

RELIANT ENERGY INC  
Form 10-Q  
August 05, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 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 June 30, 2008**

**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)

**76-0655566**

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

**1000 Main Street**

**Houston, Texas 77002**

(Address of Principal Executive Offices) (Zip Code)

**(713) 497-3000**

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

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

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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, capital structure and other financial items, our plans and objectives for future operations or about our future economic performance, transactions and dispositions and financings and approvals related thereto. In many cases, you can identify forward-looking statements by terminology such as anticipate, estimate, believe, continue, could, intend, may, plan, should, will, expect, objective, projection, forecast, goal, guidance, outlook, effort, target and . However, the absence of these words does not mean that the statements are not forward-looking. Actual results may differ materially from those expressed or implied by the forward-looking statements as a result of many factors or events, including, but not limited to, the following:

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

Limitations on our ability to set rates at market prices;

Legislative, regulatory and/or market developments;

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

Interruption or breakdown of our generating equipment and processes;

Failure of third parties to perform contractual obligations;

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

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

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

Ineffective hedging and other risk management activities;

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

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

Weather-related events or other events beyond our control;

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

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

Failure of our credit-enhanced retail structure; and

Financial market conditions and our access to capital.

Other factors that could cause our actual results to differ from our projected results are discussed or referred to in the Risk Factors section of our most recent Annual Report on Form 10-K filed with the Securities and Exchange

Commission.

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

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**PART I.**  
**FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

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

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

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

See Notes to our Unaudited Consolidated Interim Financial Statements



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

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

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|   |                      |                      |
|---|----------------------|----------------------|
| Current liabilities of discontinued operations  | 4,766                |                      |
| Total current liabilities   | 4,953,988            | 2,052,027            |
| <b>Other Liabilities:</b>   |                      |                      |
| Derivative liabilities  | 1,385,211            | 473,516              |
| Other   | 399,584              | 278,641              |
| Long-term liabilities of discontinued operations  | 3,542                | 3,542                |
| Total other liabilities   | 1,788,337            | 755,699              |
| <b>Long-term Debt</b>   | <b>2,877,848</b>     | <b>2,902,346</b>     |
| <b>Commitments and Contingencies</b>  |                      |                      |
| <b>Temporary Equity Stock-based Compensation</b>  | <b>5,603</b>         | <b>4,694</b>         |
| <b>Stockholders Equity:</b>   |                      |                      |
| Preferred stock; par value \$0.001 per share (125,000,000 shares authorized; none outstanding)                  |                      |                      |
| Common stock; par value \$0.001 per share (2,000,000,000 shares authorized; 347,813,336 and 344,579,508 issued) | 109                  | 106                  |
| Additional paid-in capital  | 6,228,514            | 6,215,512            |
| Accumulated deficit   | (899,626)            | (1,635,526)          |
| Accumulated other comprehensive loss  | (86,814)             | (103,058)            |
| Total stockholders equity   | 5,242,183            | 4,477,034            |
| <b>Total Liabilities and Equity</b>   | <b>\$ 14,867,959</b> | <b>\$ 10,191,800</b> |

See Notes to our Unaudited Consolidated Interim Financial Statements

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

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

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

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**RELIANT ENERGY, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**(1) Background and Basis of Presentation**

**(a) Background.**

Reliant Energy refers to Reliant Energy, Inc. and we, us and our refer to Reliant Energy, Inc. and its consolidated subsidiaries. Our business consists primarily of two business segments, retail energy and wholesale energy. See note 13. Our consolidated interim financial statements and notes (interim financial statements) are unaudited, omit certain disclosures and should be read in conjunction with our audited consolidated financial statements and notes in our Form 10-K.

**(b) Basis of Presentation.**

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

the reported amount of assets, liabilities and equity;

the reported amounts of revenues and expenses; and

our disclosure of contingent assets and liabilities at the date of the financial statements.

*Adjustments and Reclassifications.* The interim financial statements reflect all normal recurring adjustments necessary, in management's opinion, to present fairly our financial position and results of operations for the reported periods. Amounts reported for interim periods, however, may not be indicative of a full year period due to seasonal fluctuations in demand for electricity and energy services, changes in commodity prices, changes in our retail revenue rates and changes in regulations, timing of maintenance and other expenditures, dispositions, changes in interest expense and other factors. We have changed the presentation of our December 31, 2007 consolidated balance sheet due to the adoption of FSP FIN 39-1, Amendment of FASB Interpretation No. 39 (FIN 39-1). See below.

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

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

*Gross Receipts Taxes.* We record gross receipts taxes for our retail energy segment on a gross basis in revenues and operations and maintenance in our consolidated statements of operations. During the three months ended June 30, 2008 and 2007, our retail energy segment's revenues and operation and maintenance include gross receipts taxes of \$27 million and \$24 million, respectively, and during the six months ended June 30, 2008 and 2007, \$48 million and \$45 million, respectively.

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

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

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

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

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

**(2) Stock-based Compensation**

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

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

During February 2008, the compensation committee of our board of directors granted stock-based compensation awards to 47 of our officers under the Reliant Energy, Inc. 2002 Long-Term Incentive Plan. The committee granted 461,824 time-based stock options (exercise price of \$23.38 per share, which vest in three equal installments during February 2009, 2010 and 2011), 215,527 time-based restricted stock units (which vest during February 2011) and 371,586 market-based cash units (each payable into a cash amount equal to the market value of one share of our common stock if our common stock closes at \$32 or higher for 20 consecutive trading days before February 19, 2011). In addition, during February 2008, the committee granted 95,574 time-based restricted stock units and 95,574 time-based cash units to other employees under the Reliant Energy, Inc. 2002 Stock Plan. These awards will vest during February 2011.

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



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

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

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

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

**Level 3:** This category includes our energy derivative instruments whose fair value is estimated based on internally developed models and methodologies utilizing significant inputs that are generally less readily observable from objective sources (such as market heat rates, implied volatilities and correlations). Our OTC, complex or structured derivative instruments that are transacted in less liquid markets with limited pricing information are included in Level 3. Examples are structured power supply contracts, coal contracts, longer term natural gas contracts and options. We value some of our OTC, complex or structured derivative instruments using valuation models, which utilize inputs that may not be corroborated by market data. When such inputs are significant to the fair value measurement, the derivative assets or liabilities are classified as Level 3 when we do not have corroborating market evidence to support significant valuation model inputs and cannot verify the model to market transactions. We believe the transaction price is the best estimate of fair value at inception under the exit price methodology. Accordingly, when a pricing model is used to value such an instrument, the resulting value is adjusted so the model value at inception equals the transaction price. Valuation models are typically impacted by Level 1 or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Subsequent to initial recognition, we update Level 1 and Level 2 inputs to reflect observable market changes. Level 3 inputs are updated when corroborated by available market evidence. In the absence of such evidence, management's best estimate is used.

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

|                              | <b>June 30, 2008</b> |                |                |  | <b>Total</b>      |
|------------------------------|----------------------|----------------|----------------|--|-------------------|
|                              | <b>Level 1</b>       | <b>Level 2</b> | <b>Level 3</b> | <b>Reclassifications<sup>(1)</sup></b> | <b>Fair Value</b> |
|                              | <b>(in millions)</b> |                |                |  |                   |
| Total derivative assets      | \$ 962               | \$ 3,519       | \$ 861         | \$ (40)                                | \$ 5,302          |
| Total derivative liabilities | 1,095                | 3,017          | 379            | (40)                                   | 4,451             |

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



balance sheet  
presentation.

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

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

(1) Recorded in revenues and cost of sales.

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

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

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

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

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

**(4) Comprehensive Income (Loss)**

The components of total comprehensive income (loss) are:

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

**(5) Goodwill**

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

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

**Table of Contents****(6) Derivative Instruments**

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

|                                      | Three Months Ended June<br>30, |                       | Six Months Ended June<br>30, |                     |
|--------------------------------------|--------------------------------|-----------------------|------------------------------|---------------------|
|                                      | 2008                           | 2007                  | 2008                         | 2007                |
|                                      | (in millions)                  |                       |                              |                     |
| Energy derivatives:                  |                                |                       |                              |                     |
| Hedge ineffectiveness gains (losses) | \$ 1 <sup>(1)</sup>            | \$ (1) <sup>(1)</sup> | \$ (1) <sup>(1)</sup>        | \$ 2 <sup>(1)</sup> |
| Other net unrealized gains (losses)  | 569                            | (325)                 | 1,128                        | 194                 |
| Interest rate derivatives:           |                                |                       |                              |                     |
| Other net unrealized losses          |                                | (2)                   |                              | (5)                 |
| Total <sup>(2)(3)</sup>              | \$ 570                         | \$ (328)              | \$ 1,128                     | \$ 191              |

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

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

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

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

Amounts included in accumulated other comprehensive loss:

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

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

|               | <b>Three Months Ended June<br/>30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|---------------|--|-------------|----------------------------------|-------------|
|               | <b>2008</b>                            | <b>2007</b> | <b>2008</b>                      | <b>2007</b> |
|               | <b>(in millions)</b>                   |             |                                  |             |
| Revenues      | \$                                     | \$          | \$                               | \$          |
| Cost of sales | (13)                                   |             | (17)                             |             |
| Total         | \$ (13)                                | \$          | \$ (17)                          | \$          |

**Table of Contents****(7) Debt**

Our outstanding debt:

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

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

(2)

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

- (3) In July 2008, we called the remaining \$13 million.
- (4) In April 2008, nearly all of these outstanding notes were converted to common stock.
- (5) PEDFA is the Pennsylvania Economic Development Financing Authority.
- (6) Debt acquired in the acquisition of Orion Power Holdings, Inc. and subsidiaries was adjusted to fair value as of the acquisition date. Included in interest expense is amortization for valuation adjustments for debt of \$3 million and \$4 million during the three months ended June 30, 2008 and 2007,

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

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

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



**Table of Contents****(8) Earnings Per Share**

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

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

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

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

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

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

(1) See note (2) above regarding diluted loss per share.

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

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

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

(2) Includes stock options.

(3) In December 2006,

we converted  
99.2% of our  
convertible  
senior  
subordinated  
notes to common  
stock.

**Table of Contents****(9) Income Taxes****(a) Tax Rate Reconciliation.**

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

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

**(b) Valuation Allowances.**

We assess our future ability to use federal, state and foreign net operating loss carryforwards, capital loss carryforwards and other deferred tax assets using the more-likely-than-not criteria. These assessments include an evaluation of our recent history of earnings and losses, future reversals of temporary differences and identification of other sources of future taxable income, including the identification of tax planning strategies in certain situations. Our valuation allowances for deferred tax assets are:

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

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

Effective January 1, 2007, we adopted FIN 48, Accounting for Uncertainty in Income Taxes. This interpretation addresses whether (and when) tax benefits claimed in our tax returns should be recorded in our financial statements. Pursuant to FIN 48, we may only recognize the tax benefit for financial reporting purposes from an uncertain tax position when it is more-likely-than-not that, based on the technical merits, the position will be sustained by taxing authorities or the courts. The recognized tax benefits are measured as the largest benefit having a greater than fifty percent likelihood of being realized upon settlement with a taxing authority. FIN 48 also provides guidance for derecognition, classification, interest and penalties, disclosures, transition rules and related matters. We classify accrued interest and penalties related to uncertain income tax positions in income tax expense/benefit.

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

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

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

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

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**(10) Guarantees and Indemnifications**

We have guaranteed some non-qualified benefits of CenterPoint's existing retirees at September 20, 2002. The estimated maximum potential amount of future payments under the guarantee was approximately \$55 million as of June 30, 2008 and no liability is recorded in our consolidated balance sheets for this item.

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

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

We have guaranteed payments to a third party relating to energy sales from El Dorado Energy, LLC, a former investment. The estimated maximum potential amount of future payments under this guarantee was approximately \$21 million as of June 30, 2008 and no liability is recorded in our consolidated balance sheets for this item.

