,853      |
| Income of equity investment, net   | (4,075)                         | (3,655)      |
| Debt extinguishments   | 72,589                          |              |
| Net changes in energy derivatives  | (126,819)                       | 351,711      |
| Amortization of deferred financing costs   | 47,817                          | 12,101       |
| Other, net   | 8,909                           | 12,657       |
| Changes in other assets and liabilities:   |                                 |              |
| Accounts and notes receivable, net   | (368,989)                       | (187,224)    |
| Change in notes with affiliates, net   | (4,225)                         |              |
| Inventory  | (6,117)                         | 13,698       |
| Margin deposits, net   | 200,928                         | 220,321      |
| Net derivative assets and liabilities  | (30,949)                        | (127,512)    |
| Western states and similar settlements payments  | (35,000)                        | (159,885)    |
| Accounts payable   | 172,789                         | 25,712       |
| Other current assets   | (14,586)                        | 14,972       |
| Other assets   | (35,155)                        | (25,598)     |
| Taxes payable/receivable   | (12,334)                        | (8,141)      |
| Other current liabilities  | 6,352                           | 77,330       |
| Other liabilities  | (9,168)                         | (3,341)      |
| Net cash provided by continuing operations from operating activities                               | 331,941                         | 39,725       |
| Net cash used in discontinued operations from operating activities                                 | (3,754)                         | (45,093)     |
| Net cash provided by (used in) operating activities  | 328,187                         | (5,368)      |
| <b>Cash Flows from Investing Activities:</b>   |                                 |              |
| Capital expenditures   | (135,473)                       | (63,887)     |
| Proceeds from sales of assets, net   | 30,380                          | 1,417        |
| Proceeds from sales of emission allowances   | 6,794                           | 205,186      |
| Purchases of emission allowances   | (52,160)                        | (12,443)     |
| Restricted cash  | 4,716                           | 16,497       |
| Other, net   | 5,295                           | 5,750        |
| Net cash provided by (used in) continuing operations from investing activities                     | (140,448)                       | 152,520      |
| Net cash provided by discontinued operations from investing activities                             | 520                             | 967,566      |
| Net cash provided by (used in) investing activities  | (139,928)                       | 1,120,086    |
| <b>Cash Flows from Financing Activities:</b>   |                                 |              |
| Payments of long-term debt   | (1,497,887)                     | (331,028)    |
| Proceeds from long-term debt   | 1,300,000                       |              |
| Increase (decrease) in short-term borrowings and revolving credit facilities, net                  | 6,554                           | (189,364)    |
| Payments of financing costs  | (31,245)                        |              |

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|  |            |             |
|--|------------|-------------|
| Payments of debt extinguishment costs  | (72,589)   |             |
| Proceeds from issuances of stock   | 39,401     | 21,947      |
| Net cash used in continuing operations from financing activities                 | (255,766)  | (498,445)   |
| Net cash used in discontinued operations from financing activities               |            | (638,000)   |
| Net cash used in financing activities  | (255,766)  | (1,136,445) |
| <b>Net Change in Cash and Cash Equivalents</b>                                   | (67,507)   | (21,727)    |
| <b>Cash and Cash Equivalents at Beginning of Period</b>                          | 463,909    | 88,397      |
| <b>Cash and Cash Equivalents at End of Period</b>                                | \$ 396,402 | \$ 66,670   |
| <b>Supplemental Disclosure of Cash Flow Information:</b>                         |            |             |
| Cash Payments:   |            |             |
| Interest paid (net of amounts capitalized) for continuing operations             | \$ 218,592 | \$ 279,232  |
| Income taxes paid (net of income tax refunds received) for continuing operations | 28,115     | 40,027      |
| See Notes to our Unaudited Consolidated Interim Financial Statements             |            |             |

**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.

*Deconsolidation of Channelview.* On August 20, 2007, four of our wholly-owned subsidiaries, Reliant Energy 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.

Since Channelview's results are no longer consolidated, any adjustments reflected in Channelview's financial statements subsequent to August 19, 2007 (relating to the recoverability and classification of recorded asset amounts and classification of liabilities or the effects on existing equity, as well as adjustments made to Channelview's financial information for loss contingencies and other matters), are not expected to directly impact our consolidated financial results.

We will reevaluate the accounting treatment of our investment in Channelview (as a cost method investment) when Channelview's bankruptcies are resolved or other factors, if any, indicate a change in control of Channelview.

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The following pro forma financial data reflects our results of operations, excluding Channelview for the entire periods indicated:

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2007                                | 2006      | 2007                               | 2006      |
| (in millions, except per share amounts)                      |                                     |           |                                    |           |
| Revenues   | \$ 3,485                            | \$ 3,272  | \$ 8,422                           | \$ 8,426  |
| Revenues affiliates  | 88                                  | 87        | 270                                | 264       |
| Total revenues   | 3,573                               | 3,359     | 8,692                              | 8,690     |
| Operating income (loss)                                      | 287                                 | (169)     | 500                                | (16)      |
| Income (loss) from continuing operations before income taxes | 225                                 | (253)     | 197                                | (276)     |
| Income (loss) from continuing operations                     | 163                                 | (153)     | 156                                | (250)     |
| Net income (loss) per share:                                 |                                     |           |                                    |           |
| Basic  | \$ 0.48                             | \$ (0.50) | \$ 0.45                            | \$ (0.82) |
| Diluted  | \$ 0.47                             | \$ (0.50) | \$ 0.44                            | \$ (0.82) |

See note 13 for further discussion of Channelview and the related bankruptcy filings.

*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 September 30, 2007 and 2006, our retail energy segment's revenues and operation and maintenance include gross receipts taxes of \$31 million and \$33 million, respectively, and during the nine months ended September 30, 2007 and 2006, \$76 million and \$82 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, which requires us to evaluate the fair value of our assets and liabilities according to a specified fair value hierarchy and present additional disclosures. It is also expected that the adoption will affect the measurement of certain liabilities by incorporating our own credit standing. 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 is applicable for us beginning in 2008. This interpretation 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. The adoption could have a significant impact on our consolidated balance sheet.



(2) **Stock-based Compensation**

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

|  | Three Months Ended<br>September 30,<br>2007 |   | 2006 |   | Nine Months Ended<br>September 30,<br>2007 |    | 2006 |    |
|--|---|---|------|---|--|----|------|----|
|  | (in millions)                               |   |      |   |  |    |      |    |
| Stock-based incentive plans compensation expense (pre-tax) | \$  | 3 | \$   | 9 | \$   | 23 | \$   | 26 |

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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 second quarter of 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.

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No tax benefits in excess of deferred tax assets related to stock-based compensation were realized during the three and nine months ended September 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<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|------------------------------------|----------|
|   | 2007                                | 2006     | 2007                               | 2006     |
|   | (in millions)                       |          |                                    |          |
| Net income (loss)   | \$ 162                              | \$ (155) | \$ 138                             | \$ (274) |
| Other comprehensive income (loss), net of tax:  |                                     |          |                                    |          |
| Deferred income (loss) from cash flow hedges  | 1                                   | (23)     | 4                                  | (134)    |
| Reclassification of net deferred loss from cash flow hedges realized in net income/loss | 24                                  | 110      | 69                                 | 181      |
| Amortization of prior service costs   | 1                                   |          | 1                                  |          |
| Comprehensive income (loss)   | \$ 188                              | \$ (68)  | \$ 212                             | \$ (227) |

**(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<br>September 30, |                 | Nine Months Ended<br>September 30, |                 |
|-------------------------------------|-------------------------------------|-----------------|------------------------------------|-----------------|
|                                     | 2007                                | 2006            | 2007                               | 2006            |
|                                     | (in millions)                       |                 |                                    |                 |
| <b>Energy derivatives:</b>          |                                     |                 |                                    |                 |
| Hedge ineffectiveness               | \$ 9 <sup>(1)</sup>                 | \$ 5            | \$ 11 <sup>(1)</sup>               | \$ (65)         |
| Other net unrealized gains (losses) | (37)                                | (360)           | 157                                | (215)           |
| <b>Interest rate derivatives:</b>   |                                     |                 |                                    |                 |
| <b>Hedge ineffectiveness</b>        |                                     |                 |                                    |                 |
| Other net unrealized gains (losses) | 1                                   | (3)             | (4)                                | (8)             |
| <b>Total<sup>(2)(3)</sup></b>       | <b>\$ (27)</b>                      | <b>\$ (358)</b> | <b>\$ 164</b>                      | <b>\$ (288)</b> |

(1) As discussed below, during the first quarter of 2007, we de-designated our remaining cash flow hedges; the amounts reflected here subsequent to that time relate to previously measured ineffectiveness reversing due to settlement of the derivative contract.

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

(3) During the three months ended September 30, 2007 and 2006, \$0 and during the nine months ended September 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 September 30, 2007, we have no cash flow hedges.

Amounts included in accumulated other comprehensive loss:

|                                | September 30, 2007       |  |
|--------------------------------|--------------------------|--|
|                                | At the End of the Period | Expected to be Reclassified into Results of Operations in Next 12 Months |
|                                | (in millions)            |  |
| Designated cash flow hedges    | \$                       | \$   |
| De-designated cash flow hedges | (99)                     | (44)   |
|                                | \$ (99)                  | \$ (44)  |

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<br>September 30, |      | Nine Months Ended<br>September 30, |       |
|---------------|-------------------------------------|------|------------------------------------|-------|
|               | 2007                                | 2006 | 2007                               | 2006  |
|               | (in millions)                       |      |                                    |       |
| Revenues      | \$ 8                                | \$ 9 | \$ 8                               | \$ 19 |
| Cost of sales |                                     |      |                                    |       |

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|       |    |   |    |   |    |   |    |    |
|-------|----|---|----|---|----|---|----|----|
| Total | \$ | 8 | \$ | 9 | \$ | 8 | \$ | 19 |
|-------|----|---|----|---|----|---|----|----|

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(6) Debt

(a) Overview.

Our outstanding debt is:

|   | Weighted<br>Average<br>Stated<br>Interest<br>Rate <sup>(1)</sup> | September 30, 2007 |         | Weighted<br>Average<br>Stated<br>Interest<br>Rate <sup>(1)</sup> | December 31, 2006 |         |
|---|--|--------------------|---------|--|-------------------|---------|
|   |  | Long-term          | Current |  | Long-term         | Current |
| <b>Banking or Credit Facilities, Bonds and Notes:</b>                     |  |                    |         |  |                   |         |
| (in millions, except interest rates)                                      |  |                    |         |  |                   |         |
| <b>Reliant Energy:</b>  |  |                    |         |  |                   |         |
| Senior secured revolver due 2012  | 6.98%  | \$                 | \$      |  | \$                | \$      |
| Senior secured term loans (B)   |  |                    |         | 7.73   | 397               | 3       |
| Senior unsecured notes due 2010 <sup>(2)</sup>                            |  |                    |         | 9.25   | 550               |         |
| Senior unsecured notes due 2013 <sup>(3)</sup>                            | 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                 |         |
| <b>Subsidiary Obligations:</b>  |  |                    |         |  |                   |         |
| Orion Power Holdings, Inc. senior notes due 2010 (unsecured)              | 12.00  |                    | 400     | 12.00  | 400               |         |
| Reliant Energy Seward, LLC PEDFA <sup>(4)</sup> fixed-rate bonds due 2036 | 6.75   |                    | 500     | 6.75   | 500               |         |
| Reliant Energy Channelview LP <sup>(5)</sup> :                            |  |                    |         |  |                   |         |
| Term loans and revolving working capital facility:                        |  |                    |         |  |                   |         |
| Floating rate debt due 2007 to 2024                                       |  |                    |         | 6.95   |                   | 267     |
| Fixed rate debt due 2014 to 2024  |  |                    |         | 9.55   |                   | 75      |
| Reliant Energy Power Supply, LLC working capital facility due 2012        | 5.58   |                    |         | 5.80   |                   |         |
| Total facilities, bonds and notes   |  |                    | 2,965   |  | 3,149             | 345     |
| <b>Other:</b>   |  |                    |         |  |                   |         |
| Adjustment to fair value of debt <sup>(6)</sup>                           |  |                    | 20      |  | 29                | 10      |
| Total other debt  |  |                    | 20      |  | 29                | 10      |
| Total debt  |  | \$                 | 2,985   | \$   | 3,178             | \$ 355  |

(1) The weighted average stated interest rates are as of September 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) Channelview was deconsolidated on August 20, 2007. See notes 1(b) and 13.

(6) 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 \$1 million and \$3 million during the three months ended September 30, 2007 and 2006, respectively, and \$8 million and \$7 million during the nine months ended September 30, 2007 and 2006, respectively.

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

|   | Total<br>Committed<br>Credit | Drawn<br>Amount | Letters<br>of Credit | Unused<br>Amount |
|---|------------------------------|-----------------|----------------------|------------------|
|   | (in millions)                |                 |                      |                  |
| Reliant Energy senior secured revolver due 2012 | \$ 500                       | \$              | \$ 195               | \$ 305           |
| Letter of credit facility due 2014              | 250                          |                 | 244                  | 6                |
| Retail working capital facility due 2012        | 300                          |                 |                      | 300              |
|   | \$ 1,050                     | \$              | \$ 439               | \$ 611           |

**(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).

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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.

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*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.

|  |    | <b>Nine Months Ended<br/>September 30, 2007<br/>(in millions)</b> |
|--|----|---|
| Balance, January 1, 2007   | \$ | 92  |
| Capitalized  |    | 31  |
| Amortized  |    | (8)   |
| Accelerated amortization/write-offs due to early extinguishments |    | (40)  |
| Channelview deconsolidation(1)                                   |    | (5)   |
| Balance, September 30, 2007                                      | \$ | 70  |

(1) Channelview was deconsolidated on August 20, 2007. See notes 1(b) and 13.

### (c) Channelview.

For discussion of Channelview's debt and the related bankruptcy filings, see notes 1(b) and 13.

### (7) Earnings Per Share

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

|   | <b>Three Months Ended September 30,</b> |             | <b>Nine Months Ended September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2007</b>                             | <b>2006</b> | <b>2007</b>                            | <b>2006</b> |
|   | (in millions)                           |             |  |             |
| Income (loss) from continuing operations (basic)                                  | \$ 160                                  | \$ (154)    | \$ 139                                 | \$ (270)    |
| Plus: Interest expense on 5.00% convertible senior subordinated notes, net of tax | (1)                                     | (2)         | (1)                                    | (2)         |
| Income (loss) from continuing operations (diluted)                                | \$ 160                                  | \$ (154)    | \$ 139                                 | \$ (270)    |

(1) In December 2006, we converted 99.2% of our convertible senior subordinated notes 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.



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|   | Three Months Ended September 30, |         | Nine Months Ended September 30, |         |
|---|----------------------------------|---------|---------------------------------|---------|
|   | 2007                             | 2006    | 2007                            | 2006    |
|   | (shares in thousands)            |         |                                 |         |
| <b>Diluted Weighted Average Shares Calculation:</b>               |                                  |         |                                 |         |
| Weighted average shares outstanding (basic)                       | 343,835                          | 307,975 | 341,768                         | 306,804 |
| Plus: Incremental shares from assumed conversions:                |                                  |         |                                 |         |
| Stock options   | 4,957                            | (1)     | 4,950                           | (1)     |
| Restricted stock  | 521                              | (1)     | 492                             | (1)     |
| Employee stock purchase plan                                      |                                  | (1)     | 60                              | (1)     |
| 5.00% convertible senior subordinated notes                       | 212                              | (1)     | 214                             | (1)     |
| Warrants  | 4,679                            | (1)     | 4,841                           | (1)     |
| Weighted average shares outstanding assuming conversion (diluted) | 354,204                          | 307,975 | 352,325                         | 306,804 |

(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 September 30,           |           | Nine Months Ended September 30, |           |
|--|--|-----------|---------------------------------|-----------|
|  | 2007                                       | 2006      | 2007                            | 2006      |
|  | (shares in thousands, dollars in millions) |           |                                 |           |
| Shares excluded from the calculation of diluted earnings/loss per share  | N/A(1)                                     | 36,180(2) | N/A(1)                          | 35,832(2) |
| Shares excluded from the calculation of diluted earnings/loss per share because the exercise price exceeded the average market price | 1,943(3)                                   | 2,561(3)  | 2,047(3)                        | 2,647(3)  |
| Interest expense that would be added to income if 5.00% convertible senior subordinated notes were dilutive                          | N/A(1)                                     | \$ 2      | N/A(1)                          | \$ 6      |

(1) Not applicable as we included the item in the calculation of diluted earnings/loss per share.

(2) 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.

(3) Includes stock options.

(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 September 30, |        | Nine Months Ended September 30, |        |
|---|----------------------------------|--------|---------------------------------|--------|
|   | 2007                             | 2006   | 2007                            | 2006   |
| Federal statutory rate                          | 35%                              | 35%    | 35%                             | 35%    |
| Additions (reductions) resulting from:          |                                  |        |                                 |        |
| Federal tax uncertainties                       |                                  | (3)    | (3)                             | (3)    |
| Federal valuation allowance(1)                  | (13)                             | 12     | (13)                            | (20)   |
| State income taxes, net of federal income taxes | 3                                | (4)(2) | 2                               | (2)(2) |
| Other, net                                      | 4                                | (1)    | 2                               | (1)    |
| Effective rate                                  | 29%                              | 39%    | 23%                             | 9%     |

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

(2) During the three and nine months ended September 30, 2006, we recorded a deferred state tax expense of \$10 million and a deferred state tax benefit of \$9 million, respectively, 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 |         | State<br>(in millions) |      | Capital, Foreign<br>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                                 |
| Changes in valuation allowance |         | (22)    |                        | 11   |                                    |
| Channelview deconsolidation    |         | (13)(2) |                        |      |                                    |
| As of September 30, 2007       | \$      | 47      | \$                     | 90   | \$ 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 second quarter of 2007.

(2) Channelview was deconsolidated on August 20, 2007. See notes 1(b) and 13.

(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.

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

|                             | <b>Adoption Effect on<br/>January 1, 2007<br/>Increase (Decrease)<br/>(in millions)</b> |
|-----------------------------|---|
| 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 September 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 September 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 September 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.

Except as otherwise noted, 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 Reports on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007, respectively, 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 September 2007, the Ninth Circuit Court of Appeals issued decisions in a number of the 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 plaintiff's 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.

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. The New Jersey Department of Environmental Protection (NJDEP) has alleged that New Source Review violations occurred at one of our power plants located in Pennsylvania and has taken a series of administrative and



judicial actions (including notice of intent to sue us under the Clean Air Act) to object to the issuance of an operating permit by the Pennsylvania Department of Environmental Protection (PADEP). We are unable to predict the ultimate outcome of the EPA's investigation or the NJDEP's efforts, 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 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 \$8 million and \$7 million as of September 30, 2007 and December 31, 2006, respectively.

*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.

(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 September 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 retail energy business, became non-guarantors. We have retrospectively adjusted the information presented for the three and nine months ended September 30, 2006 to be comparable to 2007.

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Condensed Consolidating Statements of Operations.

|  | Three Months Ended September 30, 2007 |            |                |                            |              |
|--|---------------------------------------|------------|----------------|----------------------------|--------------|
|  | Reliant Energy                        | Guarantors | Non-Guarantors | Adjustments <sup>(1)</sup> | Consolidated |
|  | (in millions)                         |            |                |                            |              |
| Revenues   | \$                                    | \$ 1,152   | \$ 3,103       | \$ (711)                   | \$ 3,544     |
| Cost of sales  |                                       | 1,006      | 2,542          | (709)                      | 2,839        |
| Operation and maintenance                                      |                                       | 49         | 163            | (1)                        | 211          |
| Selling, general and administrative                            |                                       | 4          | 96             | (1)                        | 99           |
| (Gains) losses on sales of assets and emission allowances, net |                                       | (18)       | 1              |                            | (17)         |
| Depreciation and amortization                                  |                                       | 36         | 86             |                            | 122          |
| Total  |                                       | 1,077      | 2,888          | (711)                      | 3,254        |
| Operating income   |                                       | 75         | 215            |                            | 290          |
| Income of equity investment, net                               |                                       | 1          |                |                            | 1            |
| Income of equity investments of consolidated subsidiaries      | 120                                   | 30         |                | (150)                      |              |
| Debt extinguishments   | (1)                                   |            |                |                            | (1)          |
| Other, net   |                                       | 2          |                |                            | 2            |
| Interest expense   | (43)                                  | (9)        | (22)           |                            | (74)         |
| Interest income  | 1                                     | 2          | 3              |                            | 6            |
| Interest income (expense) affiliated companies, net            | 81                                    | (59)       | (22)           |                            |              |
| Total other income (expense)                                   | 158                                   | (33)       | (41)           | (150)                      | (66)         |
| Income from continuing operations before income taxes          | 158                                   | 42         | 174            | (150)                      | 224          |
| Income tax expense (benefit)                                   | (4)                                   | 5          | 72             | (9)                        | 64           |
| Income from continuing operations                              | 162                                   | 37         | 102            | (141)                      | 160          |
| Income from discontinued operations                            |                                       |            | 2              |                            | 2            |
| Net income   | \$ 162                                | \$ 37      | \$ 104         | \$ (141)                   | \$ 162       |

|  | Three Months Ended September 30, 2006 |            |                |                            |              |
|--|---------------------------------------|------------|----------------|----------------------------|--------------|
|  | Reliant Energy                        | Guarantors | Non-Guarantors | Adjustments <sup>(1)</sup> | Consolidated |
|  | (in millions)                         |            |                |                            |              |
| Revenues   | \$                                    | \$ 2,674   | \$ 3,444       | \$ (2,813)                 | \$ 3,305     |
| Cost of sales  |                                       | 2,903      | 2,900          | (2,813)                    | 2,990        |
| Operation and maintenance  |                                       | 49         | 170            |                            | 219          |
| Western states and similar settlements                           |                                       | 35         |                |                            | 35           |
| Selling, general and administrative                              |                                       | 3          | 114            |                            | 117          |
| (Gain) loss on sales of receivables                              |                                       | 1          | (1)            |                            |              |
| Gains on sales of assets and emission allowances, net            |                                       | (2)        | (1)            |                            | (3)          |
| Depreciation and amortization                                    |                                       | 40         | 68             |                            | 108          |
| Total  |                                       | 3,029      | 3,250          | (2,813)                    | 3,466        |
| Operating income (loss)  |                                       | (355)      | 194            |                            | (161)        |
| Income of equity investment, net                                 |                                       | 2          |                |                            | 2            |
| Other, net   |                                       | (1)        |                |                            | (1)          |
| Income (loss) of equity investments of consolidated subsidiaries | (187)                                 | (4)        | 2              | 189                        |              |
| Interest expense   | (68)                                  | (9)        | (24)           |                            | (101)        |
| Interest income  |                                       | 6          | 1              |                            | 7            |
| Interest income (expense) affiliated companies, net              | 82                                    | (82)       |                |                            |              |
| Total other expense  | (173)                                 | (88)       | (21)           | 189                        | (93)         |
| Income (loss) from continuing operations before income taxes     | (173)                                 | (443)      | 173            | 189                        | (254)        |

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|  |          |          |       |        |
|--|----------|----------|-------|--------|
| Income tax expense (benefit)             | (18)     | (159)    | 77    | (100)  |
| Income (loss) from continuing operations | (155)    | (284)    | 96    | 189    |
| Loss from discontinued operations        |          |          | (1)   | (1)    |
| Net income (loss)                        | \$ (155) | \$ (284) | \$ 95 | \$ 189 |

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|  | Nine Months Ended September 30, 2007 |            |                |                            |              |
|--|--------------------------------------|------------|----------------|----------------------------|--------------|
|  | Reliant Energy                       | Guarantors | Non-Guarantors | Adjustments <sup>(1)</sup> | Consolidated |
|  | (in millions)                        |            |                |                            |              |
| Revenues   | \$                                   | \$ 2,834   | \$ 7,551       | \$ (1,829)                 | \$ 8,556     |
| Cost of sales  |                                      | 2,610      | 5,968          | (1,820)                    | 6,758        |
| Operation and maintenance  |                                      | 153        | 526            | (4)                        | 675          |
| Selling, general and administrative                              |                                      | 16         | 280            | (5)                        | 291          |
| Western states and similar settlements                           |                                      | 22         |                |                            | 22           |
| Gains on sales of assets and emission allowances, net            |                                      | (9)        | (10)           |                            | (19)         |
| Depreciation and amortization                                    |                                      | 122        | 202            |                            | 324          |
| Total  |                                      | 2,914      | 6,966          | (1,829)                    | 8,051        |
| Operating income (loss)  |                                      | (80)       | 585            |                            | 505          |
| Income of equity investment, net                                 |                                      | 4          |                |                            | 4            |
| Income (loss) of equity investments of consolidated subsidiaries | 115                                  | (6)        |                | (109)                      |              |
| Debt extinguishments   | (72)                                 |            |                |                            | (72)         |
| Other, net   |                                      | 2          |                |                            | 2            |
| Interest expense   | (192)                                | (26)       | (65)           |                            | (283)        |
| Interest income  | 7                                    | 6          | 11             |                            | 24           |
| Interest income (expense) affiliated companies, net              | 265                                  | (201)      | (64)           |                            |              |
| Total other income (expense)                                     | 123                                  | (221)      | (118)          | (109)                      | (325)        |
| Income (loss) from continuing operations before income taxes     | 123                                  | (301)      | 467            | (109)                      | 180          |
| Income tax expense (benefit)                                     | (15)                                 | (110)      | 181            | (15)                       | 41           |
| Income (loss) from continuing operations                         | 138                                  | (191)      | 286            | (94)                       | 139          |
| Loss from discontinued operations                                |                                      |            | (1)            |                            | (1)          |
| Net income (loss)  | \$ 138                               | \$ (191)   | \$ 285         | \$ (94)                    | \$ 138       |

|  | Nine Months Ended September 30, 2006 |            |                |                            |              |
|--|--------------------------------------|------------|----------------|----------------------------|--------------|
|  | Reliant Energy                       | Guarantors | Non-Guarantors | Adjustments <sup>(1)</sup> | Consolidated |
|  | (in millions)                        |            |                |                            |              |
| Revenues   | \$                                   | \$ 7,333   | \$ 7,606       | \$ (6,406)                 | \$ 8,533     |
| Cost of sales  |                                      | 7,485      | 6,395          | (6,406)                    | 7,474        |
| Operation and maintenance  |                                      | 142        | 493            |                            | 635          |
| Western states and similar settlements                           |                                      | 35         |                |                            | 35           |
| Selling, general and administrative                              |                                      | 4          | 275            |                            | 279          |
| (Gain) loss on sales of receivables                              |                                      | 6          | (6)            |                            |              |
| Gains on sales of assets and emission allowances, net            |                                      | (20)       | (139)          |                            | (159)        |
| Depreciation and amortization                                    |                                      | 117        | 163            |                            | 280          |
| Total  |                                      | 7,769      | 7,181          | (6,406)                    | 8,544        |
| Operating income (loss)  |                                      | (436)      | 425            |                            | (11)         |
| Income of equity investment, net                                 |                                      | 4          |                |                            | 4            |
| Income (loss) of equity investments of consolidated subsidiaries | (186)                                | 3          | 4              | 179                        |              |

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|  |          |          |        |        |    |  |  |    |       |
|--|----------|----------|--------|--------|----|--|--|----|-------|
| subsidiaries   |          |          |        |        |    |  |  |    |       |
| Interest expense   | (216)    | (26)     | (70)   |        |    |  |  |    | (312) |
| Interest income  | 1        | 19       | 3      |        |    |  |  |    | 23    |
| Interest income (expense) affiliated companies, net          | 193      | (228)    | 35     |        |    |  |  |    |       |
| Total other expense  | (208)    | (228)    | (28)   | 179    |    |  |  |    | (285) |
| Income (loss) from continuing operations before income taxes | (208)    | (664)    | 397    | 179    |    |  |  |    | (296) |
| Income tax expense (benefit)                                 | 61       | (255)    | 168    |        |    |  |  |    | (26)  |
| Income (loss) from continuing operations                     | (269)    | (409)    | 229    | 179    |    |  |  |    | (270) |
| Income (loss) from discontinued operations                   | (5)      | (3)      | 3      |        |    |  |  |    | (5)   |
| Cumulative effect of accounting change, net of tax           |          | 1        |        |        |    |  |  |    | 1     |
| Net income (loss)  | \$ (274) | \$ (411) | \$ 232 | \$ 179 | \$ |  |  | \$ | (274) |

(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.