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

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

Except as otherwise noted, we are unable to estimate our maximum potential exposure under these agreements until an event triggering payment occurs. We do not expect to make any material payments under these agreements.

**(11) Contingencies**

We are party to many legal proceedings, some of which may involve substantial amounts. Unless otherwise noted, we cannot predict the outcome of the matters described below.

***(a) Pending Natural Gas Litigation.***

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

We are party to approximately 30 lawsuits, several of which are class action lawsuits, in state and federal courts in California, Colorado, Kansas, Missouri, Nevada, Tennessee and Wisconsin. These lawsuits relate to alleged conduct to increase natural gas prices in violation of antitrust and similar laws. The lawsuits seek treble or punitive damages, restitution and/or expenses. The lawsuits also name a number of unaffiliated energy companies as parties.

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

Recent developments in these cases include:

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

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

***(b) Environmental Matters.***

*New Source Review Matters.* The United States Environmental Protection Agency (EPA) and various states are investigating compliance of coal-fueled electric generating stations with the pre-construction permitting requirements of the Clean Air Act known as New Source Review. In 2000 and 2001, we responded to the EPA's information requests related to five of our stations, and in December 2007, we received supplemental requests for two of those stations. The EPA has agreed to share information relating to its investigations with state environmental agencies. In December 2007, the New Jersey Department of Environmental Protection (NJDEP) filed suit against us in the United States District Court in Pennsylvania, alleging that New Source Review violations occurred at one of our power plants located in Pennsylvania. The suit seeks installation of best available control technologies for each pollutant, to enjoin us from operating the plant if it is not in compliance with the Clean Air Act and civil penalties. The allegations are based on projects occurring prior to our ownership of the facility and the suit names three past owners of the plant as defendants. We believe we are indemnified by or have the right to seek indemnification from the prior owners for losses and expenses that we may incur.

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

*Ash Disposal Landfill Closures.* We are responsible for environmental costs related to the future closures of seven ash disposal landfills. We recorded the estimated discounted costs associated with these environmental liabilities as part of our asset retirement obligations. See note 2(o) to our consolidated financial statements in our Form 10-K.

*Remediation Obligations.* We are responsible for environmental costs related to site contamination investigations and remediation requirements at four power plants in New Jersey. We recorded the estimated liability for the remediation costs of \$8 million as of June 30, 2008 and December 31, 2007.

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

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

***(c) Other.***

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

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

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

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



**Table of Contents****(12) Supplemental Guarantor Information**

Our wholly-owned subsidiaries are either (a) full and unconditional guarantors, jointly and severally, or (b) non-guarantors of the senior secured notes.

*Condensed Consolidating Statements of Operations.*

|  | <b>Three Months Ended June 30, 2008</b> |                   |   |                                  |                     |
|--|---|-------------------|---|----------------------------------|---------------------|
|  | <b>Reliant<br/>Energy</b>               | <b>Guarantors</b> | <b>Non-Guarantors<br/>(in millions)</b> | <b>Adjustments<sup>(1)</sup></b> | <b>Consolidated</b> |
| Revenues   | \$                                      | \$ 1,079          | \$ 2,825                                | \$ (480)                         | \$ 3,424            |
| Cost of sales  |   | 937               | 1,951                                   | (478)                            | 2,410               |
| Operation and maintenance  |   | 51                | 180                                     | (2)                              | 229                 |
| Selling, general and administrative                                |   | 3                 | 83                                      | (1)                              | 85                  |
| Western states litigation and similar settlements                  |   |                   |   |                                  |                     |
| Gains on sales of assets and emission and exchange allowances, net |   | (20)              | (2)                                     |                                  | (22)                |
| Depreciation and amortization                                      |   | 33                | 55                                      |                                  | 88                  |
| Total  |   | 1,004             | 2,267                                   | (481)                            | 2,790               |
| Operating income   |   | 75                | 558                                     | 1                                | 634                 |
| Income of equity investment, net                                   |   | 1                 |   |                                  | 1                   |
| Income of equity investments of consolidated subsidiaries          | 353                                     | 35                |   | (388)                            |                     |
| Interest expense   | (40)                                    | (9)               | (14)                                    |                                  | (63)                |
| Interest income  | 4                                       | 3                 | 3                                       |                                  | 10                  |
| Interest income (expense) affiliated companies, net                | 46                                      | (29)              | (17)                                    |                                  |                     |
| Total other income (expense)                                       | 363                                     | 1                 | (28)                                    | (388)                            | (52)                |
| Income from continuing operations before income taxes              | 363                                     | 76                | 530                                     | (387)                            | 582                 |
| Income tax expense   | 4                                       | 19                | 197                                     | 3                                | 223                 |
| Income continuing operations                                       | 359                                     | 57                | 333                                     | (390)                            | 359                 |
| Income (loss) from discontinued operations                         |   | 1                 | (1)                                     |                                  |                     |
| Net income   | \$ 359                                  | \$ 58             | \$ 332                                  | \$ (390)                         | \$ 359              |

## Three Months Ended June 30, 2007

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

**Table of Contents***Condensed Consolidating Statements of Operations.***Six Months Ended June 30, 2008**

|  | <b>Reliant<br/>Energy</b> | <b>Guarantors</b> | <b>Non-Guarantors<br/>(in millions)</b> | <b>Adjustments<sup>(1)</sup></b> | <b>Consolidated</b> |
|--|---------------------------|-------------------|---|----------------------------------|---------------------|
| Revenues   | \$                        | \$ 1,989          | \$ 5,177                                | \$ (927)                         | \$ 6,239            |
| Cost of sales  |                           | 1,770             | 3,313                                   | (922)                            | 4,161               |
| Operation and maintenance  |                           | 112               | 332                                     | (2)                              | 442                 |
| Selling, general and<br>administrative                                   |                           | 9                 | 154                                     | (2)                              | 161                 |
| Western states litigation and<br>similar settlements                     | 34                        |                   |   |                                  | 34                  |
| Gains on sales of assets and<br>emission and exchange<br>allowances, net |                           | (21)              | (2)                                     |                                  | (23)                |
| Depreciation and amortization  |                           | 68                | 109                                     |                                  | 177                 |
| Total  | 34                        | 1,938             | 3,906                                   | (926)                            | 4,952               |
| Operating income (loss)  | (34)                      | 51                | 1,271                                   | (1)                              | 1,287               |
| Income of equity investment,<br>net                                      |                           | 1                 |   |                                  | 1                   |
| Income of equity investments<br>of consolidated subsidiaries             | 739                       | 78                |   | (817)                            |                     |
| Interest expense   | (82)                      | (17)              | (27)                                    |                                  | (126)               |
| Interest income  | 10                        | 4                 | 6                                       |                                  | 20                  |
| Interest income (expense)<br>affiliated companies, net                   | 101                       | (67)              | (34)                                    |                                  |                     |
| Total other income (expense)   | 768                       | (1)               | (55)                                    | (817)                            | (105)               |
| Income from continuing<br>operations before income taxes                 | 734                       | 50                | 1,216                                   | (818)                            | 1,182               |
| Income tax expense (benefit)   | (2)                       | (4)               | 455                                     | 3                                | 452                 |
| Income from continuing<br>operations                                     | 736                       | 54                | 761                                     | (821)                            | 730                 |
| Income (loss) from<br>discontinued operations                            |                           | 8                 | (2)                                     |                                  | 6                   |
| Net income   | \$ 736                    | \$ 62             | \$ 759                                  | \$ (821)                         | \$ 736              |

**Six Months Ended June 30, 2007**

|  | <b>Guarantors</b> | <b>Non-Guarantors</b> | <b>Adjustments<sup>(1)</sup></b> | <b>Consolidated</b> |
|--|-------------------|-----------------------|----------------------------------|---------------------|
|--|-------------------|-----------------------|----------------------------------|---------------------|

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



**Table of Contents***Condensed Consolidating Balance Sheets.*

|  | <b>June 30, 2008</b>      |                   |   |                                  |                     |
|--|---------------------------|-------------------|---|----------------------------------|---------------------|
|  | <b>Reliant<br/>Energy</b> | <b>Guarantors</b> | <b>Non-Guarantors<br/>(in millions)</b> | <b>Adjustments<sup>(1)</sup></b> | <b>Consolidated</b> |
| <b>ASSETS</b>  |                           |                   |   |                                  |                     |
| <b>Current Assets:</b>   |                           |                   |   |                                  |                     |
| Cash and cash equivalents                                      | \$ 520                    | \$                | \$ 278                                  | \$                               | \$ 798              |
| Restricted cash  |                           | 2                 | 5                                       |                                  | 7                   |
| Accounts and notes receivable,<br>principally customer, net    | 9                         | 407               | 1,098                                   | (10)                             | 1,504               |
| Accounts and notes receivable<br>affiliated companies          | 1,890                     | 323               | 292                                     | (2,505)                          |                     |
| Inventory  |                           | 164               | 167                                     |                                  | 331                 |
| Derivative assets  |                           | 295               | 3,601                                   |                                  | 3,896               |
| Investment in and receivables<br>from Channelview, net         | 1                         | 84                |   |                                  | 85                  |
| Other current assets   | 19                        | 222               | 111                                     | (20)                             | 332                 |
| Assets held for sale   |                           | 453               |   |                                  | 453                 |
| <b>Total current assets</b>                                    | <b>2,439</b>              | <b>1,950</b>      | <b>5,552</b>                            | <b>(2,535)</b>                   | <b>7,406</b>        |
| <b>Property, Plant and<br/>Equipment, net</b>                  |                           | <b>2,415</b>      | <b>2,400</b>                            |                                  | <b>4,815</b>        |
| <b>Other Assets:</b>   |                           |                   |   |                                  |                     |
| Goodwill and other intangibles,<br>net                         |                           | 144               | 483                                     | 119                              | 746                 |
| Notes receivable affiliated<br>companies                       | 2,528                     | 621               | 68                                      | (3,217)                          |                     |
| Equity investments of<br>consolidated subsidiaries             | 2,893                     | 374               |   | (3,267)                          |                     |
| Derivative assets  |                           |                   | 1,414                                   | (8)                              | 1,406               |
| Other long-term assets   | 51                        | 894               | 317                                     | (766)                            | 496                 |
| <b>Total other assets</b>                                      | <b>5,472</b>              | <b>2,033</b>      | <b>2,282</b>                            | <b>(7,139)</b>                   | <b>2,648</b>        |
| <b>Total Assets</b>  | <b>\$ 7,911</b>           | <b>\$ 6,398</b>   | <b>\$ 10,234</b>                        | <b>\$ (9,674)</b>                | <b>\$ 14,869</b>    |
| <b>LIABILITIES AND<br/>EQUITY</b>                              |                           |                   |   |                                  |                     |
| <b>Current Liabilities:</b>                                    |                           |                   |   |                                  |                     |
| Current portion of long-term<br>debt and short-term borrowings | \$ 13                     | \$                | \$ 11                                   | \$                               | \$ 24               |
| Accounts payable, principally<br>trade                         |                           | 116               | 1,076                                   | (3)                              | 1,189               |
| Accounts and notes payable<br>affiliated companies             |                           | 2,062             | 443                                     | (2,505)                          |                     |