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Condensed Consolidating Balance Sheets.

|  | September 30, 2007 |                 |                                 |                            |                 |
|--|--------------------|-----------------|---------------------------------|----------------------------|-----------------|
|  | Reliant Energy     | Guarantors      | Non-Guarantors<br>(in millions) | Adjustments <sup>(1)</sup> | Consolidated    |
| <b>ASSETS</b>  |                    |                 |                                 |                            |                 |
| <b>Current Assets:</b>   |                    |                 |                                 |                            |                 |
| Cash and cash equivalents                                      | \$ 237             | \$              | \$ 159                          | \$                         | \$ 396          |
| Restricted cash  |                    | 4               | 1                               |                            | 5               |
| Accounts and notes receivable,<br>principally customer, net    | 11                 | 269             | 1,106                           | 41                         | 1,427           |
| Accounts and notes receivable<br>affiliated companies          | 1,936              | 332             | 184                             | (2,452)                    |                 |
| Inventory  |                    | 144             | 126                             |                            | 270             |
| Derivative assets  |                    | 53              | 260                             |                            | 313             |
| Investment in and receivables<br>from Channelview, net         | 1                  | 73              |                                 |                            | 74              |
| Other current assets   | 7                  | 307             | 269                             | 15                         | 598             |
| Current assets of discontinued<br>operations                   |                    |                 | 1                               |                            | 1               |
| <b>Total current assets</b>                                    | <b>2,192</b>       | <b>1,182</b>    | <b>2,106</b>                    | <b>(2,396)</b>             | <b>3,084</b>    |
| <b>Property, Plant and<br/>Equipment, net</b>                  |                    | <b>2,940</b>    | <b>2,330</b>                    |                            | <b>5,270</b>    |
| <b>Other Assets:</b>   |                    |                 |                                 |                            |                 |
| Goodwill   |                    | 51              | 210                             | 119                        | 380             |
| Other intangibles, net   |                    | 139             | 271                             |                            | 410             |
| Notes receivable affiliated<br>companies                       | 2,529              | 662             | 68                              | (3,259)                    |                 |
| Equity investments of<br>consolidated subsidiaries             | 2,149              | 295             |                                 | (2,444)                    |                 |
| Derivative assets  |                    | 30              | 37                              |                            | 67              |
| Other long-term assets   | 61                 | 830             | 377                             | (678)                      | 590             |
| <b>Total other assets</b>                                      | <b>4,739</b>       | <b>2,007</b>    | <b>963</b>                      | <b>(6,262)</b>             | <b>1,447</b>    |
| <b>Total Assets</b>  | <b>\$ 6,931</b>    | <b>\$ 6,129</b> | <b>\$ 5,399</b>                 | <b>\$ (8,658)</b>          | <b>\$ 9,801</b> |
| <b>LIABILITIES AND EQUITY</b>                                  |                    |                 |                                 |                            |                 |
| <b>Current Liabilities:</b>                                    |                    |                 |                                 |                            |                 |
| Current portion of long-term<br>debt and short-term borrowings | \$                 | \$              | \$ 11                           | \$                         | \$ 11           |
| Accounts payable, principally<br>trade                         |                    | 77              | 677                             | 52                         | 806             |
| Accounts and notes payable<br>affiliated companies             |                    | 2,109           | 343                             | (2,452)                    |                 |
| Derivative liabilities   |                    | 140             | 575                             |                            | 715             |
| Other current liabilities                                      | 52                 | 198             | 269                             | (31)                       | 488             |
| <b>Total current liabilities</b>                               | <b>52</b>          | <b>2,524</b>    | <b>1,875</b>                    | <b>(2,431)</b>             | <b>2,020</b>    |
| <b>Other Liabilities:</b>                                      |                    |                 |                                 |                            |                 |
| Notes payable affiliated<br>companies                          |                    | 2,384           | 875                             | (3,259)                    |                 |
| Derivative liabilities   |                    | 58              | 226                             |                            | 284             |
| Other long-term liabilities                                    | 584                | 152             | 204                             | (658)                      | 282             |
| <b>Total other liabilities</b>                                 | <b>584</b>         | <b>2,594</b>    | <b>1,305</b>                    | <b>(3,917)</b>             | <b>566</b>      |
| <b>Long-term Debt</b>  | <b>2,065</b>       | <b>500</b>      | <b>420</b>                      |                            | <b>2,985</b>    |
| <b>Commitments and<br/>Contingencies</b>                       |                    |                 |                                 |                            |                 |
| <b>Temporary Equity</b>  |                    |                 |                                 |                            |                 |
| <b>Stock-based Compensation</b>                                | <b>4</b>           |                 |                                 |                            | <b>4</b>        |
| <b>Total Stockholders' Equity</b>                              | <b>4,226</b>       | <b>511</b>      | <b>1,799</b>                    | <b>(2,310)</b>             | <b>4,226</b>    |

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|                                     |    |       |    |       |    |       |    |         |    |       |
|-------------------------------------|----|-------|----|-------|----|-------|----|---------|----|-------|
| <b>Total Liabilities and Equity</b> | \$ | 6,931 | \$ | 6,129 | \$ | 5,399 | \$ | (8,658) | \$ | 9,801 |
|-------------------------------------|----|-------|----|-------|----|-------|----|---------|----|-------|

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|  | December 31, 2006 |                 |                                 |                   |                  |
|--|-------------------|-----------------|---------------------------------|-------------------|------------------|
|  | Reliant Energy    | Guarantors      | Non-Guarantors<br>(in millions) | Adjustments (1)   | Consolidated     |
| <b>ASSETS</b>  |                   |                 |                                 |                   |                  |
| <b>Current Assets:</b>   |                   |                 |                                 |                   |                  |
| Cash and cash equivalents                                      | \$ 286            | \$ 24           | \$ 154                          | \$                | \$ 464           |
| Restricted cash  |                   |                 | 25                              |                   | 25               |
| Accounts and notes receivable,<br>principally customer, net    | 10                | 264             | 779                             | (9)               | 1,044            |
| Accounts and notes receivable<br>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<br>operations                   |                   |                 | 2                               |                   | 2                |
| Total current assets   | 2,040             | 1,440           | 2,133                           | (2,440)           | 3,173            |
| <b>Property, Plant and Equipment,<br/>net</b>                  |                   | 3,044           | 2,698                           |                   | 5,742            |
| <b>Other Assets:</b>   |                   |                 |                                 |                   |                  |
| Goodwill   |                   | 51              | 212                             | 119               | 382              |
| Other intangibles, net   |                   | 131             | 293                             |                   | 424              |
| Notes receivable affiliated<br>companies                       | 3,249             | 789             | 94                              | (4,132)           |                  |
| Equity investments of consolidated<br>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            |
| <b>Total Assets</b>  | <b>\$ 6,742</b>   | <b>\$ 6,590</b> | <b>\$ 5,962</b>                 | <b>\$ (8,727)</b> | <b>\$ 10,567</b> |
| <b>LIABILITIES AND EQUITY</b>                                  |                   |                 |                                 |                   |                  |
| <b>Current Liabilities:</b>                                    |                   |                 |                                 |                   |                  |
| Current portion of long-term debt<br>and short-term borrowings | \$ 3              | \$              | \$ 352                          | \$                | \$ 355           |
| Accounts payable, principally<br>trade                         |                   | 224             | 444                             | (3)               | 665              |
| Accounts and notes payable<br>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<br>operations              |                   |                 | 3                               |                   | 3                |
| Total current liabilities                                      | 58                | 2,642           | 2,432                           | (2,440)           | 2,692            |
| <b>Other Liabilities:</b>                                      |                   |                 |                                 |                   |                  |
| Notes payable affiliated<br>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              |
| <b>Long-term Debt</b>  | <b>2,248</b>      | <b>501</b>      | <b>429</b>                      |                   | <b>3,178</b>     |
| <b>Commitments and<br/>Contingencies</b>                       |                   |                 |                                 |                   |                  |
| <b>Temporary Equity Stock-based<br/>Compensation</b>           | <b>2</b>          |                 |                                 |                   | <b>2</b>         |
| <b>Total Stockholders' Equity<br/>(Deficit)</b>                | <b>3,950</b>      | <b>(48)</b>     | <b>1,639</b>                    | <b>(1,591)</b>    | <b>3,950</b>     |
| <b>Total Liabilities and Equity</b>                            | <b>\$ 6,742</b>   | <b>\$ 6,590</b> | <b>\$ 5,962</b>                 | <b>\$ (8,727)</b> | <b>\$ 10,567</b> |

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

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(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.

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Condensed Consolidating Statements of Cash Flows.

|  | Nine Months Ended September 30, 2007 |            |                |                |              |
|--|--------------------------------------|------------|----------------|----------------|--------------|
|  | Reliant Energy                       | Guarantors | Non-Guarantors | Adjustments(1) | Consolidated |
|  | (in millions)                        |            |                |                |              |
| <b>Cash Flows from Operating Activities:</b>   |                                      |            |                |                |              |
| Net cash provided by (used in) continuing operations from operating activities       | \$ 144                               | \$ (147)   | \$ 335         | \$             | \$ 332       |
| Net cash used in discontinued operations from operating activities                   |                                      |            | (4)            |                | (4)          |
| Net cash provided by (used in) operating activities                                  | 144                                  | (147)      | 331            |                | 328          |
| <b>Cash Flows from Investing Activities:</b>   |                                      |            |                |                |              |
| Capital expenditures   |                                      | (20)       | (115)          |                | (135)        |
| Investments in, advances to and from and distributions from subsidiaries, net (2)(3) | 59                                   | (6)        | (159)          | 106            |              |
| Proceeds from sales of assets, net   |                                      | 30         |                |                | 30           |
| Net purchases of emission allowances   |                                      | (35)       | (10)           |                | (45)         |
| Restricted cash  |                                      | (4)        | 9              |                | 5            |
| Other, net   |                                      | 5          |                |                | 5            |
| Net cash provided by (used in) investing activities                                  | 59                                   | (30)       | (275)          | 106            | (140)        |
| <b>Cash Flows from Financing Activities:</b>   |                                      |            |                |                |              |
| Payments of long-term debt   | (1,487)                              |            | (10)           |                | (1,497)      |
| 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)                               |                                      | 154        | (48)           | (106)          |              |
| Payments of financing costs  | (31)                                 |            |                |                | (31)         |
| Payments of debt extinguishment costs  | (72)                                 |            |                |                | (72)         |
| Proceeds from issuances of stock   | 39                                   |            |                |                | 39           |
| Other, net   | (1)                                  | (1)        |                |                | (2)          |
| Net cash provided by (used in) financing activities                                  | (252)                                | 153        | (51)           | (106)          | (256)        |
| <b>Net Change in Cash and Cash Equivalents</b>                                       | (49)                                 | (24)       | 5              |                | (68)         |
| <b>Cash and Cash Equivalents at Beginning of Period</b>                              | 286                                  | 24         | 154            |                | 464          |
| <b>Cash and Cash Equivalents at End of Period</b>                                    | \$ 237                               | \$         | \$ 159         | \$             | \$ 396       |



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|   | Nine Months Ended September 30, 2006 |              |                                 |                |              |
|---|--------------------------------------|--------------|---------------------------------|----------------|--------------|
|   | Reliant Energy                       | Guarantors   | Non-Guarantors<br>(in millions) | Adjustments(1) | Consolidated |
| <b>Cash Flows from Operating Activities:</b>                                      |                                      |              |                                 |                |              |
| Net cash provided by (used in) continuing operations from operating activities    | \$ 9                                 | \$ (539)     | \$ 570                          | \$             | \$ 40        |
| Net cash provided by (used in) discontinued operations from operating activities  | 3                                    | (8)          | (40)                            |                | (45)         |
| Net cash provided by (used in) operating activities                               | 12                                   | (547)        | 530                             |                | (5)          |
| <b>Cash Flows from Investing Activities:</b>                                      |                                      |              |                                 |                |              |
| Capital expenditures  |                                      | (15)         | (49)                            |                | (64)         |
| Investments in, advances to and from and distributions from subsidiaries, net (2) | 410                                  | 1            | (211)                           | (200)          |              |
| Proceeds from sales of assets, net  |                                      |              | 1                               |                | 1            |
| Net sales of emission allowances  |                                      | 98           | 95                              |                | 193          |
| Restricted cash   |                                      |              | 17                              |                | 17           |
| Other, net  |                                      | 6            |                                 |                | 6            |
| Net cash provided by (used in) continuing operations from investing activities    | 410                                  | 90           | (147)                           | (200)          | 153          |
| Net cash provided by discontinued operations from investing activities            | 712                                  |              | 968                             | (712)          | 968          |
| Net cash provided by investing activities   | 1,122                                | 90           | 821                             | (912)          | 1,121        |
| <b>Cash Flows from Financing Activities:</b>                                      |                                      |              |                                 |                |              |
| Payments of long-term debt  | (320)                                |              | (11)                            |                | (331)        |
| Increase (decrease) in short-term borrowings and revolving credit facilities, net | (194)                                |              | 5                               |                | (189)        |
| Changes in notes with affiliated companies, net (4)                               |                                      | 456          | (656)                           | 200            |              |
| Proceeds from issuances of stock  | 21                                   |              |                                 |                | 21           |
| Net cash provided by (used in) continuing operations from financing activities    | (493)                                | 456          | (662)                           | 200            | (499)        |
| Net cash used in discontinued operations from financing activities                | (638)                                |              | (712)                           | 712            | (638)        |
| Net cash provided by (used in) financing activities                               | (1,131)                              | 456          | (1,374)                         | 912            | (1,137)      |
| <b>Net Change in Cash and Cash Equivalents</b>                                    | <b>3</b>                             | <b>(1)</b>   | <b>(23)</b>                     |                | <b>(21)</b>  |
| <b>Cash and Cash Equivalents at Beginning of Period</b>                           | <b>3</b>                             | <b>36</b>    | <b>49</b>                       |                | <b>88</b>    |
| <b>Cash and Cash Equivalents at End of Period</b>                                 | <b>\$ 6</b>                          | <b>\$ 35</b> | <b>\$ 26</b>                    | <b>\$</b>      | <b>\$ 67</b> |

(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.

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- (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.

**(12) Reportable Segments**

Financial data for our segments are as follows:

|  | Retail<br>Energy | Wholesale<br>Energy     | Other<br>Operations<br>(in millions) | Eliminations | Consolidated |
|--|------------------|-------------------------|--------------------------------------|--------------|--------------|
| <b>Three months ended September 30, 2007:</b>                                    |                  |                         |                                      |              |              |
| Revenues from external customers   | \$ 2,608         | \$ 936 <sup>(1)</sup>   | \$ 3                                 | \$ (120)     | \$ 3,544     |
| Intersegment revenues  |                  | 117                     | 3                                    | (120)        |              |
| Contribution margin, including unrealized gains/losses on energy derivatives (2) | 198              | 235                     | (1)                                  | (1)          | 431          |
| <b>Three months ended September 30, 2006:</b>                                    |                  |                         |                                      |              |              |
| Revenues from external customers   | \$ 2,571         | \$ 734 <sup>(3)</sup>   | \$ 10                                | \$ (162)     | \$ 3,305     |
| Intersegment revenues  |                  | 162                     |                                      | (162)        |              |
| Contribution margin, including unrealized gains/losses on energy derivatives (2) | (42)             | 65                      |                                      |              | 23           |
| <b>Nine months ended September 30, 2007 (except as denoted):</b>                 |                  |                         |                                      |              |              |
| Revenues from external customers   | \$ 6,303         | \$ 2,253 <sup>(4)</sup> | \$ 10                                | \$ (355)     | \$ 8,556     |
| Intersegment revenues  |                  | 345                     | 10                                   | (355)        |              |
| Contribution margin, including unrealized gains/losses on energy derivatives (2) | 648              | 315                     | 5                                    | (5)          | 963          |
| Total assets as of September 30, 2007  | 2,110            | 7,670                   | 920 <sup>(5)</sup>                   | (899)        | 9,801        |
| <b>Nine months ended September 30, 2006 (except as denoted):</b>                 |                  |                         |                                      |              |              |
| Revenues from external customers   | \$ 6,475         | \$ 2,057 <sup>(6)</sup> | \$ 1                                 | \$ (448)     | \$ 8,533     |
| Intersegment revenues  |                  | 448                     |                                      | (448)        |              |
| Contribution margin, including unrealized gains/losses on energy derivatives (2) | 133              | 130                     | 1                                    |              | 264          |
| Total assets as of December 31, 2006   | 1,984            | 8,402                   | 848 <sup>(7)</sup>                   | (667)        | 10,567       |

(1) Includes \$40 million from affiliates.

(2) Revenues less (a) cost of sales, (b) operation and maintenance, (c) selling and marketing and (d) bad debt expense.

(3) Includes \$395 million in revenues from a single counterparty, which represented 12% of our consolidated revenues and 54% of our wholesale energy segment revenues.

(4) Includes \$40 million from affiliates.

(5) Other operations include discontinued operations of \$1 million.

(6) Includes \$1.0 billion in revenues from a single counterparty, which represented 12% of our consolidated revenues and 49% of our wholesale energy segment revenues.

(7) Other operations include discontinued operations of \$2 million.