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|  |                 |                 |                  |                   |                  |
|--|-----------------|-----------------|------------------|-------------------|------------------|
| Derivative liabilities                           |                 | 221             | 2,845            |                   | 3,066            |
| Other current liabilities                        | 43              | 234             | 413              | (73)              | 617              |
| Liabilities held for sale                        |                 | 53              |                  |                   | 53               |
| Current liabilities of discontinued operations   |                 |                 | 5                |                   | 5                |
| <b>Total current liabilities</b>                 | <b>56</b>       | <b>2,686</b>    | <b>4,793</b>     | <b>(2,581)</b>    | <b>4,954</b>     |
| <b>Other Liabilities:</b>                        |                 |                 |                  |                   |                  |
| Notes payable affiliated companies               |                 | 2,459           | 758              | (3,217)           |                  |
| Derivative liabilities                           |                 |                 | 1,385            |                   | 1,385            |
| Other long-term liabilities                      | 641             | 128             | 348              | (717)             | 400              |
| Long-term liabilities of discontinued operations |                 |                 | 4                |                   | 4                |
| <b>Total other liabilities</b>                   | <b>641</b>      | <b>2,587</b>    | <b>2,495</b>     | <b>(3,934)</b>    | <b>1,789</b>     |
| <b>Long-term Debt</b>                            | <b>1,966</b>    | <b>501</b>      | <b>411</b>       |                   | <b>2,878</b>     |
| <b>Commitments and Contingencies</b>             |                 |                 |                  |                   |                  |
| <b>Temporary Equity</b>                          |                 |                 |                  |                   |                  |
| <b>Stock-based Compensation</b>                  | <b>6</b>        |                 |                  |                   | <b>6</b>         |
| <b>Total Stockholders Equity</b>                 | <b>5,242</b>    | <b>624</b>      | <b>2,535</b>     | <b>(3,159)</b>    | <b>5,242</b>     |
| <b>Total Liabilities and Equity</b>              | <b>\$ 7,911</b> | <b>\$ 6,398</b> | <b>\$ 10,234</b> | <b>\$ (9,674)</b> | <b>\$ 14,869</b> |

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|  | <b>December 31, 2007</b>  |                   |   |                                  |                     |
|--|---------------------------|-------------------|---|----------------------------------|---------------------|
|  | <b>Reliant<br/>Energy</b> | <b>Guarantors</b> | <b>Non-Guarantors<br/>(in millions)</b> | <b>Adjustments<sup>(1)</sup></b> | <b>Consolidated</b> |
| <b>ASSETS</b>  |                           |                   |   |                                  |                     |
| <b>Current Assets:</b>   |                           |                   |   |                                  |                     |
| Cash and cash equivalents                                      | \$ 490                    | \$ 1              | \$ 264                                  | \$                               | \$ 755              |
| Restricted cash  |                           | 1                 | 2                                       |                                  | 3                   |
| Accounts and notes receivable,<br>principally customer, net    | 11                        | 252               | 831                                     | (11)                             | 1,083               |
| Accounts and notes receivable<br>affiliated companies          | 2,009                     | 368               | 328                                     | (2,705)                          |                     |
| Inventory  |                           | 148               | 137                                     |                                  | 285                 |
| Derivative assets  |                           | 123               | 540                                     |                                  | 663                 |
| Investment in and receivables<br>from Channelview, net         | 1                         | 82                |   |                                  | 83                  |
| Other current assets   | 19                        | 160               | 197                                     | (17)                             | 359                 |
| Current assets of discontinued<br>operations                   |                           |                   | 2                                       |                                  | 2                   |
| <b>Total current assets</b>                                    | <b>2,530</b>              | <b>1,135</b>      | <b>2,301</b>                            | <b>(2,733)</b>                   | <b>3,233</b>        |
| <b>Property, Plant and<br/>Equipment, net</b>                  |                           | <b>2,870</b>      | <b>2,353</b>                            |                                  | <b>5,223</b>        |
| <b>Other Assets:</b>   |                           |                   |   |                                  |                     |
| Goodwill and other intangibles,<br>net                         |                           | 184               | 482                                     | 119                              | 785                 |
| Notes receivable affiliated<br>companies                       | 2,365                     | 656               | 68                                      | (3,089)                          |                     |
| Equity investments of<br>consolidated subsidiaries             | 2,212                     | 304               |   | (2,516)                          |                     |
| Derivative assets  |                           | 44                | 332                                     |                                  | 376                 |
| Other long-term assets   | 55                        | 860               | 356                                     | (696)                            | 575                 |
| <b>Total other assets</b>                                      | <b>4,632</b>              | <b>2,048</b>      | <b>1,238</b>                            | <b>(6,182)</b>                   | <b>1,736</b>        |
| <b>Total Assets</b>  | <b>\$ 7,162</b>           | <b>\$ 6,053</b>   | <b>\$ 5,892</b>                         | <b>\$ (8,915)</b>                | <b>\$ 10,192</b>    |
| <b>LIABILITIES AND<br/>EQUITY</b>                              |                           |                   |   |                                  |                     |
| <b>Current Liabilities:</b>                                    |                           |                   |   |                                  |                     |
| Current portion of long-term<br>debt and short-term borrowings | \$ 41                     | \$                | \$ 11                                   | \$                               | \$ 52               |
| Accounts payable, principally<br>trade                         |                           | 68                | 624                                     | (5)                              | 687                 |
|  | 103                       | 2,223             | 379                                     | (2,705)                          |                     |



|   |                 |                 |                 |                   |                  |
|---|-----------------|-----------------|-----------------|-------------------|------------------|
| Accounts and notes payable<br>affiliated companies  |                 |                 |                 |                   |                  |
| Derivative liabilities                              |                 | 112             | 773             |                   | 885              |
| Other current liabilities                           | 11              | 182             | 256             | (23)              | 426              |
| <b>Total current liabilities</b>                    | <b>155</b>      | <b>2,585</b>    | <b>2,043</b>    | <b>(2,733)</b>    | <b>2,050</b>     |
| <b>Other Liabilities:</b>                           |                 |                 |                 |                   |                  |
| Notes payable affiliated<br>companies               |                 | 2,213           | 876             | (3,089)           |                  |
| Derivative liabilities                              |                 | 57              | 417             |                   | 474              |
| Other long-term liabilities                         | 539             | 152             | 284             | (696)             | 279              |
| Long-term liabilities of<br>discontinued operations |                 |                 | 4               |                   | 4                |
| <b>Total other liabilities</b>                      | <b>539</b>      | <b>2,422</b>    | <b>1,581</b>    | <b>(3,785)</b>    | <b>757</b>       |
| <b>Long-term Debt</b>                               | <b>1,986</b>    | <b>500</b>      | <b>417</b>      |                   | <b>2,903</b>     |
| <b>Commitments and<br/>Contingencies</b>            |                 |                 |                 |                   |                  |
| <b>Temporary Equity</b>                             |                 |                 |                 |                   |                  |
| <b>Stock-based Compensation</b>                     | <b>5</b>        |                 |                 |                   | <b>5</b>         |
| <b>Total Stockholders Equity</b>                    | <b>4,477</b>    | <b>546</b>      | <b>1,851</b>    | <b>(2,397)</b>    | <b>4,477</b>     |
| <b>Total Liabilities and Equity</b>                 | <b>\$ 7,162</b> | <b>\$ 6,053</b> | <b>\$ 5,892</b> | <b>\$ (8,915)</b> | <b>\$ 10,192</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.

**Table of Contents***Condensed Consolidating Statements of Cash Flows.***Six Months Ended June 30, 2008**

|  | <b>Reliant<br/>Energy</b> | <b>Guarantors</b> | <b>Non-Guarantors<br/>(in millions)</b> | <b>Adjustments<sup>(1)</sup></b> | <b>Consolidated</b> |
|--|---------------------------|-------------------|---|----------------------------------|---------------------|
| <b>Cash Flows from Operating Activities:</b>   |                           |                   |   |                                  |                     |
| Net cash provided by (used in) continuing operations from operating activities               | \$ 39                     | \$ (140)          | \$ 283                                  | \$                               | \$ 182              |
| Net cash provided by discontinued operations from operating activities                       |                           | 7                 | 2                                       |                                  | 9                   |
| Net cash provided by (used in) operating activities  | 39                        | (133)             | 285                                     |                                  | 191                 |
| <b>Cash Flows from Investing Activities:</b>   |                           |                   |   |                                  |                     |
| Capital expenditures   |                           | (13)              | (104)                                   |                                  | (117)               |
| Investments in, advances to and from and distributions from subsidiaries, net <sup>(2)</sup> | 30                        | 8                 | (83)                                    | 45                               |                     |
| Proceeds from sales (purchases) of emission and exchange allowances                          |                           | 59                | (48)                                    |                                  | 11                  |
| Restricted cash  |                           |                   | (4)                                     |                                  | (4)                 |
| Other, net   |                           | 1                 |   |                                  | 1                   |
| Net cash provided by (used in) investing activities  | 30                        | 55                | (239)                                   | 45                               | (109)               |
| <b>Cash Flows from Financing Activities:</b>   |                           |                   |   |                                  |                     |
| Payments of long-term debt   | (45)                      |                   |   |                                  | (45)                |
| Changes in notes with affiliated companies, net <sup>(3)</sup>                               |                           | 77                | (32)                                    | (45)                             |                     |
| Proceeds from issuances of stock   | 6                         |                   |   |                                  | 6                   |
| Net cash provided by (used in) financing activities  | (39)                      | 77                | (32)                                    | (45)                             | (39)                |
| <b>Net Change in Cash and Cash Equivalents</b>   | <b>30</b>                 | <b>(1)</b>        | <b>14</b>                               |                                  | <b>43</b>           |
| <b>Cash and Cash Equivalents at Beginning of Period</b>                                      | <b>490</b>                | <b>1</b>          | <b>264</b>                              |                                  | <b>755</b>          |
|  | \$ 520                    | \$                | \$ 278                                  | \$                               | \$ 798              |

**Cash and Cash Equivalents  
at End of Period**

**Table of Contents****Six Months Ended June 30, 2007**

|   | <b>Reliant<br/>Energy</b> | <b>Guarantors</b> | <b>Non-Guarantors<br/>(in millions)</b> | <b>Adjustments<sup>(1)</sup></b> | <b>Consolidated</b> |
|---|---------------------------|-------------------|---|----------------------------------|---------------------|
| <b>Cash Flows from Operating Activities:</b>  |                           |                   |   |                                  |                     |
| Net cash provided by (used in) continuing operations from operating activities                  | \$ 60                     | \$ (237)          | \$ 201                                  | \$                               | \$ 24               |
| Net cash used in discontinued operations from operating activities                              |                           |                   | (3)                                     |                                  | (3)                 |
| Net cash provided by (used in) operating activities   | 60                        | (237)             | 198                                     |                                  | 21                  |
| <b>Cash Flows from Investing Activities:</b>  |                           |                   |   |                                  |                     |
| Capital expenditures  |                           | (12)              | (87)                                    |                                  | (99)                |
| Investments in, advances to and from and distributions from subsidiaries, net <sup>(2)(3)</sup> | (40)                      |                   | (259)                                   | 299                              |                     |
| Net purchases of emission and exchange allowances   |                           | (3)               | (8)                                     |                                  | (11)                |
| Restricted cash   |                           | (1)               | 21                                      |                                  | 20                  |
| Other, net  |                           | 3                 | (1)                                     |                                  | 2                   |
| Net cash used in investing activities   | (40)                      | (13)              | (334)                                   | 299                              | (88)                |
| <b>Cash Flows from Financing Activities:</b>  |                           |                   |   |                                  |                     |
| Payments of long-term debt  | (1,458)                   |                   | (7)                                     |                                  | (1,465)             |
| Proceeds from long-term debt  | 1,300                     |                   |   |                                  | 1,300               |
| Increase in short-term borrowings and revolving credit facilities, net                          |                           |                   | 7                                       |                                  | 7                   |
| Changes in notes with affiliated companies, net <sup>(3)(4)</sup>                               |                           | 228               | 71                                      | (299)                            |                     |
| Payments of financing costs   | (30)                      |                   |   |                                  | (30)                |
| Payments of debt extinguishments  | (71)                      |                   |   |                                  | (71)                |
| Proceeds from issuances of stock  | 29                        |                   |   |                                  | 29                  |
| Other, net  | (1)                       |                   |   |                                  | (1)                 |
| Net cash provided by (used in) financing activities   | (231)                     | 228               | 71                                      | (299)                            | (231)               |

|   |       |      |       |        |
|---|-------|------|-------|--------|
| <b>Net Change in Cash and Cash Equivalents</b>          | (211) | (22) | (65)  | (298)  |
| <b>Cash and Cash Equivalents at Beginning of Period</b> | 286   | 24   | 154   | 464    |
| <b>Cash and Cash Equivalents at End of Period</b>       | \$ 75 | \$ 2 | \$ 89 | \$ 166 |

- (1) These amounts relate to either (a) eliminations and adjustments recorded in the normal consolidation process or (b) reclassifications recorded due to differences in classifications at the subsidiary levels compared to the consolidated level.
- (2) Net investments in, advances to and from and distributions from subsidiaries are classified as investing activities.
- (3) Reliant Energy converted intercompany notes payable of a guarantor subsidiary of \$753 million to equity during 2007.
- (4) Net changes in notes with affiliated companies are classified as financing activities for subsidiaries of Reliant Energy and as investing

activities for Reliant  
Energy.

**Table of Contents****(13) Reportable Segments**

Financial data for our segments are as follows:

|  | Retail<br>Energy | Wholesale<br>Energy     | Other<br>Operations<br>(in<br>millions) | Eliminations | Consolidated |
|--|------------------|-------------------------|---|--------------|--------------|
| <b>Three months ended</b>  |                  |                         |   |              |              |
| <b>June 30, 2008:</b>  |                  |                         |   |              |              |
| Revenues from external customers   | \$ 2,410         | \$ 1,014 <sup>(1)</sup> | \$ 3                                    | \$ (86)      | \$ 3,424     |
| Intersegment revenues  |                  | 83                      | 3                                       | (86)         |              |
| Contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives <sup>(2)(3)</sup> | 462              | 279 <sup>(4)</sup>      | 2                                       | (2)          | 741          |
| <b>Three months ended</b>  |                  |                         |   |              |              |
| <b>June 30, 2007:</b>  |                  |                         |   |              |              |
| Revenues from external customers   | \$ 1,994         | \$ 656                  | \$ 4                                    | \$ (145)     | \$ 2,650     |
| Intersegment revenues  |                  | 141                     | 4                                       | (145)        |              |
| Contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives <sup>(2)(5)</sup> | (234)            | 122 <sup>(6)</sup>      | 4                                       | (2)          | (110)        |
| <b>Six months ended June 30, 2008 (except as denoted):</b>   |                  |                         |   |              |              |
| Revenues from external customers   | \$ 4,345         | \$ 1,893 <sup>(7)</sup> | \$ 1                                    | \$ (137)     | \$ 6,239     |
| Intersegment revenues  |                  | 131                     | 6                                       | (137)        |              |
| Contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives <sup>(2)(8)</sup> | 1,056            | 496 <sup>(9)</sup>      | 3                                       | (3)          | 1,552        |
| Total assets as of June 30, 2008   | 6,372            | 8,340                   | 957                                     | (800)        | 14,869       |
| <b>Six months ended June 30, 2007 (except as denoted):</b>   |                  |                         |   |              |              |
| Revenues from external customers   | \$ 3,695         | \$ 1,317 <sup>(1)</sup> | \$ 7                                    | \$ (235)     | \$ 5,012     |
| Intersegment revenues  |                  | 228                     | 7                                       | (235)        |              |
| Contribution margin, including historical and  | 450              | 80 <sup>(11)</sup>      | 6                                       | (4)          | 532          |

operational wholesale hedges  
and unrealized gains/losses on  
energy derivatives <sup>(2)</sup>(10)

|   |       |       |                       |       |        |
|---|-------|-------|-----------------------|-------|--------|
| Total assets as of<br>December 31, 2007 | 2,285 | 7,720 | 1,081 <sup>(12)</sup> | (894) | 10,192 |
|---|-------|-------|-----------------------|-------|--------|

- (1) Includes \$146 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 \$502 million, \$68 million and \$570 million in retail energy, wholesale energy and consolidated, respectively, results relating to unrealized gains on energy derivatives, which is a non-cash item.
- (4) Includes \$69 million relating to historical and operational wholesale hedges.
- (5) Includes \$(360) million, \$34 million and \$(326) million in retail energy, wholesale



energy and consolidated, respectively, results relating to unrealized gains (losses) on energy derivatives, which is a non-cash item.

(6) Includes \$(30) million relating to historical and operational wholesale hedges.

(7) Includes \$253 million from affiliates.

(8) Includes \$1.0 billion, \$98 million and \$1.1 billion in retail energy, wholesale energy and consolidated, respectively, results relating to unrealized gains on energy derivatives, which is a non-cash item.

(9) Includes \$114 million relating to historical and operational wholesale hedges.

(10) Includes \$256 million, \$(60) million and \$196 million in

retail energy,  
wholesale  
energy and  
consolidated,  
respectively,  
results relating  
to unrealized  
gains (losses) on  
energy  
derivatives,  
which is a  
non-cash item.

(11) Includes \$(63)  
million relating  
to historical and  
operational  
wholesale  
hedges.

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

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|  | <b>Three Months Ended June</b> |                           | <b>Six Months Ended June 30,</b> |             |
|--|--------------------------------|---------------------------|----------------------------------|-------------|
|  | <b>2008</b>                    | <b>30,</b><br><b>2007</b> | <b>2008</b>                      | <b>2007</b> |
|  | <b>(in millions)</b>           |                           |                                  |             |
| Contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | \$ 741                         | \$ (110)                  | \$ 1,552                         | \$ 532      |
| Other general and administrative   | 41                             | 54                        | 77                               | 95          |
| Western states litigation and similar settlements  |                                |                           | 34                               | 22          |
| Gains on sales of assets and emission and exchange allowances, net   | (22) <sup>(1)</sup>            | (2)                       | (23) <sup>(1)</sup>              | (2)         |
| Depreciation   | 68                             | 86                        | 136                              | 173         |
| Amortization   | 20                             | 24                        | 41                               | 29          |
| Operating income (loss)  | 634                            | (272)                     | 1,287                            | 215         |
| Income of equity investment, net   | 1                              | 2                         | 1                                | 3           |
| Debt extinguishments   |                                | (71)                      |                                  | (71)        |
| Other, net   |                                | (1)                       |                                  |             |
| Interest expense   | (63)                           | (122)                     | (126)                            | (209)       |
| Interest income  | 10                             | 8                         | 20                               | 18          |
| Income (loss) from continuing operations before income taxes   | 582                            | (456)                     | 1,182                            | (44)        |
| Income tax expense (benefit)   | 223                            | (175)                     | 452                              | (23)        |
| Income (loss) from continuing operations   | 359                            | (281)                     | 730                              | (21)        |
| Income (loss) from discontinued operations   |                                | (2)                       | 6                                | (3)         |
| Net income (loss)  | \$ 359                         | \$ (283)                  | \$ 736                           | \$ (24)     |

(1) Includes gains of \$26 million related to sales of carbon dioxide exchange allowances.

**(14) Sale of Channelview's Plant and the 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. Channelview LP filed for bankruptcy protection to prevent the lenders from exercising their remedies, including foreclosing on the project. 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.

In June 2008, the bankruptcy court approved the sale of Channelview's plant and assignment of related contracts for \$500 million. During the second quarter of 2008, we recognized a \$5 million charge relating to an impairment of our

net investment in and receivables from Channelview and incurrence of sale-related costs (classified in gains (losses) on sales of assets and emission and exchange allowances, net). This charge is subject to change. As of June 30, 2008, our net investment in and receivables from Channelview was \$85 million, classified as a current asset. The sale was completed on July 1, 2008, at which time Channelview LP paid off its secured lenders and distributed \$15 million to us. Channelview expects to distribute additional funds to us relating primarily to previous sales of fuel, funds from operations and funds escrowed for potential indemnification claims (of approximately \$50 million in the aggregate) over the next year.

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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. We will continue to account for Channelview as a cost method investment until the emergence from bankruptcy, which is expected to occur later in 2008. The following table contains certain combined financial information of Channelview:

|  | <b>June 30,<br/>2008</b> | <b>December 31, 2007<br/>(in millions)</b> |
|--|--------------------------|--|
| Property, plant and equipment, net                   | \$ 354                   | \$ 356                                     |
| Secured debt obligations, including accrued interest | 340                      | 340  |
| Payables to Reliant Energy and its subsidiaries, net | 90                       | 96   |

**(15) Sale of Bighorn Plant**

In April 2008, we entered into an agreement to sell our Bighorn natural gas-fired combined-cycle electric generation facility located in Clark County, Nevada with a nominal capacity of 598 megawatts and assign some related contracts. The Bighorn plant is a part of our wholesale energy segment. The \$500 million purchase price is subject to certain adjustments, which are not expected to be material. The sale is subject to customary closing conditions, including the approval of the Public Utilities Commission of Nevada. The Federal Energy Regulatory Commission has authorized the sale. We expect to close in the fourth quarter of 2008 and expect to recognize a pre-tax gain on the sale of approximately \$45 million. As of June 30, 2008, we have the following assets and liabilities classified as held for sale:

|  | <b>June 30, 2008<br/>(in millions)</b> |
|--|--|
| Property, plant and equipment, net                 | \$ 404                                 |
| Goodwill   | 21                                     |
| Prepaid and other assets                           | 28                                     |
| <b>Total held for sale assets for Bighorn</b>      | <b>\$ 453</b>                          |
| Deferred tax liabilities                           | \$ 51                                  |
| Other  | 2                                      |
| <b>Total held for sale liabilities for Bighorn</b> | <b>\$ 53</b>                           |

**(16) Discontinued Operations**

Subsequent to the sale of our New York plants in February 2006, we continue to have (a) insignificant settlements with the independent system operator and (b) property tax and sales and use tax settlements. In addition, we periodically record amounts for contingent consideration for the 2003 sale of our European energy operations. These amounts are classified as discontinued operations in our results of operations and consolidated balance sheets, as applicable.

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**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. These non-GAAP financial measures, which are discussed further in Consolidated Results of Operations, reflect an additional way of viewing aspects of our operations that, when viewed with our GAAP results, may provide a more complete understanding of factors and trends affecting our business segments. Investors should review our consolidated financial statements and publicly filed reports in their entirety and not rely on any single financial measure.

**Business Overview**

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

*Retail energy* provides electricity and energy services to approximately 1.8 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. We have approximately 15,000 megawatts 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) compared to our wholesale energy segment. We earn a margin by selling electricity to end-use customers and acquiring supply for the estimated demand. 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 (operating costs). These earnings drivers are impacted by various factors including:

Volume of electricity sales

Local weather patterns

Number and type of customers

Energy efficiency behaviors

Expansion into new markets

Unit margins

Competitive tactics of other retailers in the market

Cost of supply compared to revenue rate charged

Incremental value-added services

Operating costs

Operating efficiencies

Cost to acquire and retain customers

Ability to collect

*Wholesale Energy.* The wholesale energy segment is a capital-intensive, cyclical business. Earnings are significantly impacted by spark spreads and capacity prices. Spark spreads are driven by a number of factors, including the prices

of natural gas, coal and fuel oil, the cost of emissions, transmission, weather and global macro-economic factors, none of which we control. 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 (commercial capacity factor). The key earnings drivers in the wholesale energy segment are the amount of time our power plants are economical to operate (economic generation) and commercial capacity factor, which both determine the amount of electricity we generate, the margin we earn for each unit of electricity sold, the availability of our generating assets to meet demand (other margin) and operating costs. These earnings drivers are impacted by various factors including:

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Economic generation  
     Supply and demand fundamentals  
     Spark spreads  
     Generation asset fuel type and efficiency  
 Commercial capacity factor  
     Operations excellence  
     Maintenance practices  
 Unit margin  
     Supply and demand fundamentals  
     Commodity prices  
     Generation asset fuel type and efficiency  
 Other margin  
     Capacity prices  
     Power purchase agreements sold to others  
     Ancillary services  
 Operating costs  
     Operating efficiencies  
     Maintenance practices  
     Generation asset fuel type

**Recent Events**

*Bighorn Plant.* In April 2008, we entered into an agreement to sell our Bighorn natural gas-fired combined-cycle electric generation facility located in Clark County, Nevada with a nominal capacity of 598 megawatts for \$500 million and assign some related contracts. See note 15 to our interim financial statements for further discussion.