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|  | Three Months Ended September 30,<br>2007 |      | 2006 |       | Nine Months Ended September 30,<br>2007 |       | 2006 |       |
|--|--|------|------|-------|---|-------|------|-------|
|  | (in millions)                            |      |      |       |   |       |      |       |
| Contribution margin, including unrealized gains/losses on energy derivatives | \$                                       | 431  | \$   | 23    | \$                                      | 963   | \$   | 264   |
| Other general and administrative   |  | 36   |      | 44    |   | 131   |      | 119   |
| Western states and similar settlements                                       |  |      |      | 35    |   | 22    |      | 35    |
| Gains on sales of assets and emission allowances, net                        |  | (17) |      | (3)   |   | (19)  |      | (159) |
| Depreciation   |  | 71   |      | 75    |   | 244   |      | 226   |
| Amortization   |  | 51   |      | 33    |   | 80    |      | 54    |
| Operating income (loss)  |  | 290  |      | (161) |   | 505   |      | (11)  |
| Income of equity investment, net   |  | 1    |      | 2     |   | 4     |      | 4     |
| Debt extinguishments   |  | (1)  |      |       |   | (72)  |      |       |
| Other, net   |  | 2    |      | (1)   |   | 2     |      |       |
| Interest expense   |  | (74) |      | (101) |   | (283) |      | (312) |
| Interest income  |  | 6    |      | 7     |   | 24    |      | 23    |
| Income (loss) from continuing operations before income taxes                 |  | 224  |      | (254) |   | 180   |      | (296) |
| Income tax expense (benefit)   |  | 64   |      | (100) |   | 41    |      | (26)  |
| Income (loss) from continuing operations                                     |  | 160  |      | (154) |   | 139   |      | (270) |
| Income (loss) from discontinued operations                                   |  | 2    |      | (1)   |   | (1)   |      | (5)   |
| Income (loss) before cumulative effect of accounting change                  |  | 162  |      | (155) |   | 138   |      | (275) |
| Cumulative effect of accounting change, net of tax                           |  |      |      |       |   |       |      | 1     |
| Net income (loss)  | \$                                       | 162  | \$   | (155) | \$                                      | 138   | \$   | (274) |

### (13) Channelview's Bankruptcy Filings

On August 20, 2007, Channelview filed voluntary petitions in the United States Bankruptcy Court for the District of Delaware for reorganization under Chapter 11 of the Bankruptcy Code. The bankruptcy cases are being jointly administered, with Channelview managing its business in the ordinary course as debtors-in-possession subject to the supervision of the bankruptcy court.

Under Channelview's credit agreement, Reliant Energy Channelview LP (the partnership) was required to maintain a working capital requirement of \$14 million. The covenant was previously met by the \$14 million revolving working capital facility. That facility matured on August 15, 2007. Failure to meet the working capital requirement would eventually have constituted an event of default. Channelview filed for bankruptcy protection to prevent the lenders from exercising their remedies, including foreclosing on the project. During the three and nine months ended September 30, 2007, we incurred \$2 million in selling, general and administrative expenses related to these bankruptcy filings and associated costs, which do not include the reorganization costs that Channelview incurred subsequent to August 19, 2007. See the tables below for the reorganization costs incurred by Channelview.

We plan to continue to explore strategic alternatives with respect to our interests in Channelview, including selling our equity interests, selling the plant or refinancing Channelview's debt. Channelview's debt is non-recourse to Reliant Energy and the bankruptcy filings did not cause a default under any of our other debt. The bankruptcy filings have not and are not expected to have a material impact on our consolidated liquidity or financial positions. As of September 30, 2007, our net investment in and receivables from Channelview is \$74 million, classified in current assets. As of September 30, 2007, based upon our assessment of the fair value of Channelview, we determined that there was no impairment of this amount.

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As a result of the bankruptcies, we deconsolidated Channelview's financial results beginning August 20, 2007, and began reporting our investment in Channelview using the cost method. The following tables contain summarized combined financial information of Channelview:

|  | September 30, 2007 |     | December 31, 2006 |     |
|--|--------------------|-----|-------------------|-----|
|  | (in millions)      |     |                   |     |
| Current assets                                       | \$                 | 62  | \$                | 50  |
| Property, plant and equipment, net                   |                    | 358 |                   | 368 |
| Other assets   |                    | 15  |                   | 15  |
| Total assets   | \$                 | 435 | \$                | 433 |
| Secured debt obligations, including accrued interest | \$                 | 340 | \$                | 343 |
| Payables to Reliant Energy and its subsidiaries, net |                    | 87  |                   | 72  |
| Other liabilities                                    |                    | 17  |                   | 14  |
| Equity (deficit)                                     |                    | (9) |                   | 4   |
| Total liabilities and equity (deficit)               | \$                 | 435 | \$                | 433 |

|  | Three Months Ended September 30, |      | Nine Months Ended September 30, |      |
|--|----------------------------------|------|---------------------------------|------|
|  | 2007                             | 2006 | 2007                            | 2006 |
|  | (in millions)                    |      |                                 |      |
| Revenues   | \$                               | 33   | \$                              | 33   |
| Revenues affiliates  |                                  | 78   |                                 | 72   |
| Total revenues   |                                  | 111  |                                 | 105  |
| Cost of sales  |                                  |      |                                 | 1    |
| Cost of sales affiliates   |                                  | 88   |                                 | 87   |
| Total cost of sales  |                                  | 88   |                                 | 87   |
| Other operating expenses (including \$0, \$1 million, \$1 million and \$2 million from affiliates) |                                  | 11   |                                 | 10   |
| Operating income   |                                  | 12   |                                 | 8    |
| Interest expense, net  |                                  | (7)  |                                 | (7)  |
| Interest expense affiliates  |                                  | (1)  |                                 | (2)  |
| Total other expense  |                                  | (8)  |                                 | (9)  |
| Income (loss) before reorganization items and income taxes   |                                  | 4    |                                 | (1)  |
| Reorganization items   |                                  | (2)  |                                 | (2)  |
| Income (loss) before income taxes  |                                  | 2    |                                 | (1)  |
| Income tax expense   |                                  | 1    |                                 |      |
| Net income (loss)  | \$                               | 1    | \$                              | (1)  |
|  |                                  |      | \$                              | (13) |
|  |                                  |      | \$                              | (20) |

**(14) 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

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\$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:

|  | <b>Nine Months Ended<br/>September 30, 2006<br/>(in millions)</b> |     |
|--|---|-----|
| Revenues                               | \$  | 108 |
| Loss before income tax expense/benefit |   | (7) |

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 more than 1.8 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 September 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, the margin we earn for each unit of electricity sold and the availability of our generating assets to meet demand. 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).

Channelview filed for reorganization under Chapter 11 of the Bankruptcy Code. See notes 1(b) and 13 to our interim financial statements.

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 facility 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 (for 2007/2008, 2008/2009 and 2009/2010 supply) support our view of tightening supply and demand in the wholesale energy business. RPM is a model utilized by the PJM Interconnection, LLC (PJM) to meet load serving entities' forecasted capacity obligations via a forward-looking commitment of capacity resources.

In September 2007, Duquesne Light Company (Duquesne) notified PJM of its intent to withdraw from PJM and join the Midwest Independent Transmission System Operator (MISO). Approximately 1300 megawatts of the generation capacity that we operate in PJM is located in Duquesne's control area. The capacity payment revenue we expect to receive associated with this generation as a result of the 2007 RPM auctions ranges from \$19 million in 2007/2008 to \$46 million in 2008/2009. Additionally, we serve approximately 100 megawatts of retail load in the Duquesne control area. Duquesne must obtain FERC's approval in order to withdraw from PJM. We cannot predict FERC's response to Duquesne's proposed application or its potential impact to the competitive markets in which we operate. However, if FERC permits Duquesne to withdraw from PJM and join MISO, depending on what conditions, if any, are imposed by FERC in connection with such withdrawal, Duquesne's actions could have a material impact on our future results of operations. We intend to aggressively pursue our regulatory and other possible remedies regarding Duquesne's possible withdrawal from PJM and have taken actions to that end before both the FERC and the Pennsylvania Public Utility Commission.

#### **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 September 30, 2007 Compared to Three Months Ended September 30, 2006

We reported \$162 million consolidated net income, or \$0.46 earnings per diluted share, for the three months ended September 30, 2007 compared to \$155 million consolidated net loss, or \$0.50 loss per share, for the same period in 2006.

|   | 2007   | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change |
|---|--------|---|----|--------|
| Retail energy contribution margin, including unrealized gains/losses on energy derivatives  | \$ 198 | \$ (42)   | \$ | 240    |
| Wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | 235    | 65  |    | 170    |
| Other contribution margin   | (2)    |   |    | (2)    |
| Other general and administrative  | (36)   | (44)  |    | 8      |
| Western states and similar settlements  |        | (35)  |    | 35     |
| Gains on sales of assets and emission allowances, net   | 17     | 3   |    | 14     |
| Depreciation and amortization   | (122)  | (108)   |    | (14)   |
| Income of equity investment, net  | 1      | 2   |    | (1)    |
| Debt extinguishments  | (1)    |   |    | (1)    |
| Other, net  | 2      | (1)   |    | 3      |
| Interest expense  | (74)   | (101)   |    | 27     |
| Interest income   | 6      | 7   |    | (1)    |
| Income tax (expense) benefit  | (64)   | 100   |    | (164)  |
| Income (loss) from continuing operations  | 160    | (154)   |    | 314    |
| Income (loss) from discontinued operations  | 2      | (1)   |    | 3      |
| Net income (loss)   | \$ 162 | \$ (155)  | \$ | 317    |

**Retail Energy Segment.**

In analyzing the results of our retail energy segment, we use the non-GAAP financial measures retail gross margin and retail contribution margin, as well as our retail energy segment profit and loss measure, contribution margin, including unrealized gains/losses on energy derivatives. Retail gross margin and retail contribution margin should not be relied upon to the exclusion of GAAP financial measures. The item that is excluded from these non-GAAP financial measures has a recurring effect on our earnings and reflects aspects of our business that are not taken into account by this measure.

*Unrealized Gains/Losses on Energy Derivatives.* We use derivative instruments to manage operational or market constraints and to execute our retail energy segment's supply procurement strategy. We are required to record in our consolidated statement of operations non-cash gains/losses related to future periods based on current changes in forward commodity prices for derivative instruments receiving mark-to-market accounting treatment. We refer to these gains and losses prior to settlement, as well as ineffectiveness on cash flow hedges, as unrealized gains/losses on energy derivatives. In substantially all cases, the underlying transactions being hedged receive accrual accounting treatment, resulting in a mismatch of accounting treatments. Since the application of mark-to-market accounting has the effect of pulling forward into current periods non-cash gains/losses relating to and reversing in future delivery periods, analysis of results of operations from one period to another can be difficult. We believe that excluding these unrealized gains/losses on energy derivatives provides a more meaningful representation of our economic performance in the reporting period and is therefore useful to us, investors, analysts and others in facilitating the analysis of our results of operations from one period to another.

Our retail energy segment's contribution margin, including unrealized gains/losses on energy derivatives was \$198 million during the three months ended September 30, 2007, compared to \$(42) million in the same period of 2006. The \$240 million increase was primarily due to the net change in unrealized gains/losses on energy derivatives of \$330 million, partially offset by a \$101 million decrease in retail gross margin. See Retail Energy Margins below for explanations.



*Retail Energy Operational Data.*

|   | Three Months Ended September 30, |        |
|---|----------------------------------|--------|
|   | 2007                             | 2006   |
|   | (gigawatt hours)                 |        |
| <b>Electricity Sales to End-Use Retail Customers:</b> |                                  |        |
| Mass:   |                                  |        |
| Residential:  |                                  |        |
| Houston   | 4,740                            | 5,403  |
| Non-Houston   | 2,774                            | 2,680  |
| Small Business:                                       |                                  |        |
| Houston   | 926                              | 1,116  |
| Non-Houston   | 467                              | 463    |
| Total Mass  | 8,907                            | 9,662  |
| Commercial and Industrial:                            |                                  |        |
| ERCOT(1)(2)   | 10,491                           | 9,283  |
| Non-ERCOT   | 1,364                            | 1,334  |
| Total Commercial and Industrial                       | 11,855                           | 10,617 |
| Market usage adjustments(3)                           | 12                               | (115)  |
| Total   | 20,774                           | 20,164 |

(1) These volumes include customers of the Texas General Land Office for whom we provide services.

(2) ERCOT is the Electric Reliability Council of Texas.

(3) The revenues and the related energy supply costs in our retail energy segment include our estimates of customer usage based on initial usage information provided by the independent system operators and the distribution companies. We revise these estimates and record any changes in the period as additional settlement information becomes available (collectively referred to as market usage adjustments). These amounts represent the adjustments to volumes for market usage adjustments. See footnote (3) under Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006 Retail Energy Margins.

|  | Three Months Ended September 30,  |       |
|--|-----------------------------------|-------|
|  | 2007                              | 2006  |
|  | (in thousands, metered locations) |       |
| <b>Weighted Average Retail Customer Count:</b> |                                   |       |
| Mass:  |                                   |       |
| Residential:                                   |                                   |       |
| Houston  | 1,052                             | 1,147 |
| Non-Houston                                    | 571                               | 516   |
| Small Business:                                |                                   |       |
| Houston  | 115                               | 131   |
| Non-Houston                                    | 37                                | 29    |
| Total Mass                                     | 1,775                             | 1,823 |
| Commercial and Industrial:                     |                                   |       |
| ERCOT(1)                                       | 89                                | 75    |
| Non-ERCOT                                      | 2                                 | 1     |
| Total Commercial and Industrial                | 91                                | 76    |
| Total  | 1,866                             | 1,899 |

(1) Includes customers of the Texas General Land Office for whom we provide services.



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|                                 | September 30, 2007                | December 31, 2006 |
|---------------------------------|-----------------------------------|-------------------|
|                                 | (in thousands, metered locations) |                   |
| <b>Retail Customers:</b>        |                                   |                   |
| Mass:                           |                                   |                   |
| Residential:                    |                                   |                   |
| Houston                         | 1,038                             | 1,095             |
| Non-Houston                     | 567                               | 547               |
| Small Business:                 |                                   |                   |
| Houston                         | 114                               | 124               |
| Non-Houston                     | 37                                | 33                |
| Total Mass                      | 1,756                             | 1,799             |
| Commercial and Industrial:      |                                   |                   |
| ERCOT(1)                        | 90                                | 75                |
| Non-ERCOT                       | 2                                 | 1                 |
| Total Commercial and Industrial | 92                                | 76                |
| Total                           | 1,848                             | 1,875             |

(1) Includes customers of the Texas General Land Office for whom we provide services.

*Retail Energy Revenues.*

|   | 2007     | Three Months Ended September 30,<br>2006 |    | Change   |
|---|----------|--|----|----------|
|   |          | (in millions)                            |    |          |
| Retail energy revenues from end-use retail customers:                               |          |  |    |          |
| Mass:   |          |  |    |          |
| Residential:  |          |  |    |          |
| Houston   | \$ 722   | \$ 863                                   | \$ | (141)(1) |
| Non-Houston   | 396      | 390                                      |    | 6        |
| Small Business:   |          |  |    |          |
| Houston   | 151      | 207                                      |    | (56)(2)  |
| Non-Houston   | 64       | 61                                       |    | 3        |
| Total Mass  | 1,333    | 1,521                                    |    | (188)    |
| Commercial and Industrial:  |          |  |    |          |
| ERCOT   | 941      | 833                                      |    | 108(3)   |
| Non-ERCOT   | 119      | 95                                       |    | 24(4)    |
| Total Commercial and Industrial   | 1,060    | 928                                      |    | 132      |
| Total   | 2,393    | 2,449                                    |    | (56)     |
| Retail energy revenues from resales of purchased power and other hedging activities |          |  |    |          |
|   | 212      | 148                                      |    | 64(5)    |
| Market usage adjustments  | 3        | (29)                                     |    | 32       |
| Unrealized gains on energy derivatives  |          | 3  |    | (3)      |
| Total retail energy revenues  | \$ 2,608 | \$ 2,571                                 | \$ | 37       |

(1) Decrease primarily due to (a) lower volumes driven by (i) fewer number of customers and (ii) a decrease in average customer usage due in part to milder weather and (b) lower unit sales prices.

(2) Decrease primarily due to (a) lower volumes driven by (i) fewer number of customers and (ii) lower average usage per customer and (b) lower unit sales prices.

(3) Increase primarily due to increased volumes due to increased number of customers, partially offset by a change in customer usage and mix.



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- (4) Increase primarily due to (a) increased number of customers and (b) higher unit sales prices. These increases were partially offset by a change in customer usage and mix.
- (5) Increase primarily due to our supply management activities in various markets in Texas.









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*Retail Energy Cost of Sales.*

|   | 2007     | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change   |
|---|----------|---|----|----------|
| Cost of sales                           | \$ 2,143 | \$ 1,986  | \$ | 157      |
| Retail energy intersegments costs       | 117      | 162   |    | (45)     |
| Subtotal                                | 2,260    | 2,148   |    | 112(1)   |
| Market usage adjustments                | 13       | (16)  |    | 29       |
| Unrealized losses on energy derivatives | 8        | 341   |    | (333)(2) |
| Total retail energy cost of sales       | \$ 2,281 | \$ 2,473  | \$ | (192)    |

(1) Increase primarily due to (a) higher costs of purchased power at the time of procurement and (b) higher volumes due to change in customer usage and mix.

(2) See footnote (5) under Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006 Retail Energy Margins.

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### *Retail Energy Margins.*

|   | 2007   | Three Months Ended September 30,<br>2006<br>(in millions) |         | Change |
|---|--------|---|---------|--------|
| Mass gross margin   | \$ 244 | \$ 315  | \$ (71) | (1)    |
| Commercial and industrial gross margin  | 101    | 134   | (33)    | (2)    |
| Market usage adjustments(3)   | (10)   | (13)  | 3       |        |
| Retail gross margin(4)  | 335    | 436   | (101)   |        |
| Operation and maintenance   | (65)   | (68)  | 3       |        |
| Selling and marketing expense   | (34)   | (38)  | 4       |        |
| Bad debt expense  | (30)   | (34)  | 4       |        |
| Retail contribution margin  | 206    | 296   | (90)    |        |
| Unrealized losses on energy derivatives   | (8)    | (338)   | 330     | (5)    |
| Total retail energy contribution margin, including unrealized gains/losses on energy derivatives(6) | \$ 198 | \$ (42)   | \$ 240  |        |

(1) Decrease primarily due to (a) lower unit margins (lower sales prices partially offset by lower costs of purchased power at the time of procurement) and (b) lower volumes driven by (i) a decrease in average customer usage due in part to milder weather and (ii) fewer number of customers.

(2) Decrease primarily due to lower unit margins (higher costs of purchased power at the time of procurement, partially offset by higher unit sales prices).

(3) The revenues and the related energy supply costs in our retail energy segment include our estimates of customer usage based on initial usage information provided by the independent system operators and the distribution companies. We revise these estimates and record any changes in the period as additional settlement information becomes available (collectively referred to as market usage adjustments).

(4) Previously titled Adjusted retail gross margin.

(5) Increase primarily due to (a) \$273 million gain due to changes in prices on our derivatives marked to market and (b) \$56 million of increased gains on energy derivatives which settled during the period.

(6) Retail energy segment profit and loss measure.

### *Wholesale Energy Segment.*

In analyzing the results of our wholesale energy segment, we use the non-GAAP financial measures open energy gross margin, open wholesale gross margin and open wholesale contribution margin, which exclude the items described below, as well as our wholesale energy segment profit and loss measure, contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives. Open energy gross margin, open wholesale gross margin and open wholesale contribution margin should not be relied upon to the exclusion of GAAP financial measures. The items that are excluded from these non-GAAP financial measures have or have had a recurring effect on our earnings and reflect aspects of our business that are not taken into account by these measures.

*Historical and Operational Wholesale Hedges.* We exclude the effect of certain historical, although recurring until the contracts terminate, wholesale hedges that were entered into in order to hedge the economics of a portion of our wholesale operations. These amounts primarily relate to settlements of forward power hedges, long-term tolling

purchases, long-term natural gas transportation contracts not serving our generation assets and our legacy energy trading. We also exclude the effect of certain on-going operational wholesale hedges that were entered into primarily to mitigate certain operational risks at our generation assets. These amounts primarily relate to settlements of fuel hedges, long-term natural gas transportation contracts and storage contracts. Operational wholesale hedges are derived based on methodology consistent with the calculation of open energy gross margin. We believe that it is useful to us, investors, analysts and others to show our results in the absence of both historical and operational hedges. The impact of these hedges on our financial results is not a function of the operating performance of our generation assets and excluding the impact better reflects the operating performance of our generation assets based on prevailing market conditions.

*Unrealized Gains/Losses on Energy Derivatives.* We use derivative instruments to manage operational or market constraints and to increase the return on our generation assets. We are required to record in our consolidated statement of operations non-cash gains/losses related to future periods based on current changes in forward commodity prices for derivative instruments receiving mark-to-market accounting treatment. We refer to these gains and losses prior to settlement, as well as ineffectiveness on cash flow hedges, as unrealized gains/losses on energy derivatives. In some cases, the underlying transactions being hedged receive accrual accounting treatment, resulting in a mismatch of accounting treatments. Since the application of mark-to-market accounting has the effect of pulling forward into current periods non-cash gains/losses relating to and reversing in future delivery periods, analysis of results of operations from one period to another can be difficult. We believe that excluding these unrealized gains/losses on energy derivatives provides a more meaningful representation of our economic performance in the reporting period and is therefore useful to us, investors, analysts and others in facilitating the analysis of our results of operations from one period to another. These gains/losses are also not a function of the operating performance of our generation assets, and excluding their impact helps isolate the operating performance of our generation assets under prevailing market conditions.

Our wholesale energy segment's contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives was \$235 million during the three months ended September 30, 2007 compared to \$65 million in the same period of 2006. The \$170 million increase was primarily due to (a) a reduced negative effect of historical and operational wholesale hedges of \$109 million and (b) \$55 million increase in open wholesale gross margin. See Wholesale Energy Margins below for explanations.



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Wholesale Energy Operational and Financial Data.

|  | Three Months Ended September 30, |                           |          |                           |
|--|----------------------------------|---------------------------|----------|---------------------------|
|  | 2007                             |                           | 2006     |                           |
|  | GWh                              | % Economic <sup>(1)</sup> | GWh      | % Economic <sup>(1)</sup> |
| <b>Economic Generation<sup>(2):</sup></b>              |                                  |                           |          |                           |
| PJM Coal   | 5,973.6                          | 82%                       | 5,930.6  | 81%                       |
| MISO Coal  | 1,941.8                          | 70%                       | 1,677.8  | 61%                       |
| PJM/MISO Gas   | 777.2                            | 11%                       | 662.8    | 9%                        |
| West <sup>(3)</sup>                                    | 2,303.5                          | 33%                       | 1,341.0  | 24%                       |
| Other <sup>(3)</sup>                                   | 1,021.5                          | 38%                       | 1,481.6  | 87%                       |
| Total  | 12,017.6                         | 45%                       | 11,093.8 | 45%                       |
| <b>Commercial Capacity Factor<sup>(4):</sup></b>       |                                  |                           |          |                           |
| PJM Coal   | 89.5%                            |                           | 87.2%    |                           |
| MISO Coal  | 85.7%                            |                           | 85.3%    |                           |
| PJM/MISO Gas   | 92.8%                            |                           | 97.1%    |                           |
| West   | 96.7%                            |                           | 73.8%    |                           |
| Other  | 93.1%                            |                           | 99.5%    |                           |
| Total  | 90.8%                            |                           | 87.5%    |                           |
| <b>Generation<sup>(5):</sup></b>                       |                                  |                           |          |                           |
| PJM Coal   | 5,345.4                          |                           | 5,171.7  |                           |
| MISO Coal  | 1,664.1                          |                           | 1,431.5  |                           |
| PJM/MISO Gas   | 721.0                            |                           | 643.7    |                           |
| West   | 2,228.2                          |                           | 990.2    |                           |
| Other  | 951.3                            |                           | 1,474.1  |                           |
| Total  | 10,910.0                         |                           | 9,711.2  |                           |
| <b>Open Energy Unit Margin (\$/MWh)<sup>(6):</sup></b> |                                  |                           |          |                           |
| PJM Coal   | \$ 31.05                         |                           | \$ 32.48 |                           |
| MISO Coal  | 29.45                            |                           | 27.94    |                           |
| PJM/MISO Gas   | 38.83                            |                           | 52.82    |                           |
| West   | 12.57                            |                           | 17.17    |                           |
| Other  | 9.46                             |                           | 3.39     |                           |
| Total weighted average                                 | \$ 25.66                         |                           | \$ 27.19 |                           |

(1) Represents economic generation (hours) divided by maximum generation hours (maximum plant capacity x 8,760 hours).

(2) Estimated generation at 100% plant availability based on an hourly analysis of when it is economical to generate based on the price of power, fuel, emission allowances and variable operating costs.

(3) Includes maximum generation hours from certain units in 2007 that were excluded in 2006 because a purchase power agreement was in place during that period.

(4) Generation divided by economic generation.

(5) Excludes generation related to power purchase agreements, including tolling agreements.

(6) Represents open energy gross margin divided by generation.



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*Wholesale Energy Revenues.*

|  | 2007     | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change  |
|--|----------|---|----|---------|
| Wholesale energy third-party revenues  | \$ 889   | \$ 751  | \$ | 138(1)  |
| Wholesale energy intersegment revenues | 117      | 162   |    | (45)(2) |
| Subtotal                               | 1,006    | 913   |    | 93      |
| Revenues affiliates                    | 40       |   |    | 40(3)   |
| Unrealized gains (losses)              | 7        | (17)  |    | 24(4)   |
| Total wholesale energy revenues        | \$ 1,053 | \$ 896  | \$ | 157     |

(1) Increase primarily due to (a) increased power sales volumes and (b) higher power sales prices. These increases were partially offset by decreased natural gas sales volumes.

(2) Decrease primarily due to lower power sales volumes, partially offset by higher power sales prices.

(3) We deconsolidated Channelview on August 20, 2007. These revenues represent sales of fuel to Channelview. See notes 1(b) and 13 to our interim financial statements.

(4) See footnote (12) under Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006 Wholesale Energy Margins.



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Wholesale Energy Cost of Sales.

|   | 2007          | Three Months Ended September 30,<br>2006 |           | Change     |
|---|---------------|--|-----------|------------|
|   |               | (in millions)                            |           |            |
| Wholesale energy third-party costs          | \$ 610        | \$ 679                                   | \$        | (69)(1)    |
| Cost of sales affiliates                    | 38            |  |           | 38(2)      |
| Unrealized losses                           | 27            |  |           | 27(3)      |
| <u>Total wholesale energy cost of sales</u> | <u>\$ 675</u> | <u>\$ 679</u>                            | <u>\$</u> | <u>(4)</u> |

- (1) Decrease primarily due to (a) lower purchased natural gas volumes, (b) lower purchased capacity, (c) lower prices paid for natural gas and (d) lower purchased power volumes. These decreases were partially offset by increased purchases of coal volumes.
- (2) We deconsolidated Channelview on August 20, 2007. These cost of sales represent purchases of power from Channelview. See notes 1(b) and 13 to our interim financial statements.
- (3) See footnote (12) under Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006 Wholesale Energy Margins.

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Wholesale Energy Margins.

|  | 2007          | Three Months Ended September 30,<br>2006<br>(in millions) |            | Change        |
|--|---------------|---|------------|---------------|
| <b>Open energy gross margin(1):</b>  |               |   |            |               |
| PJM Coal   | \$ 166        | \$  | 168        | \$ (2)(2)     |
| MISO Coal  | 49            |   | 40         | 9(3)          |
| PJM/MISO Gas   | 28            |   | 34         | (6)(4)        |
| West   | 28            |   | 17         | 11(5)         |
| Other  | 9             |   | 5          | 4             |
| <b>Total</b>   | <b>280</b>    |   | <b>264</b> | <b>16</b>     |
| <b>Other margin(6):</b>  |               |   |            |               |
| PJM Coal   | 20            |   | 9          | 11(7)         |
| MISO Coal  | 6             |   | 4          | 2             |
| PJM/MISO Gas   | 43            |   | 16         | 27(7)         |
| West   | 48            |   | 39         | 9(8)          |
| Other  | 18            |   | 28         | (10)(9)       |
| <b>Total</b>   | <b>135</b>    |   | <b>96</b>  | <b>39</b>     |
| <b>Open wholesale gross margin</b>   | <b>415</b>    |   | <b>360</b> | <b>55</b>     |
| Operation and maintenance  | (144)         |   | (151)      | 7(10)         |
| Bad debt expense   | 1             |   | (1)        | 2             |
| Open wholesale contribution margin   | 272           |   | 208        | 64            |
| Historical and operational wholesale hedges  | (17)          |   | (126)      | 109(11)       |
| Unrealized losses on energy derivatives  | (20)          |   | (17)       | (3)(12)       |
| <b>Total wholesale energy contribution margin,<br/>including historical and operational wholesale<br/>hedges and unrealized gains/losses on energy derivatives(13)</b> | <b>\$ 235</b> | <b>\$</b>   | <b>65</b>  | <b>\$ 170</b> |

(1) Open energy gross margin is calculated using the power sales prices received by the plants less delivered spot fuel prices. This figure excludes the effects of other margin and our historical and operational wholesale hedges.

(2) Decrease primarily due to lower open energy unit margins (higher fuel costs partially offset by higher power prices). This decrease was partially offset by higher commercial capacity factor due to lower unplanned outages in 2007.

(3) Increase primarily due to (a) higher economic generation and (b) higher open energy unit margins (higher power prices).

(4) Decrease primarily due to lower open energy unit margins (lower power prices). This decrease was partially offset by higher economic generation.

(5) Increase primarily due to higher economic generation related to increased merchant activity in 2007. This increase was partially offset by lower open energy unit margins (lower power prices partially offset by lower fuel costs).

(6) Other margin represents power purchase agreements, capacity payments, ancillary revenues and selective commercial hedge strategies.

(7) Increase primarily due to RPM capacity payments.

(8) Increase primarily due to (a) selective commercial hedge activities and (b) higher capacity payments. These increases were partially offset by lower revenue from power purchase agreements.

(9) Decrease primarily due to (a) lower revenue from capacity payments and (b) the deconsolidation of Channelview on August 20, 2007. See notes 1(b) and 13 to our interim financial statements.