*Retail Energy Segment.* The Houston area experienced thirty-year record heat in late May and early June 2008. As a result, load demand in Houston and south Texas was greater than we expected. Additionally, transmission constraints limited the ability to move power into the Houston and south Texas zones, which caused some of our power supply to be unavailable to meet expected demand. In response, we purchased power in Houston and south Texas to meet our increased load at market prices, which resulted in negative retail contribution margin in our retail energy segment for the second quarter of 2008. We have secured retail supply for the remainder of 2008 and beyond from sources in Houston and south Texas for our expected load, which will result in lower third quarter retail contribution margin in 2008 compared to 2007. Given the significant volatility in supply prices, we have and will continue to refine our pricing and supply strategies. See Consolidated Results of Operations below for further explanation and Risk Factors in Item 1A of our Form 10-K.

*Channelview.* In July 2008, Channelview completed the sale of its plant for \$500 million. See note 14 to our interim financial statements for further discussion.

*Environmental Matters.* In July 2008, the District of Columbia Circuit Court of Appeals vacated the EPA's Clean Air Interstate Rule (CAIR) and remanded it to the EPA. The decision raises questions as to whether the EPA can design new cap-and-trade programs for nitrogen oxides (NO<sub>x</sub>) and sulfur dioxide (SO<sub>2</sub>) that are consistent with the Clean Air Act provisions that address upwind contributions to downward states noncompliance with national ambient air quality standards for ozone and fine particulate matter. The decision sets aside CAIR's proposed annual allowance-based NO<sub>x</sub>



program and the increased surrender rate for SO<sub>2</sub> allowances. The existing ozone season NO<sub>x</sub> program and the SO<sub>2</sub> allowance requirements under the Clean Air Act's acid rain program will continue. We do not know if the EPA will appeal the decision. We cannot reasonably estimate changes, if any, to our capital expenditures or operating costs for this ruling or any additional regulations that may be enacted.

In June 2008, we revised our estimated capital expenditures for compliance with the first phase of Pennsylvania's mercury control program to approximately \$50 million. This amount is adjusted from our preliminary estimate for the first phase of the program of \$88 million to \$103 million as a result of refined site-specific engineering and technology evaluations.

**Table of Contents****Consolidated Results of Operations****Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007**

We reported \$359 million consolidated net income, or \$1.01 income per diluted share, for the three months ended June 30, 2008 compared to \$283 million consolidated net loss, or \$0.83 loss per share, for the same period in 2007.

|   | <b>Three Months Ended June 30,</b> |             |               |
|---|------------------------------------|-------------|---------------|
|   | <b>2008</b>                        | <b>2007</b> | <b>Change</b> |
|   | <b>(in millions)</b>               |             |               |
| Retail energy contribution margin, including unrealized gains/losses on energy derivatives  | \$ 462                             | \$ (234)    | \$ 696        |
| Wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | 279                                | 122         | 157           |
| Other contribution margin   |                                    | 2           | (2)           |
| Other general and administrative  | (41)                               | (54)        | 13            |
| Gains on sales of assets and emission and exchange allowances, net  | 22                                 | 2           | 20            |
| Depreciation and amortization   | (88)                               | (110)       | 22            |
| Income of equity investment, net  | 1                                  | 2           | (1)           |
| Debt extinguishments  |                                    | (71)        | 71            |
| Other, net  |                                    | (1)         | 1             |
| Interest expense  | (63)                               | (122)       | 59            |
| Interest income   | 10                                 | 8           | 2             |
| Income tax (expense) benefit  | (223)                              | 175         | (398)         |
| Income (loss) from continuing operations  | 359                                | (281)       | 640           |
| Loss from discontinued operations   |                                    | (2)         | 2             |
| Net income (loss)   | \$ 359                             | \$ (283)    | \$ 642        |

***Retail Energy Segment.***

In analyzing the results of our retail energy segment and in communications with investors, analysts, rating agencies, banks and other parties, we use the non-GAAP financial measures retail gross margin and retail contribution margin, which excludes the item described below, 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 without considering the GAAP financial measures.

*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 \$462 million during the three months ended June 30, 2008, compared to \$(234) million in the same period of 2007. The \$696 million increase was primarily due to the net change in unrealized gains/losses on energy derivatives of \$862 million. Retail contribution margin decreased \$166 million primarily due to \$170 million decrease in retail gross margin, partially offset by \$15 million decrease in bad debt expense. See Retail Energy Margins below for explanations.

**Table of Contents***Retail Energy Operational Data.*

|   | <b>Three Months Ended June 30,</b> |             |
|---|------------------------------------|-------------|
|   | <b>2008</b>                        | <b>2007</b> |
|   | <b>(gigawatt hours)</b>            |             |
| <b>Electricity Sales to End-Use Retail Customers:</b> |                                    |             |
| Mass:   |                                    |             |
| Residential:  |                                    |             |
| Houston   | 3,523                              | 3,542       |
| Non-Houston   | 2,000                              | 1,923       |
| Small Business:                                       |                                    |             |
| Houston   | 738                                | 756         |
| Non-Houston   | 382                                | 365         |
| Total Mass  | 6,643                              | 6,586       |
| Commercial and Industrial:                            |                                    |             |
| ERCOT <sup>(1)(2)</sup>                               | 9,752                              | 9,052       |
| Non-ERCOT   | 1,506                              | 1,106       |
| Total Commercial and Industrial                       | 11,258                             | 10,158      |
| Market usage adjustments                              | 5                                  | 28          |
| Total   | 17,906                             | 16,772      |

(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.

|  | <b>Three Months Ended June 30,</b>       |             |
|--|--|-------------|
|  | <b>2008</b>                              | <b>2007</b> |
|  | <b>(in thousands, metered locations)</b> |             |
| <b>Weighted Average Retail Customer Count:</b> |  |             |
| Mass:  |  |             |
| Residential:                                   |  |             |
| Houston  | 988                                      | 1,066       |

|  |       |       |
|--|-------|-------|
| Non-Houston                              | 541   | 565   |
| Small Business:                          |       |       |
| Houston                                  | 109   | 117   |
| Non-Houston                              | 39    | 35    |
| Total Mass                               | 1,677 | 1,783 |
| Commercial and Industrial <sup>(1)</sup> | 93    | 89    |
| Total                                    | 1,770 | 1,872 |

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

|  | <b>June 30,<br/>2008</b>                 | <b>December 31,<br/>2007</b> |
|--|--|------------------------------|
|  | <b>(in thousands, metered locations)</b> |                              |
| <b>Retail Customers:</b>                 |  |                              |
| Mass:                                    |  |                              |
| Residential:                             |  |                              |
| Houston                                  | 999                                      | 1,016                        |
| Non-Houston                              | 549                                      | 555                          |
| Small Business:                          |  |                              |
| Houston                                  | 110                                      | 109                          |
| Non-Houston                              | 39                                       | 38                           |
| Total Mass                               | 1,697                                    | 1,718                        |
| Commercial and Industrial <sup>(1)</sup> | 93                                       | 93                           |
| Total                                    | 1,790                                    | 1,811                        |

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

**Table of Contents***Retail Energy Revenues.*

|  | <b>Three Months Ended June 30,</b> |             |                        |
|--|------------------------------------|-------------|------------------------|
|  | <b>2008</b>                        | <b>2007</b> | <b>Change</b>          |
|  | <b>(in millions)</b>               |             |                        |
| Retail energy revenues from end-use retail customers:                                  |                                    |             |                        |
| Mass:  |                                    |             |                        |
| Residential:   |                                    |             |                        |
| Houston  | \$ 529                             | \$ 542      | \$ (13) <sup>(1)</sup> |
| Non-Houston  | 275                                | 271         | 4                      |
| Small Business:  |                                    |             |                        |
| Houston  | 115                                | 122         | (7)                    |
| Non-Houston  | 54                                 | 51          | 3                      |
| Total Mass   | 973                                | 986         | (13)                   |
| Commercial and Industrial:   |                                    |             |                        |
| ERCOT  | 1,036                              | 822         | 214 <sup>(2)</sup>     |
| Non-ERCOT  | 140                                | 80          | 60 <sup>(3)</sup>      |
| Total Commercial and Industrial  | 1,176                              | 902         | 274                    |
| Total  | 2,149                              | 1,888       | 261                    |
| Retail energy revenues from resales of purchased power and other<br>hedging activities | 261                                | 112         | 149 <sup>(4)</sup>     |
| Market usage adjustments <sup>(5)</sup>  |                                    | (6)         | 6                      |
| Total retail energy revenues   | \$ 2,410                           | \$ 1,994    | \$ 416                 |

(1) Decrease primarily due to  
(a) lower unit sales prices and  
(b) lower volumes driven by (i) fewer number of customers and (ii) a change in customer usage and mix, partially offset by warmer weather.

(2)

Increase primarily due to (a) higher unit sales prices due to (i) variable rate contracts, which are tied to the market price of natural gas and (ii) fixed price contracts renewed at higher market rates due to higher prices of electricity when contracts were executed and (b) higher volumes due to (i) increased number of customers and (ii) a change in customer usage and mix.

(3) Increase primarily due to (a) higher unit sales prices due to higher prices of electricity when contracts were executed and (b) higher volumes due to increased number of customers, partially offset by a change in customer usage and mix.

(4) Increase primarily due to our supply management activities in various markets

in Texas.

- (5) 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 ).

*Retail Energy Cost of Sales.*

|   | <b>Three Months Ended June 30,</b> |             |                      |
|---|------------------------------------|-------------|----------------------|
|   | <b>2008</b>                        | <b>2007</b> | <b>Change</b>        |
|   | <b>(in millions)</b>               |             |                      |
| Costs of sales                                  | \$ 2,260                           | \$ 1,606    | \$ 654               |
| Retail energy intersegments costs               | 83                                 | 141         | (58)                 |
| Subtotal  | 2,343                              | 1,747       | 596 <sup>(1)</sup>   |
| Market usage adjustments                        |                                    | 10          | (10)                 |
| Unrealized (gains) losses on energy derivatives | (502)                              | 360         | (862) <sup>(2)</sup> |
| Total retail energy cost of sales               | \$ 1,841                           | \$ 2,117    | \$ (276)             |



- (1) Increase primarily due to
  - (a) higher unit prices of purchased power at the time of procurement due in part to weather and
  - (b) higher volumes due to
    - (i) warmer weather and
    - (ii) increased number of commercial and industrial customers. This increase was partially offset by lower volumes due to
      - (a) fewer number of mass customers and
      - (b) a change in customer usage and mix.
  
- (2) See footnote 4 under Retail Energy Margins.

**Table of Contents***Retail Energy Margins.*

|   | <b>Three Months Ended June 30,</b> |             |                         |
|---|------------------------------------|-------------|-------------------------|
|   | <b>2008</b>                        | <b>2007</b> | <b>Change</b>           |
|   | <b>(in millions)</b>               |             |                         |
| Mass gross margin   | \$ 66                              | \$ 201      | \$ (135) <sup>(1)</sup> |
| Commercial and industrial gross margin  | 1                                  | 52          | (51) <sup>(2)</sup>     |
| Market usage adjustments  |                                    | (16)        | 16                      |
| Retail gross margin   | 67                                 | 237         | (170)                   |
| Operation and maintenance   | (63)                               | (60)        | (3)                     |
| Selling and marketing expense   | (38)                               | (30)        | (8)                     |
| Bad debt expense  | (6)                                | (21)        | 15 <sup>(3)</sup>       |
| Retail contribution margin  | (40)                               | 126         | (166)                   |
| Unrealized gains (losses) on energy derivatives   | 502                                | (360)       | 862 <sup>(4)</sup>      |
| Total retail energy contribution margin, including unrealized gains/losses on energy derivatives <sup>(5)</sup> | \$ 462                             | \$ (234)    | \$ 696                  |

- (1) Decrease primarily due to lower unit margins driven by (a) higher unit prices of purchased power at the time of procurement, (b) higher market rates on incremental volumes purchased for higher customer load due to weather, (c) increased cost of intra-month congestion and (d) lower unit sales prices.

- (2) Decrease primarily due to lower unit margins driven by (a) higher unit prices of purchased power at the time of procurement, (b) increased cost of intra-month congestion and (c) higher load related charges. This decrease was partially offset by (a) higher unit sales prices driven by (i) variable rate contracts, which are tied to the market price of natural gas and (ii) fixed price contracts renewed at higher market rates due to higher prices of electricity when the contracts were executed and (b) higher volumes due to increased number of customers.
- (3) Decrease primarily due to improved collections.
- (4) Increase primarily due to \$1.1 billion gain from changes in

prices on our derivatives marked to market, partially offset by \$190 million loss on energy derivatives settled during the period.

- (5) Retail energy segment profit and loss measure.

***Wholesale Energy Segment.***

In analyzing the results of our wholesale energy segment and in communications with investors, analysts, rating agencies, banks and other parties, 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 without considering the GAAP financial measures.

*Historical and Operational Wholesale Hedges.* We exclude the recurring effect of certain historical 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.



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Our wholesale energy segment's contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives was \$279 million during the three months ended June 30, 2008 compared to \$122 million in the same period of 2007. The \$157 million increase was primarily due to (a) \$99 million increase in historical and operational wholesale hedges and (b) net change in unrealized gains/losses on energy derivatives of \$34 million. Open wholesale contribution margin increased \$24 million primarily due to \$15 million increase in open wholesale gross margin and \$9 million decrease in operation and maintenance expenses. See Wholesale Energy Margins below for explanations.

*Wholesale Energy Operational and Financial Data.*

|  | <b>Three Months Ended June 30,</b> |                                     |             |                                     |
|--|------------------------------------|-------------------------------------|-------------|-------------------------------------|
|  | <b>2008</b>                        |                                     | <b>2007</b> |                                     |
|  | <b>GWh</b>                         | <b>%<br/>Economic<sup>(1)</sup></b> | <b>GWh</b>  | <b>%<br/>Economic<sup>(1)</sup></b> |
| <b>Economic Generation<sup>(2)(3)</sup>:</b>           |                                    |                                     |             |                                     |
| PJM Coal   | 5,316.6                            | 73%                                 | 6,028.7     | 83%                                 |
| MISO Coal  | 1,359.3                            | 49%                                 | 2,063.3     | 75%                                 |
| PJM/MISO Gas   | 352.0                              | 5%                                  | 339.4       | 5%                                  |
| West   | 308.6                              | 4%                                  | 898.9       | 13%                                 |
| Other  | 7.0                                | 1%                                  | 1,413.3     | 69%                                 |
| Total  | 7,343.5                            | 29%                                 | 10,743.6    | 41%                                 |
| <b>Commercial Capacity Factor<sup>(4)</sup>:</b>       |                                    |                                     |             |                                     |
| PJM Coal   |                                    | 83.7%                               |             | 75.9%                               |
| MISO Coal  |                                    | 90.8%                               |             | 51.3%                               |
| PJM/MISO Gas   |                                    | 91.6%                               |             | 91.1%                               |
| West   |                                    | 94.1%                               |             | 95.1%                               |
| Other  |                                    | 81.4%                               |             | 91.9%                               |
| Total  |                                    | 85.9%                               |             | 75.4%                               |
| <b>Generation<sup>(3)</sup>:</b>                       |                                    |                                     |             |                                     |
| PJM Coal   | 4,452.3                            |                                     | 4,575.2     |                                     |
| MISO Coal  | 1,233.9                            |                                     | 1,058.7     |                                     |
| PJM/MISO Gas   | 322.6                              |                                     | 309.2       |                                     |
| West   | 290.4                              |                                     | 855.2       |                                     |
| Other  | 5.7                                |                                     | 1,298.7     |                                     |
| Total  | 6,304.9                            |                                     | 8,097.0     |                                     |
| <b>Open Energy Unit Margin (\$/MWh)<sup>(5)</sup>:</b> |                                    |                                     |             |                                     |
| PJM Coal   | \$ 36.16                           |                                     | \$ 32.57    |                                     |
| MISO Coal  | 23.50                              |                                     | 30.23       |                                     |
| PJM/MISO Gas   | 46.50                              |                                     | 29.11       |                                     |
| West   | NM <sup>(6)</sup>                  |                                     |             |                                     |
| Other  |                                    |                                     | 5.39        |                                     |

|                        |          |          |
|------------------------|----------|----------|
| Total weighted average | \$ 32.04 | \$ 24.33 |
|------------------------|----------|----------|

(1) Represents economic generation (hours) divided by maximum generation hours (maximum plant capacity multiplied by 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) Excludes generation related to power purchase agreements, including tolling agreements.

(4) Generation divided by economic generation.

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

(6)

NM is not  
meaningful.



**Table of Contents***Wholesale Energy Revenues.*

|  | <b>Three Months Ended June 30,</b> |             |                       |
|--|------------------------------------|-------------|-----------------------|
|  | <b>2008</b>                        | <b>2007</b> | <b>Change</b>         |
|  | <b>(in millions)</b>               |             |                       |
| Wholesale energy third-party revenues  | \$ 862                             | \$ 667      | \$ 195 <sup>(1)</sup> |
| Wholesale energy intersegment revenues | 83                                 | 141         | (58) <sup>(2)</sup>   |
| Subtotal                               | 945                                | 808         | 137                   |
| Revenues affiliates                    | 146 <sup>(3)</sup>                 |             | 146                   |
| Unrealized gains (losses)              | 6                                  | (11)        | 17 <sup>(4)</sup>     |
| Total wholesale energy revenues        | \$ 1,097                           | \$ 797      | \$ 300                |

- (1) Increase primarily due to
- (a) higher power and natural gas sales prices,
  - (b) higher RPM capacity payments and
  - (c) higher power sales volumes.
- RPM is the model utilized by the PJM Interconnection, LLC to meet load serving entities forecasted capacity obligations via a forward-looking commitment of capacity resources. This increase was partially offset by (a) lower natural gas sales volumes and (b) lower steam

sales due to the deconsolidation of Channelview on August 20, 2007.

(2) Decrease primarily due to (a) lower power sales volumes and (b) lower natural gas sales volumes related to a contract that ended in October 2007. This decrease was partially offset by higher power sales prices.

(3) We deconsolidated Channelview on August 20, 2007. These revenues represent sales of fuel to Channelview.

(4) See footnote 9 under Wholesale Energy Margins.

*Wholesale Energy Cost of Sales.*

|                                      | <b>Three Months Ended June 30,</b> |             |                      |
|--------------------------------------|------------------------------------|-------------|----------------------|
|                                      | <b>2008</b>                        | <b>2007</b> | <b>Change</b>        |
|                                      | <b>(in millions)</b>               |             |                      |
| Wholesale energy third-party costs   | \$ 593                             | \$ 545      | \$ 48 <sup>(1)</sup> |
| Cost of sales affiliates             | 121 <sup>(2)</sup>                 |             | 121                  |
| Unrealized gains                     | (62)                               | (45)        | (17) <sup>(3)</sup>  |
| Total wholesale energy cost of sales | \$ 652                             | \$ 500      | \$ 152               |

(1)

Increase primarily due to (a) higher prices paid for natural gas and (b) higher coal prices. This increase was partially offset by lower purchased natural gas volumes.

(2) We deconsolidated Channelview on August 20, 2007. These cost of sales represent purchases of power from Channelview.

(3) See footnote 9 under Wholesale Energy Margins.

**Table of Contents***Wholesale Energy Margins.*

|   | <b>Three Months Ended June 30,</b> |             |                      |
|---|------------------------------------|-------------|----------------------|
|   | <b>2008</b>                        | <b>2007</b> | <b>Change</b>        |
|   | <b>(in millions)</b>               |             |                      |
| Open energy gross margin <sup>(1)</sup> :   |                                    |             |                      |
| PJM Coal  | \$ 161                             | \$ 149      | \$ 12 <sup>(2)</sup> |
| MISO Coal   | 29                                 | 32          | (3)                  |
| PJM/MISO Gas  | 15                                 | 9           | 6                    |
| West  | (3)                                |             | (3)                  |
| Other   |                                    | 7           | (7)                  |
| Total   | 202                                | 197         | 5                    |
| Other margin <sup>(3)</sup> :   |                                    |             |                      |
| PJM Coal  | 26                                 | 15          | 11 <sup>(4)</sup>    |
| MISO Coal   | 3                                  | 3           |                      |
| PJM/MISO Gas  | 33                                 | 25          | 8 <sup>(5)</sup>     |
| West  | 34                                 | 36          | (2)                  |
| Other   | 10                                 | 17          | (7) <sup>(6)</sup>   |
| Total   | 106                                | 96          | 10                   |
| Open wholesale gross margin   | 308                                | 293         | 15                   |
| Operation and maintenance   | (166)                              | (175)       | 9 <sup>(7)</sup>     |
| Open wholesale contribution margin  | 142                                | 118         | 24                   |
| Historical and operational wholesale hedges   | 69                                 | (30)        | 99 <sup>(8)</sup>    |
| Unrealized gains on energy derivatives  | 68                                 | 34          | 34 <sup>(9)</sup>    |
| Total wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives <sup>(10)</sup> | \$ 279                             | \$ 122      | \$ 157               |

(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, our historical and operational wholesale hedges and unrealized gains/losses on energy derivatives.

- (2) Increase primarily due to
  - (a) higher open energy unit margins (higher power prices partially offset by higher fuel costs) and
  - (b) higher commercial capacity factor related to fewer planned outages in 2008. This increase was partially offset by lower economic generation.
- (3) Other margin represents power purchase agreements, capacity payments, ancillary services revenues and selective commercial hedge strategies.
- (4) Increase primarily due to higher RPM capacity payments.

- (5) Increase primarily due to higher RPM capacity payments, partially offset by lower revenue from power purchase agreements.
- (6) Decrease primarily due to the deconsolidation of Channelview on August 20, 2007.
- (7) Decrease primarily due to (a) the deconsolidation of Channelview on August 20, 2007 and (b) \$3 million decrease in planned outages and maintenance spending. This decrease was partially offset by \$6 million increase in services and support.
- (8) Increase primarily due to (a) \$82 million in higher margins on operational hedges and (b) \$38 million decrease in losses on closed power hedges. This increase

was partially offset by \$19 million decrease on hedges of gas transportation.

- (9) Increase primarily due to \$90 million gain from changes in prices on our derivatives marked to market, partially offset by \$58 million loss on energy derivatives settled during the period.

- (10) Wholesale energy segment profit and loss measure.