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- (10) Decrease primarily due to \$16 million decrease in planned outages and maintenance spending. This decrease was partially offset by \$10 million increase in services and support primarily due to strategic initiatives for improving plant performance (\$7 million).
- (11) Increase primarily due to (a) \$56 million of decreases in losses on closed power hedges and (b) \$46 million in higher margins on natural gas transportation and storage contracts.
- (12) Decrease primarily due to \$30 million loss due to changes in prices on our derivatives marked to market. This loss was partially offset by \$23 million gain on energy derivatives which settled during the period.
- (13) Wholesale energy segment profit and loss measure.

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*Other General and Administrative.*

|  | 2007  | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change |
|--|-------|---|----|--------|
| Salaries and benefits  | \$ 17 | \$ 24   | \$ | (7)(1) |
| Professional fees, contract services and information systems maintenance | 8     | 8   |    |        |
| Rent and utilities   | 5     | 5   |    |        |
| Legal costs  | 2     | 4   |    | (2)    |
| Costs in connection with Channelview's reorganization                    | 2     |   |    | 2      |
| Other, net   | 2     | 3   |    | (1)    |
| Other general and administrative   | \$ 36 | \$ 44   | \$ | (8)    |

(1) Decrease primarily due to the Key Employee Award Program.

*Western States and Similar Settlements.* See note 10(a) to our interim financial statements.

*Gains on Sales of Assets and Emission Allowances, Net.*

|   | 2007  | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change |
|---|-------|---|----|--------|
| Equipment   | \$ 18 | \$  | \$ | 18     |
| Emission allowances                                   | (1)   | 3   |    | (4)    |
| Gains on sales of assets and emission allowances, net | \$ 17 | \$ 3  | \$ | 14     |

*Depreciation and Amortization.*

|                                     | 2007   | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change |
|-------------------------------------|--------|---|----|--------|
| Depreciation on plants              | \$ 60  | \$ 61   | \$ | (1)    |
| Depreciation on information systems | 9      | 13  |    | (4)    |
| Other, net depreciation             | 2      | 1   |    | 1      |
| Depreciation                        | 71     | 75  |    | (4)    |
| Amortization of emission allowances | 50     | 32  |    | 18(1)  |
| Other, net amortization             | 1      | 1   |    |        |
| Amortization                        | 51     | 33  |    | 18     |
| Depreciation and amortization       | \$ 122 | \$ 108  | \$ | 14     |

(1) Increase primarily due to higher average cost of SO<sub>2</sub> allowances purchased and used.

*Income of Equity Investment, Net.*

|  | 2007 | Three Months Ended September 30,<br>2006<br>(in millions) |  | Change |
|--|------|---|--|--------|
|--|------|---|--|--------|



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|                                  |    |   |    |   |    |     |
|----------------------------------|----|---|----|---|----|-----|
| Sabine Cogen, LP                 | \$ | 1 | \$ | 2 | \$ | (1) |
| Income of equity investment, net | \$ | 1 | \$ | 2 | \$ | (1) |

*Debt Extinguishments.* See note 6(b) to our interim financial statements.

*Other, Net.* Other, net did not change significantly.

*Interest Expense.*

|  | 2007  | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change  |
|--|-------|---|----|---------|
| Fixed-rate debt  | \$ 59 | \$ 62   | \$ | (3)     |
| Fees for MWh s delivered under credit-enhanced retail structure(1) | 8     |   |    | 8       |
| Financing fees expensed  | 4     | 6   |    | (2)     |
| Channelview  | 3     | 7   |    | (4)(2)  |
| Variable-rate debt   |       | 21  |    | (21)(3) |
| Deferred financing costs   | 3     | 4   |    | (1)     |
| Unrealized losses on derivatives                                   |       | 3   |    | (3)     |
| Capitalized interest   | (1)   |   |    | (1)     |
| Amortization of fair value adjustment of acquired debt             | (1)   | (3)   |    | 2       |
| Other, net   | (1)   | 1   |    | (2)     |
| Interest expense   | \$ 74 | \$ 101  | \$ | (27)    |

(1) See note 7 to our consolidated financial statements in our Form 10-K.

(2) Decrease primarily due to the deconsolidation of Channelview on August 20, 2007. See notes 1(b) and 13 to our interim financial statements.

(3) Decrease primarily due to decrease in balances.

*Interest Income.*

|  | 2007 | Three Months Ended September 30,<br>2006<br>(in millions) |    | Change |
|--|------|---|----|--------|
| Interest on temporary cash investments | \$ 4 | \$ 1  | \$ | 3      |
| Net margin deposits                    | 2    | 6   |    | (4)    |
| Interest income                        | \$ 6 | \$ 7  | \$ | (1)    |

*Income Tax Expense (Benefit).* See note 8 to our interim financial statements.

*Income (Loss) from Discontinued Operations.* See note 13 to our interim financial statements.

**Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006**

We reported \$138 million consolidated net income, or \$0.39 earnings per diluted share, for the nine months ended September 30, 2007 compared to \$274 million consolidated net loss, or \$0.89 loss per share, for the same period in 2006.

|   | 2007   | Nine Months Ended September 30,<br>2006<br>(in millions) | Change |
|---|--------|--|--------|
| Retail energy contribution margin, including unrealized gains/losses on energy derivatives  | \$ 648 | \$ 133   | \$ 515 |
| Wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | 315    | 130  | 185    |
| Other contribution margin   |        | 1  | (1)    |
| Other general and administrative  | (131)  | (119)  | (12)   |
| Western states and similar settlements  | (22)   | (35)   | 13     |
| Gains on sales of assets and emission allowances, net   | 19     | 159  | (140)  |
| Depreciation and amortization   | (324)  | (280)  | (44)   |
| Income of equity investment, net  | 4      | 4  |        |
| Debt extinguishments  | (72)   |  | (72)   |
| Other, net  | 2      |  | 2      |
| Interest expense  | (283)  | (312)  | 29     |
| Interest income   | 24     | 23   | 1      |
| Income tax expense  | (41)   | 26   | (67)   |
| Income (loss) from continuing operations  | 139    | (270)  | 409    |
| Loss from discontinued operations   | (1)    | (5)  | 4      |
| Cumulative effect of accounting change, net of tax  |        | 1  | (1)    |
| Net income (loss)   | \$ 138 | \$ (274)   | \$ 412 |

**Retail Energy Segment.**

Our retail energy segment's contribution margin, including unrealized gains/losses on energy derivatives was \$648 million during the nine months ended September 30, 2007, compared to \$133 million in the same period of 2006. The \$515 million increase was primarily due to the net change in unrealized gains/losses on energy derivatives of \$616 million, partially offset by a \$92 million decrease in retail gross margin. See Retail Energy Margins below for explanations.

*Retail Energy Operational Data.*

|   | Nine Months Ended September 30, |        |
|---|---------------------------------|--------|
|   | 2007                            | 2006   |
|   | (gigawatt hours)                |        |
| <b>Electricity Sales to End-Use Retail Customers:</b> |                                 |        |
| Mass:   |                                 |        |
| Residential:  |                                 |        |
| Houston   | 10,848                          | 12,635 |
| Non-Houston   | 6,622                           | 6,206  |
| Small Business:                                       |                                 |        |
| Houston   | 2,421                           | 2,888  |
| Non-Houston   | 1,127                           | 1,093  |
| Total Mass  | 21,018                          | 22,822 |
| Commercial and Industrial:                            |                                 |        |
| ERCOT(1)  | 27,601                          | 25,415 |
| Non-ERCOT   | 3,472                           | 4,488  |
| Total Commercial and Industrial                       | 31,073                          | 29,903 |
| Market usage adjustments                              | (68)                            | 12     |
| Total   | 52,023                          | 52,737 |

(1) These volumes include customers of the Texas General Land Office for whom we provide services.

|  | Nine Months Ended September 30,   |       |
|--|-----------------------------------|-------|
|  | 2007                              | 2006  |
|  | (in thousands, metered locations) |       |
| <b>Weighted Average Retail Customer Count:</b> |                                   |       |
| Mass:  |                                   |       |
| Residential:                                   |                                   |       |
| Houston  | 1,067                             | 1,184 |
| Non-Houston                                    | 564                               | 492   |
| Small Business:                                |                                   |       |
| Houston  | 117                               | 133   |
| Non-Houston                                    | 35                                | 28    |
| Total Mass                                     | 1,783                             | 1,837 |
| Commercial and Industrial:                     |                                   |       |
| ERCOT(1)                                       | 86                                | 75    |
| Non-ERCOT                                      | 2                                 | 1     |
| Total Commercial and Industrial                | 88                                | 76    |
| Total  | 1,871                             | 1,913 |

(1) Includes customers of the Texas General Land Office for whom we provide services.

*Retail Energy Revenues.*

|  | 2007     | Nine Months Ended September 30,<br>2006<br>(in millions) |    | Change   |
|--|----------|--|----|----------|
| Retail energy revenues from end-use retail customers:                                  |          |  |    |          |
| Mass:  |          |  |    |          |
| Residential:   |          |  |    |          |
| Houston  | \$ 1,658 | \$ 2,020   | \$ | (362)(1) |
| Non-Houston  | 932      | 866  |    | 66(2)    |
| Small Business:  |          |  |    |          |
| Houston  | 397      | 486  |    | (89)(3)  |
| Non-Houston  | 157      | 148  |    | 9        |
| Total Mass   | 3,144    | 3,520  |    | (376)    |
| Commercial and Industrial:   |          |  |    |          |
| ERCOT  | 2,489    | 2,288  |    | 201(4)   |
| Non-ERCOT  | 273      | 306  |    | (33)(5)  |
| Total Commercial and Industrial  | 2,762    | 2,594  |    | 168      |
| Total  | 5,906    | 6,114  |    | (208)    |
| Retail energy revenues from resales of purchased power and other<br>hedging activities |          |  |    |          |
|  | 401      | 353  |    | 48(6)    |
| Market usage adjustments   | (4)      | 8  |    | (12)     |
| Total retail energy revenues   | \$ 6,303 | \$ 6,475   | \$ | (172)    |

(1) Decrease primarily due to (a) lower volumes driven by (i) fewer number of customers and (ii) a decrease in average customer usage due in part to milder weather and (b) lower unit sales prices.

(2) Increase primarily due to increased volumes due to increased number of customers, partially offset by a decrease in average customer usage due in part to milder weather.

(3) Decrease primarily due to lower volumes primarily driven by (a) fewer number of customers and (b) lower average usage per customer.

(4) Increase primarily due to increased volumes due to increased number of customers, partially offset by a change in customer usage and mix.

(5) Decrease primarily due to lower volumes due to change in customer mix, partially offset by higher unit sales prices.

(6) Increase primarily due to our supply management activities in various markets in Texas.

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*Retail Energy Cost of Sales.*

|   | 2007     | Nine Months Ended September 30,<br>2006<br>(in millions) |          | Change |
|---|----------|--|----------|--------|
| Cost of sales                                   | \$ 5,204 | \$ 5,179   | \$ 25    |        |
| Retail energy intersegments costs               | 345      | 448  | (103)    |        |
| Subtotal  | 5,549    | 5,627  | (78)     | (1)    |
| Market usage adjustments                        | 6        | 8  | (2)      |        |
| Unrealized (gains) losses on energy derivatives | (248)    | 368  | (616)    | (2)    |
| Total retail energy cost of sales               | \$ 5,307 | \$ 6,003   | \$ (696) |        |

(1) Decrease primarily due to lower volumes due to change in customer usage and mix, partially offset by higher unit prices of purchased power at the time of procurement.

(2) See footnote (4) under Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006 Retail Energy Margins.

*Retail Energy Margins.*

|  | 2007   | Nine Months Ended September 30,<br>2006<br>(in millions) |    | Change  |
|--|--------|--|----|---------|
| Mass gross margin  | \$ 595 | \$ 606   | \$ | (11)(1) |
| Commercial and industrial gross margin   | 163    | 234  |    | (71)(2) |
| Market usage adjustments   | (10)   |  |    | (10)    |
| Retail gross margin  | 748    | 840  |    | (92)    |
| Operation and maintenance  | (186)  | (177)  |    | (9)(3)  |
| Selling and marketing expense  | (94)   | (92)   |    | (2)     |
| Bad debt expense   | (68)   | (70)   |    | 2       |
| Retail contribution margin   | 400    | 501  |    | (101)   |
| Unrealized gains (losses) on energy derivatives  | 248    | (368)  |    | 616(4)  |
| Total retail energy contribution margin, including unrealized gains/losses on energy derivatives | \$ 648 | \$ 133   | \$ | 515     |

(1) Decrease primarily due to lower volumes driven by (a) decrease in average customer usage due in part to milder weather and (b) fewer number of customers. These decreases were partially offset by higher unit margins (lower costs of purchased power at the time of procurement, partially offset by lower unit sales prices).

(2) Decrease primarily due to lower unit margins (higher costs of purchased power at the time of procurement, partially offset by higher unit sales prices).

(3) Increase primarily due to \$17 million from increases in salaries, contract services and professional fees, partially offset by \$6 million from decreases in gross receipts taxes.

(4) Increase primarily due to (a) \$178 million of increased gains on energy derivatives which settled during the period, (b) \$71 million of decreased losses from cash flow hedge ineffectiveness, (c) \$289 million of decreased losses due to changes in prices on our derivatives marked to market and (d) \$51 million of decreased losses resulting from the termination of commodity contracts with a counterparty.

*Wholesale Energy Segment.*

Our wholesale energy segment's contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives was \$315 million during the nine months ended September 30, 2007 compared to \$130 million in the same period of 2006. The \$185 million increase was primarily due to (a) a reduced negative effect of historical and operational wholesale hedges of \$255 million and (b) \$129 million increase in open wholesale gross margin. These increases were partially offset by (a) net change in unrealized gains/losses on energy derivatives of \$168 million and (b) \$31 million increase in operation and maintenance expenses. See Wholesale Energy Margins below for explanations.

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Wholesale Energy Operational and Financial Data.

|  | Nine Months Ended September 30, |            |          |            |
|--|---------------------------------|------------|----------|------------|
|  | 2007                            |            | 2006     |            |
|  | GWh                             | % Economic | GWh      | % Economic |
| <b>Economic Generation:</b>              |                                 |            |          |            |
| PJM Coal                                 | 18,100.9                        | 83%        | 17,622.9 | 81%        |
| MISO Coal                                | 6,186.5                         | 75%        | 4,718.1  | 57%        |
| PJM/MISO Gas                             | 1,194.5                         | 6%         | 950.1    | 4%         |
| West(1)                                  | 3,211.0                         | 16%        | 2,611.9  | 13%        |
| Other(1)                                 | 3,771.7                         | 55%        | 4,356.0  | 88%        |
| Total                                    | 32,464.6                        | 41%        | 30,259.0 | 40%        |
| <b>Commercial Capacity Factor:</b>       |                                 |            |          |            |
| PJM Coal                                 | 81.5%                           |            | 81.3%    |            |
| MISO Coal                                | 65.6%                           |            | 84.9%    |            |
| PJM/MISO Gas                             | 89.8%                           |            | 92.3%    |            |
| West                                     | 96.3%                           |            | 84.9%    |            |
| Other                                    | 91.8%                           |            | 92.5%    |            |
| Total                                    | 81.4%                           |            | 84.1%    |            |
| <b>Generation:</b>                       |                                 |            |          |            |
| PJM Coal                                 | 14,752.9                        |            | 14,330.3 |            |
| MISO Coal                                | 4,059.1                         |            | 4,005.2  |            |
| PJM/MISO Gas                             | 1,072.9                         |            | 877.3    |            |
| West                                     | 3,091.9                         |            | 2,218.1  |            |
| Other                                    | 3,464.0                         |            | 4,027.6  |            |
| Total                                    | 26,440.8                        |            | 25,458.5 |            |
| <b>Open Energy Unit Margin (\$/MWh):</b> |                                 |            |          |            |
| PJM Coal                                 | \$ 31.45                        |            | \$ 28.96 |            |
| MISO Coal                                | 29.07                           |            | 23.72    |            |
| PJM/MISO Gas                             | 35.42                           |            | 49.01    |            |
| West                                     | 7.76                            |            | 6.76     |            |
| Other                                    | 6.64                            |            | 0.99     |            |
| Total weighted average                   | \$ 25.23                        |            | \$ 22.47 |            |

(1) Includes maximum generation hours from certain units in 2007 that were excluded in 2006 because a purchase power agreement was in place during that period.