**Table of Contents***Other General and Administrative.*

|  | <b>Three Months Ended June 30,</b> |             |               |
|--|------------------------------------|-------------|---------------|
|  | <b>2008</b>                        | <b>2007</b> | <b>Change</b> |
|  | <b>(in millions)</b>               |             |               |
| Salaries and benefits  | \$ 24                              | \$ 31       | \$ (7)        |
| Professional fees, contract services and information systems maintenance | 9                                  | 12          | (3)           |
| Rent and utilities   | 5                                  | 5           |               |
| Legal costs  | 1                                  | 2           | (1)           |
| Other, net   | 2                                  | 4           | (2)           |
| Other general and administrative   | \$ 41                              | \$ 54       | \$ (13)       |

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

|  | <b>Three Months Ended June 30,</b> |             |               |
|--|------------------------------------|-------------|---------------|
|  | <b>2008</b>                        | <b>2007</b> | <b>Change</b> |
|  | <b>(in millions)</b>               |             |               |
| Emission and exchange allowances                                   | \$ 27 <sup>(1)</sup>               | \$ 2        | \$ 25         |
| Investment in and receivables from Channelview                     | (5) <sup>(2)</sup>                 |             | (5)           |
| Gains on sales of assets and emission and exchange allowances, net | \$ 22                              | \$ 2        | \$ 20         |

(1) Includes gains of \$26 million related to sales of carbon dioxide exchange allowances.

(2) In the second quarter of 2008, we executed an agreement to sell the Channelview plant and assign related contracts. This amount represents our



estimated loss on the sale. See note 14 to our interim financial statements.

*Depreciation and Amortization.*

|                                     | <b>Three Months Ended June 30,</b> |             |                        |
|-------------------------------------|------------------------------------|-------------|------------------------|
|                                     | <b>2008</b>                        | <b>2007</b> | <b>Change</b>          |
|                                     | <b>(in millions)</b>               |             |                        |
| Depreciation on plants              | \$ 59                              | \$ 76       | \$ (17) <sup>(1)</sup> |
| Depreciation on information systems | 8                                  | 8           |                        |
| Other, net depreciation             | 1                                  | 2           | (1)                    |
| Depreciation                        | 68                                 | 86          | (18)                   |
| Amortization of emission allowances | 19                                 | 23          | (4)                    |
| Other, net amortization             | 1                                  | 1           |                        |
| Amortization                        | 20                                 | 24          | (4)                    |
| Depreciation and amortization       | \$ 88                              | \$ 110      | \$ (22)                |

(1) Decrease primarily due to (a) early retirements of plant components when replacement components are installed for upgrades (from \$13 million in 2007 to \$4 million in 2008), (b) the deconsolidation of Channelview on August 20, 2007 and (c) the classification of Bighorn assets as held for sale in April 2008, which requires depreciation to

cease.

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*Income of Equity Investment, Net.* This represents income, which did not change significantly, from our equity method investment in Sabine Cogen, LP.

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

*Interest Expense.*

|   | <b>Three Months Ended June 30,</b> |             |                     |
|---|------------------------------------|-------------|---------------------|
|   | <b>2008</b>                        | <b>2007</b> | <b>Change</b>       |
|   | <b>(in millions)</b>               |             |                     |
| Fixed-rate debt   | \$ 58                              | \$ 59       | \$ (1)              |
| Fees for MWh's delivered under credit-enhanced retail structure | 7                                  | 7           |                     |
| Deferred financing costs  | 1                                  | 42          | (41) <sup>(1)</sup> |
| Variable-rate debt  |                                    | 6           | (6)                 |
| Channelview   |                                    | 7           | (7) <sup>(2)</sup>  |
| Amortization of fair value adjustment of acquired debt          | (3)                                | (4)         | 1                   |
| Capitalized interest  | (4)                                | (2)         | (2)                 |
| Other, net  | 4                                  | 7           | (3)                 |
| Interest expense  | \$ 63                              | \$ 122      | \$ (59)             |

(1) Decrease primarily due to \$39 million write-off due to early extinguishments of debt in the second quarter of 2007.

(2) Decrease due to the deconsolidation of Channelview on August 20, 2007.

*Interest Income.*

|  | <b>Three Months Ended June 30,</b> |             |               |
|--|------------------------------------|-------------|---------------|
|  | <b>2008</b>                        | <b>2007</b> | <b>Change</b> |
|  | <b>(in millions)</b>               |             |               |
| Interest on temporary cash investments | \$ 7                               | \$ 6        | \$ 1          |
| Net margin deposits                    | 3                                  | 2           | 1             |
| Interest income                        | \$ 10                              | \$ 8        | \$ 2          |

*Income Tax Expense.* See note 9 to our interim financial statements.

*Income (Loss) from Discontinued Operations.* See note 16 to our interim financial statements.

**Table of Contents****Six Months Ended June 30, 2008 Compared to Six Months Ended June 30, 2007**

We reported \$736 million consolidated net income, or \$2.08 income per diluted share, for the six months ended June 30, 2008 compared to \$24 million consolidated net loss, or \$0.07 loss per share, for the same period in 2007.

|   | <b>Six Months Ended June 30,</b> |             |               |
|---|----------------------------------|-------------|---------------|
|   | <b>2008</b>                      | <b>2007</b> | <b>Change</b> |
|   | <b>(in millions)</b>             |             |               |
| Retail energy contribution margin, including unrealized gains/losses on energy derivatives  | \$ 1,056                         | \$ 450      | \$ 606        |
| Wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | 496                              | 80          | 416           |
| Other contribution margin   |                                  | 2           | (2)           |
| Other general and administrative  | (77)                             | (95)        | 18            |
| Western states litigation and similar settlements   | (34)                             | (22)        | (12)          |
| Gains on sales of assets and emission and exchange allowances, net  | 23                               | 2           | 21            |
| Depreciation and amortization   | (177)                            | (202)       | 25            |
| Income of equity investment, net  | 1                                | 3           | (2)           |
| Debt extinguishments  |                                  | (71)        | 71            |
| Interest expense  | (126)                            | (209)       | 83            |
| Interest income   | 20                               | 18          | 2             |
| Income tax (expense) benefit  | (452)                            | 23          | (475)         |
| Income (loss) from continuing operations  | 730                              | (21)        | 751           |
| Income (loss) from discontinued operations  | 6                                | (3)         | 9             |
| Net income (loss)   | \$ 736                           | \$ (24)     | \$ 760        |

**Retail Energy Segment.**

Our retail energy segment's contribution margin, including unrealized gains/losses on energy derivatives was \$1,056 million during the six months ended June 30, 2008, compared to \$450 million in the same period of 2007. The \$606 million increase was primarily due to the net change in unrealized gains/losses on energy derivatives of \$774 million. Retail contribution margin decreased \$168 million primarily due to \$181 million decrease in retail gross margin, partially offset by \$25 million decrease in bad debt expense. See [Retail Energy Margins](#) below for explanations.

**Retail Energy Operational Data.**

|   | <b>Six Months Ended June 30,</b> |             |
|---|----------------------------------|-------------|
|   | <b>2008</b>                      | <b>2007</b> |
|   | <b>(gigawatt hours)</b>          |             |
| <b>Electricity Sales to End-Use Retail Customers:</b> |                                  |             |
| Mass:   |                                  |             |
| Residential:  |                                  |             |
| Houston   | 5,832                            | 6,187       |
| Non-Houston   | 3,772                            | 3,849       |
| Small Business:                                       |                                  |             |
| Houston   | 1,321                            | 1,471       |

|                                 |        |        |
|---------------------------------|--------|--------|
| Non-Houston                     | 676    | 668    |
| Total Mass                      | 11,601 | 12,175 |
| Commercial and Industrial:      |        |        |
| ERCOT <sup>(1)</sup>            | 18,525 | 17,062 |
| Non-ERCOT                       | 2,833  | 2,085  |
| Total Commercial and Industrial | 21,358 | 19,147 |
| Market usage adjustments        | (62)   | (73)   |
| Total                           | 32,897 | 31,249 |

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

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|  | <b>Six Months Ended June 30,</b>         |             |
|--|--|-------------|
|  | <b>2008</b>                              | <b>2007</b> |
|  | <b>(in thousands, metered locations)</b> |             |
| <b>Weighted Average Retail Customer Count:</b> |  |             |
| Mass:  |  |             |
| Residential:                                   |  |             |
| Houston  | 996                                      | 1,074       |
| Non-Houston                                    | 545                                      | 560         |
| Small Business:                                |  |             |
| Houston  | 109                                      | 119         |
| Non-Houston                                    | 38                                       | 34          |
| Total Mass                                     | 1,688                                    | 1,787       |
| Commercial and Industrial <sup>(1)</sup>       | 92                                       | 87          |
| Total  | 1,780                                    | 1,874       |

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

*Retail Energy Revenues.*

|   | <b>Six Months Ended June 30,</b> |             |                        |
|---|----------------------------------|-------------|------------------------|
|   | <b>2008</b>                      | <b>2007</b> | <b>Change</b>          |
|   | <b>(in millions)</b>             |             |                        |
| Retail energy revenues from end-use retail customers: |                                  |             |                        |
| Mass:   |                                  |             |                        |
| Residential:  |                                  |             |                        |
| Houston   | \$ 866                           | \$ 947      | \$ (81) <sup>(1)</sup> |
| Non-Houston   | 514                              | 535         | (21) <sup>(1)</sup>    |
| Small Business:                                       |                                  |             |                        |
| Houston   | 208                              | 242         | (34) <sup>(2)</sup>    |
| Non-Houston   | 98                               | 95          | 3                      |
| Total Mass  | 1,686                            | 1,819       | (133)                  |
| Commercial and Industrial:                            |                                  |             |                        |
| ERCOT   | 1,864                            | 1,542       | 322 <sup>(3)</sup>     |
| Non-ERCOT   | 257                              | 150         | 107 <sup>(4)</sup>     |
| Total Commercial and Industrial                       | 2,121                            | 1,692       | 429                    |
| Total   | 3,807                            | 3,511       | 296                    |

|   |          |          |                    |
|---|----------|----------|--------------------|
| Retail energy revenues from resales of purchased power and other hedging activities | 543      | 189      | 354 <sup>(5)</sup> |
| Market usage adjustments  | (5)      | (5)      |                    |
| Total retail energy revenues  | \$ 4,345 | \$ 3,695 | \$ 650             |

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

(2) Decrease primarily due to (a) lower volumes due to fewer number of customers and (b) lower unit sales prices.

(3) Increase primarily due to (a) higher unit sales prices due to (i) variable rate contracts, which are tied to the market price of natural gas and (ii) fixed price contracts renewed at higher market rates due to higher prices of electricity when



the contracts were executed and (b) higher volumes primarily driven by increased number of customers.

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

**Table of Contents***Retail Energy Cost of Sales.*

|  | <b>Six Months Ended June 30,</b> |             |                      |
|--|----------------------------------|-------------|----------------------|
|  | <b>2008</b>                      | <b>2007</b> | <b>Change</b>        |
|  | <b>(in millions)</b>             |             |                      |
| Costs of sales                         | \$ 3,984                         | \$ 3,048    | \$ 936               |
| Retail energy intersegments costs      | 131                              | 228         | (97)                 |
| Subtotal                               | 4,115                            | 3,276       | 839 <sup>(1)</sup>   |
| Market usage adjustments               | (2)                              | 6           | (8)                  |
| Unrealized gains on energy derivatives | (1,030)                          | (256)       | (774) <sup>(2)</sup> |
| Total retail energy cost of sales      | \$ 3,083                         | \$ 3,026    | \$ 57                |

(1) Increase primarily due to (a) higher unit prices of purchased power at the time of procurement due in part to weather and (b) higher volumes due to (i) warmer weather and (ii) increased number of commercial and industrial customers, partially offset by (x) fewer number of mass customers and (y) a change in customer usage and mix.

(2) See footnote 5 under Retail Energy Margins.