Wholesale Energy Revenues.

|  | Nine Months Ended September 30, |               |    |          |
|--|---------------------------------|---------------|----|----------|
|  | 2007                            | 2006          |    | Change   |
|  |                                 | (in millions) |    |          |
| Wholesale energy third-party revenues  | \$ 2,202                        | \$ 1,869      | \$ | 333(1)   |
| Wholesale energy intersegment revenues | 345                             | 448           |    | (103)(2) |
| Subtotal                               | 2,547                           | 2,317         |    | 230      |
| Revenues affiliates                    | 40                              |               |    | 40(3)    |
| Unrealized gains                       | 11                              | 188           |    | (177)(4) |
| Total wholesale energy revenues        | \$ 2,598                        | \$ 2,505      | \$ | 93       |



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- (1) Increase primarily due to (a) higher power sales prices and (b) increased power sales volumes. These increases were partially offset by lower natural gas sales volumes.
- (2) Decrease primarily due to lower power sales volumes. This decrease was partially offset by (a) higher power sales prices and (b) increased natural gas sales volumes and prices related to a tolling agreement.
- (3) We deconsolidated Channelview on August 20, 2007. These revenues represent sales of fuel to Channelview. See notes 1(b) and 13 to our interim financial statements.
- (4) See footnote (12) under Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006 Wholesale Energy Margins.









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*Wholesale Energy Cost of Sales.*

|   | 2007            | Nine Months Ended September 30,<br>2006<br>(in millions) |           | Change       |
|---|-----------------|--|-----------|--------------|
| Wholesale energy third-party costs          | \$ 1,667        | \$ 1,819   | \$        | (152)(1)     |
| Cost of sales affiliates                    | 38              |  |           | 38(2)        |
| Unrealized losses                           | 91              | 100  |           | (9)(3)       |
| <u>Total wholesale energy cost of sales</u> | <u>\$ 1,796</u> | <u>\$ 1,919</u>  | <u>\$</u> | <u>(123)</u> |

(1) Decrease primarily due to (a) decreased purchased natural gas and power volumes, (b) lower purchased capacity and (c) lower prices paid for natural gas.

(2) We deconsolidated Channelview on August 20, 2007. These cost of sales represent purchases of power from Channelview. See notes 1(b) and 13 to our interim financial statements.

(3) See footnote (12) under Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006 Wholesale Energy Margins.











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Wholesale Energy Margins.

|   | 2007 | Nine Months Ended September 30, |        | Change    |
|---|------|---------------------------------|--------|-----------|
|   |      | 2006                            |        |           |
|   |      | (in millions)                   |        |           |
| <b>Open energy gross margin:</b>  |      |                                 |        |           |
| PJM Coal  | \$   | 464                             | \$ 415 | \$ 49(1)  |
| MISO Coal   |      | 118                             | 95     | 23(2)     |
| PJM/MISO Gas  |      | 38                              | 43     | (5)(3)    |
| West  |      | 24                              | 15     | 9(4)      |
| Other   |      | 23                              | 4      | 19(5)     |
| Total   |      | 667                             | 572    | 95        |
| <b>Other margin:</b>  |      |                                 |        |           |
| PJM Coal  |      | 42                              | 21     | 21(6)     |
| MISO Coal   |      | 11                              | 7      | 4         |
| PJM/MISO Gas  |      | 79                              | 31     | 48(7)     |
| West  |      | 107                             | 122    | (15)(8)   |
| Other   |      | 56                              | 80     | (24)(9)   |
| Total   |      | 295                             | 261    | 34        |
| Open wholesale gross margin   |      | 962                             | 833    | 129       |
| Operation and maintenance   |      | (489)                           | (458)  | (31)(10)  |
| Bad debt expense  |      | 2                               | 2      |           |
| Open wholesale contribution margin  |      | 475                             | 377    | 98        |
| Historical and operational wholesale hedges   |      | (80)                            | (335)  | 255(11)   |
| Unrealized gains (losses) on energy derivatives   |      | (80)                            | 88     | (168)(12) |
| Total wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | \$   | 315                             | \$ 130 | \$ 185    |

- (1) Increase primarily due to (a) higher open energy unit margins (higher power prices partially offset by higher fuel costs) and (b) higher economic generation.
- (2) Increase primarily due to (a) higher economic generation and (b) higher open energy unit margins (higher power prices). These increases were partially offset by lower commercial capacity factor primarily due to higher planned outages in 2007.
- (3) Decrease primarily due to lower open energy unit margins (higher fuel costs partially offset by higher power prices). This decrease was partially offset by higher economic generation.
- (4) Increase primarily due to higher economic generation related to increased merchant activity in 2007.
- (5) Increase primarily due to higher open energy unit margins (higher power prices partially offset by higher fuel costs). This increase was partially offset due to the deconsolidation of Channelview on August 20, 2007. See notes 1(b) and 13 to our interim financial statements.
- (6) Increase primarily due to (a) RPM capacity payments and (b) ancillary services.
- (7) Increase primarily due to (a) RPM capacity payments and (b) a reliability-must-run contract from May 2006 to July 2007.
- (8) Decrease primarily due to (a) fewer selective commercial hedge activities and (b) lower revenue from power purchase agreements. These decreases were partially offset by higher capacity payments.
- (9) Decrease primarily due to (a) lower revenues from capacity payments and (b) the deconsolidation of Channelview on August 20, 2007. See notes 1(b) and 13 to our interim financial statements.
- (10) Increase primarily due to (a) \$18 million increase in planned outages and maintenance spending and (b) \$12 million increase in services and support primarily due to strategic initiatives for improving plant performance (\$9 million).
- (11) Increase primarily due to (a) \$125 million decrease in losses on closed power hedges and (b) \$124 million in higher margins on natural gas transportation and storage contracts.

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(12) Decrease primarily due to (a) \$126 million loss due to changes in prices on our derivatives marked to market and (b) \$53 million reduction in gains on energy derivatives which settled during the period.

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*Other General and Administrative.*

|  | 2007   | Nine Months Ended September 30,<br>2006<br>(in millions) |    | Change |
|--|--------|--|----|--------|
| Salaries and benefits  | \$ 67  | \$ 68  | \$ | (1)    |
| Professional fees, contract services and information systems maintenance | 27     | 21   |    | 6      |
| Rent and utilities   | 16     | 15   |    | 1      |
| Legal costs  | 11     | 8  |    | 3      |
| Costs in connection with Channelview's reorganization                    | 2      |  |    | 2      |
| Other, net   | 8      | 7  |    | 1      |
| Other general and administrative   | \$ 131 | \$ 119   | \$ | 12     |

*Western States and Similar Settlements.* See note 10(a) to our interim financial statements.

*Gains on Sales of Assets and Emission Allowances, Net.*

|   | 2007  | Nine Months Ended September 30,<br>2006<br>(in millions) |    | Change   |
|---|-------|--|----|----------|
| Equipment   | \$ 18 | \$   | \$ | 18       |
| Emission allowances                                   | 1     | 159  |    | (158)(1) |
| Gains on sales of assets and emission allowances, net | \$ 19 | \$ 159   | \$ | (140)    |

(1) See Business Environmental Matters Air Quality and SO<sub>2</sub> Emissions in our Form 10-K.

*Depreciation and Amortization.*

|                                     | 2007   | Nine Months Ended September 30,<br>2006<br>(in millions) |    | Change  |
|-------------------------------------|--------|--|----|---------|
| Depreciation on plants              | \$ 212 | \$ 184   | \$ | 28(1)   |
| Depreciation on information systems | 27     | 38   |    | (11)(2) |
| Other, net depreciation             | 5      | 4  |    | 1       |
| Depreciation                        | 244    | 226  |    | 18      |
| Amortization of emission allowances | 77     | 51   |    | 26(3)   |
| Other, net amortization             | 3      | 3  |    |         |
| Amortization                        | 80     | 54   |    | 26      |
| Depreciation and amortization       | \$ 324 | \$ 280   | \$ | 44      |

(1) Increase primarily due to early retirements of plant components when replacement components are installed (from \$3 million in 2006 to \$27 million in 2007).

(2) Decrease primarily due to information systems assets being fully depreciated.

(3) Increase primarily due to higher average cost of SO<sub>2</sub> allowances purchased and used.

*Income of Equity Investment, Net.*

Recent Events

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|                                  | 2007 | Nine Months Ended September 30,<br>2006<br>(in millions) |      | Change |
|----------------------------------|------|--|------|--------|
| Sabine Cogen, LP                 | \$ 4 | \$ 4   | \$ 4 | \$     |
| Income of equity investment, net | \$ 4 | \$ 4   | \$ 4 | \$     |

*Debt Extinguishments.* See note 6(b) to our interim financial statements.

*Other, Net.* Other, net did not change significantly.

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*Interest Expense.*

|  | 2007   | Nine Months Ended September 30,<br>2006<br>(in millions) |    | Change  |
|--|--------|--|----|---------|
| Fixed-rate debt  | \$ 177 | \$ 187   | \$ | (10)(1) |
| Deferred financing costs   | 48     | 12   |    | 36(2)   |
| Variable-rate debt   | 14     | 72   |    | (58)(3) |
| Fees for MWh s delivered under credit-enhanced retail structure(4) | 20     |  |    | 20      |
| Channelview  | 16     | 19   |    | (3)(5)  |
| Financing fees expensed  | 11     | 18   |    | (7)     |
| Unrealized losses on derivatives                                   | 5      | 8  |    | (3)     |
| Capitalized interest   | (3)    |  |    | (3)     |
| Amortization of fair value adjustment of acquired debt             | (8)    | (7)  |    | (1)     |
| Other, net   | 3      | 3  |    |         |
| Interest expense   | \$ 283 | \$ 312   | \$ | (29)    |

- (1) Decrease primarily due to decrease in balances.
- (2) See note 6(b) to our interim financial statements.
- (3) Decrease primarily due to \$60 million due to decrease in balances, partially offset by \$2 million due to increase in rates.
- (4) See note 7 to our consolidated financial statements in our Form 10-K.
- (5) Decrease primarily due to the deconsolidation of Channelview on August 20, 2007. See notes 1(b) and 13 to our interim financial statements.

*Interest Income.*

|  | 2007  | Nine Months Ended September 30,<br>2006<br>(in millions) |    | Change  |
|--|-------|--|----|---------|
| Interest on temporary cash investments | \$ 17 | \$ 4   | \$ | 13(1)   |
| Net margin deposits                    | 7     | 19   |    | (12)(2) |
| Interest income                        | \$ 24 | \$ 23  | \$ | 1       |

- (1) Increase primarily due to increase in cash and cash equivalents due to (a) the return of net margin deposits as a result of the credit-enhanced retail structure that became effective on December 1, 2006 and (b) cash flow from operations. See note 7 to our consolidated financial statements in our Form 10-K.
- (2) Decrease primarily due to the credit-enhanced retail structure that became effective on December 1, 2006. See note 7 to our consolidated financial statements in our Form 10-K.

*Income Tax Expense (Benefit).* See note 8 to our interim financial statements.

*Loss from Discontinued Operations.* See note 13 to our interim financial statements.

**Liquidity and Capital Resources**

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In June 2007, we refinanced a significant portion of our senior secured debt. See [Business Overview](#), [Recent Events](#) and note 6 to our interim financial statements.

During the nine months ended September 30, 2007, we generated \$332 million in operating cash flows from continuing operations including the changes in margin deposits of \$201 million (cash inflow) and \$57 million in payments relating to the Western states and similar settlements (cash outflow). See [Historical Cash Flows](#) for further detail of our cash flows from operating activities and explanation around our \$140 million use of cash from investing activities and \$256 million use of cash from financing activities.

As of October 31, 2007, we had total available liquidity of \$1.3 billion, comprised of unused borrowing capacity, letters of credit capacity and cash and cash equivalents. Of this amount, \$300 million is only available to our Texas retail business.



See Risk Factors in Item 1A and Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources in Item 7 of our Form 10-K and note 6 to our consolidated financial statements in our Form 10-K.

### Credit Risk

By extending credit to our counterparties, we are exposed to credit risk. As of September 30, 2007, our derivative assets and accounts receivable from our wholesale energy and retail energy power supply counterparties, after taking into consideration netting within each contract and any master netting contracts with counterparties, are:

| Credit Rating Equivalent              | Exposure Before Collateral(1) | Credit Collateral Held | Exposure Net of Collateral (dollars in millions) | Number of Counterparties >10% | Net Exposure of Counterparties >10% |
|---------------------------------------|-------------------------------|------------------------|--|-------------------------------|-------------------------------------|
| Investment grade                      | \$ 215                        | \$ (17)                | \$ 198   | 1                             | \$ 91                               |
| Non-investment grade                  | 254                           | (1)                    | 253  | 2                             | 232                                 |
| No external ratings:                  |                               |                        |  |                               |                                     |
| Internally rated Investment grade     | 46                            |                        | 46   |                               |                                     |
| Internally rated Non-investment grade | 12                            | (3)                    | 9  |                               |                                     |
| Total                                 | \$ 527                        | \$ (21)                | \$ 506   | 3                             | \$ 323                              |

(1) The table excludes amounts related to contracts classified as normal purchase/normal sale and non-derivative contractual commitments that are not recorded in our consolidated balance sheets, except for any related accounts receivable. Such contractual commitments contain credit and economic risk if a counterparty does not perform. Nonperformance could have a material adverse impact on our future results of operations, financial condition and cash flows.

As of September 30, 2007, two non-investment grade counterparties and one investment grade counterparty represented 44% (\$232 million) and 17% (\$91 million), respectively, of our credit exposure. As of December 31, 2006, two non-investment grade counterparties represented 53% (\$359 million) of our credit exposure. As of September 30, 2007 and December 31, 2006, we held no collateral from these counterparties. We have established credit reserves for these non-investment grade counterparties. There were no other counterparties representing greater than 10% of our credit exposure.

### Off-Balance Sheet Arrangements

As of September 30, 2007, we have no off-balance sheet arrangements.

**Historical Cash Flows***Cash Flows Operating Activities*

|  | 2007     | Nine Months Ended September 30,<br>2006<br>(in millions) |        | Change |
|--|----------|--|--------|--------|
| Operating income (loss)  | \$ 505   | \$ (11)  | \$ 516 |        |
| Depreciation and amortization  | 324      | 280  | 44     |        |
| Gains on sales of assets and emission allowances, net                | (19)     | (159)  | 140    |        |
| Net changes in energy derivatives                                    | (127)(1) | 352(2)   | (479)  |        |
| Western states and similar settlements                               |          | 35   | (35)   |        |
| Western states and similar settlements payments                      | (35)     | (160)  | 125    |        |
| Margin deposits, net   | 201      | 220  | (19)   |        |
| Change in accounts and notes receivable and accounts payable, net    | (196)    | (162)  | (34)   |        |
| Net option premiums purchased  | (23)     | (44)   | 21     |        |
| Settlements of exchange transactions prior to contractual period(3)  | (8)      | (81)   | 73     |        |
| Interest payments  | (219)    | (279)  | 60     |        |
| Income tax payments, net of refunds                                  | (28)     | (40)   | 12     |        |
| Other, net   | (43)     | 89   | (132)  |        |
| Net cash provided by continuing operations from operating activities | 332      | 40   | 292    |        |
| Net cash used in discontinued operations from operating activities   | (4)      | (45)   | 41     |        |
| Net cash provided by (used in) operating activities                  | \$ 328   | \$ (5)   | \$ 333 |        |

(1) Includes unrealized gains on energy derivatives of \$168 million.

(2) Includes unrealized losses on energy derivatives of \$280 million.

(3) Represents exchange transactions financially settled within three business days prior to the contractual delivery month.

*Cash Flows Investing Activities*

|  | 2007     | Nine Months Ended September 30,<br>2006<br>(in millions) |            | Change |
|--|----------|--|------------|--------|
| Capital expenditures   | \$ (135) | \$ (64)  | \$ (71)(1) |        |
| Proceeds from sales of emission allowances                                     | 7        | 205  | (198)      |        |
| Proceeds from sales of assets, net   | 30       | 1  | 29         |        |
| Purchases of emission allowances   | (52)     | (12)   | (40)       |        |
| Restricted cash  | 5        | 17   | (12)       |        |
| Other, net   | 5        | 6  | (1)        |        |
| Net cash provided by (used in) continuing operations from investing activities | (140)    | 153  | (293)      |        |
| Net cash provided by discontinued operations from investing activities         |          | 968  | (968)      |        |
| Net cash provided by (used in) investing activities                            | \$ (140) | \$ 1,121   | \$ (1,261) |        |

(1) Increase primarily due to environmental capital expenditures at two of our facilities beginning in 2007 and major maintenance capital expenditures at another facility.

**Recent Events**



*Cash Flows Financing Activities*

|  | 2007     | Nine Months Ended September 30,<br>2006<br>(in millions) |          | Change  |
|--|----------|--|----------|---------|
| Proceeds from issuance of senior unsecured notes                   | \$ 1,300 | \$   | \$ 1,300 | 1,300   |
| Payments of senior secured notes                                   | (1,087)  |  |          | (1,087) |
| Payments of senior secured term loans                              | (400)    | (321)  |          | (79)    |
| Net payments of senior secured revolver                            |          | (194)  |          | 194     |
| Payments of Channelview term loans                                 | (10)     | (10)   |          |         |
| Net borrowings from Channelview revolving working capital facility | 7        | 5  |          | 2       |
| Proceeds from issuances of stock                                   | 39       | 21   |          | 18      |
| Payments of financing costs  | (31)     |  |          | (31)    |
| Payments of debt extinguishment costs                              | (72)     |  |          | (72)    |
| Other, net   | (2)      |  |          | (2)     |
| Net cash used in continuing operations from financing activities   | (256)    | (499)  |          | 243     |
| Net cash used in discontinued operations from financing activities |          | (638)  |          | 638     |
| Net cash used in financing activities                              | \$ (256) | \$ (1,137)   | \$       | 881     |

**New Accounting Pronouncements, Significant Accounting Policies and Critical Accounting Estimates****New Accounting Pronouncements**

See notes 1 and 8(c) to our interim financial statements.

**Significant Accounting Policies**

See note 2 to our consolidated financial statements in our Form 10-K.

**Critical Accounting Estimates**

See Management's Discussion and Analysis of Financial Condition and Results of Operations Accounting Estimates New Accounting Pronouncements, Significant Accounting Policies and Critical Accounting Estimates Critical Accounting Estimates in Item 7 in our Form 10-K and note 2 to our consolidated financial statements in our Form 10-K.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Market Risks and Risk Management**

Our primary market risk exposure relates to fluctuations in commodity prices. See Quantitative and Qualitative Disclosures About Market Risk in Item 7A of our Form 10-K.

**Non-Trading Market Risks****Commodity Price Risk**

As of September 30, 2007, the fair values of the contracts related to our net non-trading derivative assets and liabilities are:

| Source of Fair Value                               | Twelve Months Ending September 30, 2008 | Remainder of 2008 | 2009    | 2010<br>(in millions) | 2011    | 2012 and thereafter | Total fair value |
|--|---|-------------------|---------|-----------------------|---------|---------------------|------------------|
| Prices actively quoted                             | \$ (20)                                 | \$ (3)            | \$ (3)  | \$ (4)                | \$ (5)  | \$ 8                | \$ (27)          |
| Prices provided by other external sources          | (251)                                   | (66)              | 35      | (3)                   |         |                     | (285)            |
| Prices based on models and other valuation methods | (51)                                    | (8)               | (32)    | 4                     | 2       | (16)                | (101)            |
| Total mark-to-market non-trading derivatives       | (322)                                   | (77)              |         | (3)                   | (3)     | (8)                 | (413)            |
| Cash flow hedges(1)                                | (87)                                    | (14)              | (34)    | (34)                  | (31)    | (18)                | (218)            |
| Total  | \$ (409)                                | \$ (91)           | \$ (34) | \$ (37)               | \$ (34) | \$ (26)             | \$ (631)         |

(1) As of September 30, 2007, all previously designated cash flow hedges have been de-designated. See note 5 to our interim financial statements.

A hypothetical 10% movement in the underlying energy prices would have the following potential gain (loss) impacts on our non-trading derivatives:

| As of              | Market Prices | Fair Value of Cash Flow Hedges<br>(in millions) | Earnings Impact of Other Derivatives | Total Potential Loss in Fair Value |
|--------------------|---------------|---|--------------------------------------|------------------------------------|
| September 30, 2007 | 10% decrease  | \$  | \$ (316)                             | \$ (316)                           |
| December 31, 2006  | 10% decrease  |   | 33                                   | (295)                              |

**Interest Rate Risk**

We remain subject to the benefits or losses associated with movements in market interest rates related to certain variable rate debt and margin deposits, which are most vulnerable to changes in the federal funds rate. As we deconsolidated Channelview on August 20, 2007 and have no borrowings under our senior secured revolver or retail working capital facility, we have no variable rate debt outstanding as of September 30, 2007.

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We assess interest rate risks using a sensitivity analysis that measures the potential change in our interest expense based on a hypothetical one percentage point movement in the underlying variable interest rate indices. If interest rates increased/decreased by one percentage point, our interest expense would have increased/decreased for the twelve months ended September 30, 2007 and December 31, 2006 by \$7 million and \$15 million, respectively, and our interest expense, net of interest income, would have increased/decreased by \$1 million and \$8 million, respectively.

We estimated these amounts by considering the impact of hypothetical changes in interest rates on our variable-rate debt adjusted for: cash and cash equivalents and net margin deposits outstanding at the respective balance sheet dates.

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If interest rates decreased by one percentage point from their September 30, 2007 and December 31, 2006 levels, the fair market values of our fixed-rate debt would have increased by \$217 million and \$189 million, respectively.

### Trading Market Risks

As of September 30, 2007, the fair values of the contracts related to our legacy trading positions and recorded as net derivative assets and liabilities are:

| Source of Fair Value                               | Twelve<br>Months<br>Ending<br>September<br>30,<br>2008 | Remainder<br>of 2008 | 2009        | 2010<br>(in millions) | 2011      | 2012 and<br>thereafter | Total fair<br>value |
|--|--|----------------------|-------------|-----------------------|-----------|------------------------|---------------------|
| Prices actively quoted                             | \$ (31)  | \$ (11)              | \$ (12)     | \$                    | \$        | \$                     | \$ (54)             |
| Prices provided by other external sources          | 39   | 14                   | 14          |                       |           |                        | 67                  |
| Prices based on models and other valuation methods | (1)  |                      |             |                       |           |                        | (1)                 |
| <b>Total</b>                                       | <b>\$ 7</b>  | <b>\$ 3</b>          | <b>\$ 2</b> | <b>\$</b>             | <b>\$</b> | <b>\$</b>              | <b>\$ 12</b>        |

Our consolidated realized and unrealized margins relating to these positions are (income (loss)):

|              | Three Months Ended September 30,<br>2007 | 2006        | (in millions) | Nine Months Ended September 30,<br>2007 | 2006         |
|--------------|--|-------------|---------------|---|--------------|
| Realized     | \$ 1                                     | \$ (2)      |               | \$ 4                                    | \$ (6)       |
| Unrealized   | 7  | 11          |               | 4                                       | 25           |
| <b>Total</b> | <b>\$ 8</b>                              | <b>\$ 9</b> |               | <b>\$ 8</b>                             | <b>\$ 19</b> |

An analysis of these net derivative assets and liabilities is:

|  | (in millions) | Nine Months Ended September 30,<br>2007 | 2006     |
|--|---------------|---|----------|
| Fair value of contracts outstanding, beginning of period                     | \$ 9          | \$                                      | (20)     |
| Contracts realized or settled  | (7)(1)        |   | (2)      |
| Changes in valuation techniques  |               |   | (8)      |
| Changes in fair values attributable to market price and other market changes |               | 10                                      | 36       |
| <b>Fair value of contracts outstanding, end of period</b>                    | <b>\$ 12</b>  | <b>\$</b>                               | <b>8</b> |

(1) Amount includes realized gain of \$4 million and deferred settlements of \$3 million.

(2) Amount includes realized loss of \$6 million offset by deferred settlements of \$6 million.





The daily value-at-risk for our legacy trading positions is:

|                                  | 2007(1)       | 2006 |
|----------------------------------|---------------|------|
|                                  | (in millions) |      |
| As of September 30               | \$ 2          | \$ 1 |
| Three months ended September 30: |               |      |
| Average                          | 3             | 2    |
| High                             | 4             | 2    |
| Low                              | 2             | 1    |
| Nine months ended September 30:  |               |      |
| Average                          | 3             | 3    |
| High                             | 5             | 7    |
| Low                              | 2             | 1    |

(1) The major parameters for calculating daily value-at-risk remain the same during 2007 as disclosed in Quantitative and Qualitative Disclosures About Market Risk in Item 7A of our Form 10-K.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (1934 Act)) as of September 30, 2007, the end of the period covered by this Form 10-Q. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of September 30, 2007, our disclosure controls and procedures were effective.

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

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the 1934 Act) during the period ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### PART II. OTHER INFORMATION

##### ITEM 1. LEGAL PROCEEDINGS

See note 10 to our interim financial statements in this Form 10-Q.

##### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In the third quarter of 2007, we issued 933,929 shares of unregistered common stock pursuant to cashless warrant exercises and no shares of unregistered common stock for cash pursuant to warrant exercises, in each case under an exemption pursuant to Section 4(2) of the Securities Act of 1933, as amended.

##### ITEM 6. EXHIBITS

Exhibits.

See Index of Exhibits.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RELIANT ENERGY, INC.  
(Registrant)

**November 8, 2007**

By: /s/ Thomas C. Livengood  
Thomas C. Livengood  
**Senior Vice President and Controller**  
**(Duly Authorized Officer and Chief Accounting Officer)**

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## INDEX OF EXHIBITS

Exhibits not incorporated by reference to a prior filing are designated by a cross (+); all exhibits not so designated are incorporated herein by reference to a prior filing as indicated. The exhibits with the asterisk symbol (\*) are compensatory arrangements filed pursuant to Item 601(b)(10)(iii) of Regulation S-K.

| Exhibit Number | Document Description   | Report or Registration Statement   | SEC File or Registration Number | Exhibit Reference |
|----------------|--|--|---------------------------------|-------------------|
| 1.1            | Underwriting Agreement among Reliant Energy, Inc., Goldman, Sachs & Co., as representative of the several underwriters named therein and M. R. Beal & Company, as qualified independent underwriter, dated as of June 6, 2007  | Reliant Energy, Inc. s Current Report on Form 8-K, filed June 12, 2007                   | 1-16455                         | 1.1               |
| 3.1            | Third Restated Certificate of Incorporation  | Reliant Energy, Inc. s Quarterly Report on Form 10-Q for the period ended June 30, 2007  | 1-16455                         | 3.1               |
| 3.2            | Third Amended and Restated Bylaws  | Reliant Energy, Inc. s Quarterly Report on Form 10-Q for the period ended March 31, 2007 | 1-16455                         | 3.3               |
| 4.1            | Registrant has omitted instruments with respect to long-term debt in an amount that does not exceed 10% of the registrant s total assets and its subsidiaries on a consolidated basis and hereby undertakes to furnish a copy of any such agreement to the Securities and Exchange Commission upon request |  |                                 |                   |
| 4.2            | Fourth Supplemental Indenture relating to the 9.25% Senior Secured Notes due 2010, among Reliant Energy, Inc., the Guarantors listed therein and Wilmington Trust Company, dated as of June 5, 2007  | Reliant Energy, Inc. s Current Report on Form 8-K, filed June 6, 2007                    | 1-16455                         | 4.1               |
| 4.3            | Fourth Supplemental Indenture relating to the 9.50% Senior Secured Notes due 2013, among Reliant Energy, Inc., the Guarantors listed therein and Wilmington Trust Company, dated as of June 5, 2007  | Reliant Energy, Inc. s Current Report on Form 8-K, filed June 6, 2007                    | 1-16455                         | 4.2               |
| 4.4            | Fourth Supplemental Indenture relating to the 7.625% Senior Notes due 2014, among Reliant Energy, Inc., the Guarantors listed therein and Wilmington Trust Company, dated as of June 13, 2007  | Reliant Energy, Inc. s Current Report on Form 8-K, filed June 15, 2007                   | 1-16455                         | 4.1               |
| 4.5            | Fifth Supplemental Indenture relating to the 7.875% Senior Notes due 2017, among Reliant Energy, Inc., the Guarantors listed therein and Wilmington Trust Company, dated as of June 13, 2007   | Reliant Energy, Inc. s Current Report on Form 8-K, filed June 15, 2007                   | 1-16455                         | 4.2               |
| +10.1A         | Amended and Restated Credit Sleeve and Reimbursement Agreement among Reliant Energy Power Supply, LLC, the Guarantors listed therein, Merrill Lynch Commodities, Inc. and Merrill Lynch & Co., Inc., dated as of August 1, 2007  |  |                                 |                   |

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- +10.1B Schedules and Exhibits to the Amended and Restated Credit Sleeve and Reimbursement Agreement dated as of August 1, 2007 (Portions of this Exhibit have been omitted pursuant to a request for confidential treatment)
  - +\*10.2 2002 Long-Term Incentive Plan  
Long Term Incentive Award Agreement for Rick J. Dobson
  - +\*10.3 Change in Control Agreement among Reliant Energy, Inc., Reliant Energy Corporate Services, LLC and Rick J. Dobson effective as of October 29, 2007
  - +31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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| <b>Exhibit<br/>Number</b> | <b>Document Description</b>   | <b>Report or Registration Statement</b> | <b>SEC File or<br/>Registration<br/>Number</b> | <b>Exhibit<br/>Reference</b> |
|---------------------------|---|---|--|------------------------------|
| +31.2                     | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |   |  |                              |
| +32.1                     | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |   |  |                              |

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