*Retail Energy Margins.*

|  | <b>Six Months Ended June 30,</b> |             |                         |
|--|----------------------------------|-------------|-------------------------|
|  | <b>2008</b>                      | <b>2007</b> | <b>Change</b>           |
|  | <b>(in millions)</b>             |             |                         |
| Mass gross margin  | \$ 187                           | \$ 356      | \$ (169) <sup>(1)</sup> |
| Commercial and industrial gross margin   | 48                               | 68          | (20) <sup>(2)</sup>     |
| Market usage adjustments   | (3)                              | (11)        | 8                       |
| Retail gross margin  | 232                              | 413         | (181)                   |
| Operation and maintenance  | (123)                            | (121)       | (2)                     |
| Selling and marketing expense  | (70)                             | (60)        | (10) <sup>(3)</sup>     |
| Bad debt expense   | (13)                             | (38)        | 25 <sup>(4)</sup>       |
| Retail contribution margin   | 26                               | 194         | (168)                   |
| Unrealized gains on energy derivatives   | 1,030                            | 256         | 774 <sup>(5)</sup>      |
| Total retail energy contribution margin, including unrealized gains/losses on energy derivatives | \$ 1,056                         | \$ 450      | \$ 606                  |

(1) Decrease primarily due to (a) lower unit margins driven by (i) higher unit prices of purchased power at the time of procurement, (ii) higher market rates on incremental volumes purchased for higher customer load due to weather, (iii) increased cost of intra-month congestion and (iv) lower unit sales prices and (b) lower volumes primarily due to

fewer  
customers.

- (2) Decrease primarily due to lower unit margins driven by (a) higher unit prices of purchased power at the time of procurement, (b) increased cost of intra-month congestion and (c) higher load related charges. This decrease was partially offset by (a) higher unit sales prices driven by (i) variable rate contracts, which are tied to the market price of natural gas and (ii) fixed price contracts renewed at higher market rates due to higher prices of electricity when the contracts were executed and (b) higher volumes due to increased number of customers.
- (3) Increase primarily due to increase in salaries, contract services and professional

fees partially  
attributable to  
Smart Energy.

(4) Decrease  
primarily due to  
improved  
collections.

(5) Increase  
primarily due to  
\$1.1 billion gain  
from changes in  
prices on our  
derivatives  
marked to  
market, partially  
offset by (a)  
\$223 million  
loss on energy  
derivatives  
settled during  
the period and  
(b) \$157 million  
loss related to  
liquidity and  
credit reserves.

***Wholesale Energy Segment.***

Our wholesale energy segment's contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives was \$496 million during the six months ended June 30, 2008 compared to \$80 million in the same period of 2007. The \$416 million increase was primarily due to (a) \$177 million increase in historical and operational wholesale hedges and (b) net change in unrealized gains/losses on energy derivatives of \$158 million. Open wholesale contribution margin increased \$81 million primarily due to \$56 million increase in open wholesale gross margin and \$27 million decrease in operation and maintenance expenses. See Wholesale Energy Margins below for explanations.

**Table of Contents***Wholesale Energy Operational and Financial Data.*

|  | <b>Six Months Ended June 30,</b> |                       |                   |                       |
|--|----------------------------------|-----------------------|-------------------|-----------------------|
|  | <b>2008</b>                      |                       | <b>2007</b>       |                       |
|  | <b>GWh</b>                       | <b>%<br/>Economic</b> | <b>GWh</b>        | <b>%<br/>Economic</b> |
| <b>Economic Generation:</b>              |                                  |                       |                   |                       |
| PJM Coal                                 | 11,280.8                         | 77%                   | 12,127.1          | 84%                   |
| MISO Coal                                | 3,407.7                          | 62%                   | 4,244.7           | 78%                   |
| PJM/MISO Gas                             | 412.7                            | 3%                    | 414.2             | 3%                    |
| West                                     | 547.0                            | 4%                    | 907.3             | 7%                    |
| Other                                    | 7.0                              | 1%                    | 2,750.2           | 67%                   |
| Total                                    | 15,655.2                         | 31%                   | 20,443.5          | 39%                   |
| <b>Commercial Capacity Factor:</b>       |                                  |                       |                   |                       |
| PJM Coal                                 | 84.3%                            |                       | 77.6%             |                       |
| MISO Coal                                | 81.5%                            |                       | 56.4%             |                       |
| PJM/MISO Gas                             | 92.0%                            |                       | 86.3%             |                       |
| West                                     | 86.3%                            |                       | 95.2%             |                       |
| Other                                    | 81.4%                            |                       | 91.4%             |                       |
| Total                                    | 84.0%                            |                       | 76.0%             |                       |
| <b>Generation:</b>                       |                                  |                       |                   |                       |
| PJM Coal                                 | 9,515.1                          |                       | 9,407.4           |                       |
| MISO Coal                                | 2,776.1                          |                       | 2,395.0           |                       |
| PJM/MISO Gas                             | 379.5                            |                       | 357.5             |                       |
| West                                     | 472.2                            |                       | 863.7             |                       |
| Other                                    | 5.7                              |                       | 2,512.8           |                       |
| Total                                    | 13,148.6                         |                       | 15,536.4          |                       |
| <b>Open Energy Unit Margin (\$/MWh):</b> |                                  |                       |                   |                       |
| PJM Coal                                 | \$ 34.89                         |                       | \$ 31.68          |                       |
| MISO Coal                                | 27.02                            |                       | 28.81             |                       |
| PJM/MISO Gas                             | 52.70                            |                       | 27.97             |                       |
| West                                     | NM <sup>(1)</sup>                |                       | NM <sup>(1)</sup> |                       |
| Other                                    |                                  |                       | 5.57              |                       |
| Total weighted average                   | \$ 31.87                         |                       | \$ 24.91          |                       |

(1)

NM is not  
meaningful.  
*Wholesale Energy Revenues.*

|  | <b>Six Months Ended June 30,</b> |                          |                       |
|--|----------------------------------|--------------------------|-----------------------|
|  | <b>2008</b>                      | <b>2007</b>              | <b>Change</b>         |
|  |                                  | <b>(in<br/>millions)</b> |                       |
| Wholesale energy third-party revenues  | \$ 1,647                         | \$ 1,313                 | \$ 334 <sup>(1)</sup> |
| Wholesale energy intersegment revenues | 131                              | 228                      | (97) <sup>(2)</sup>   |
| Subtotal                               | 1,778                            | 1,541                    | 237                   |
| Revenues affiliates                    | 253 <sup>(3)</sup>               |                          | 253                   |
| Unrealized gains (losses)              | (7)                              | 4                        | (11) <sup>(4)</sup>   |
| Total wholesale energy revenues        | \$ 2,024                         | \$ 1,545                 | \$ 479                |

(1) Increase primarily due to  
(a) higher power and natural gas sales prices,  
(b) higher power sales volumes and  
(c) higher RPM capacity payments. This increase was partially offset by (a) lower natural gas sales volumes and (b) lower steam sales due to the deconsolidation of Channelview on August 20, 2007.

(2) Decrease primarily due to  
(a) lower power sales volumes and  
(b) lower natural gas sales volumes related

to a contract that ended in October 2007. This decrease was partially offset by higher power sales prices.

- (3) We deconsolidated Channelview on August 20, 2007. These revenues represent sales of fuel to Channelview.
- (4) See footnote 8 under Wholesale Energy Margins.



**Table of Contents***Wholesale Energy Cost of Sales.*

|   | <b>Six Months Ended June 30,</b> |                          |                      |
|---|----------------------------------|--------------------------|----------------------|
|   | <b>2008</b>                      | <b>2007</b>              | <b>Change</b>        |
|   |                                  | <b>(in<br/>millions)</b> |                      |
| Wholesale energy third-party costs          | \$ 1,114                         | \$ 1,057                 | \$ 57 <sup>(1)</sup> |
| Cost of sales affiliates                    | 200 <sup>(2)</sup>               |                          | 200                  |
| Unrealized (gains) losses                   | (105)                            | 64                       | (169) <sup>(3)</sup> |
| <b>Total wholesale energy cost of sales</b> | <b>\$ 1,209</b>                  | <b>\$ 1,121</b>          | <b>\$ 88</b>         |

(1) Increase primarily due to (a) higher prices paid for natural gas and (b) higher coal prices. This increase was partially offset by lower purchased natural gas volumes.

(2) We deconsolidated Channelview on August 20, 2007. These cost of sales represent purchases of power from Channelview.

(3) See footnote 8 under Wholesale Energy Margins.

*Wholesale Energy Margins.*

| <b>Six Months Ended June 30,</b> |             |               |
|----------------------------------|-------------|---------------|
| <b>2008</b>                      | <b>2007</b> | <b>Change</b> |

|   | (in millions) |        |                      |
|---|---------------|--------|----------------------|
| Open energy gross margin:   |               |        |                      |
| PJM Coal  | \$ 332        | \$ 298 | \$ 34 <sup>(1)</sup> |
| MISO Coal   | 75            | 69     | 6                    |
| PJM/MISO Gas  | 20            | 10     | 10 <sup>(2)</sup>    |
| West  | (8)           | (4)    | (4)                  |
| Other   |               | 14     | (14) <sup>(3)</sup>  |
| Total   | 419           | 387    | 32                   |
| Other margin:   |               |        |                      |
| PJM Coal  | 44            | 22     | 22 <sup>(4)</sup>    |
| MISO Coal   | 5             | 5      |                      |
| PJM/MISO Gas  | 60            | 36     | 24 <sup>(4)</sup>    |
| West  | 56            | 59     | (3)                  |
| Other   | 19            | 38     | (19) <sup>(5)</sup>  |
| Total   | 184           | 160    | 24                   |
| Open wholesale gross margin   | 603           | 547    | 56                   |
| Operation and maintenance   | (318)         | (345)  | 27 <sup>(6)</sup>    |
| Bad debt expense  | (1)           | 1      | (2)                  |
| Open wholesale contribution margin  | 284           | 203    | 81                   |
| Historical and operational wholesale hedges   | 114           | (63)   | 177 <sup>(7)</sup>   |
| Unrealized gains (losses) on energy derivatives   | 98            | (60)   | 158 <sup>(8)</sup>   |
| Total wholesale energy contribution margin, including historical and operational wholesale hedges and unrealized gains/losses on energy derivatives | \$ 496        | \$ 80  | \$ 416               |

(1) Increase primarily due to (a) higher open energy unit margins (higher power prices partially offset by higher fuel costs) and (b) higher commercial capacity factor primarily due to lower planned outages in 2008.

This increase was partially offset by lower economic generation.

- (2) Increase primarily due to higher open energy unit margins (higher power prices partially offset by higher fuel costs).
- (3) Decrease primarily due to lower economic generation related to the deconsolidation of Channelview on August 20, 2007.
- (4) Increase primarily due to higher RPM capacity payments.
- (5) Decrease primarily due to (a) the deconsolidation of Channelview on August 20, 2007 and (b) lower revenue from power purchase agreements.
- (6) Decrease primarily due to (a) the deconsolidation of Channelview on August 20, 2007 and (b)

\$14 million decrease in planned outages and maintenance spending. This decrease was partially offset by \$7 million increase in services and support.

- (7) Increase primarily due to (a) \$121 million in higher margins on operational hedges and (b) \$77 million decrease in losses on closed power hedges. This increase was partially offset by \$20 million decrease on hedges of gas transportation.
  
- (8) Increase primarily due to \$200 million gain from changes in prices on our derivatives marked to market, partially offset by \$40 million loss on energy derivatives settled during the period.

**Table of Contents***Other General and Administrative.*

|  | <b>Six Months Ended June 30,</b> |             |               |
|--|----------------------------------|-------------|---------------|
|  | <b>2008</b>                      | <b>2007</b> | <b>Change</b> |
|  | <b>(in millions)</b>             |             |               |
| Salaries and benefits  | \$ 42                            | \$ 50       | \$ (8)        |
| Professional fees, contract services and information systems maintenance | 16                               | 19          | (3)           |
| Rent and utilities   | 11                               | 11          |               |
| Legal costs  | 3                                | 9           | (6)           |
| Other, net   | 5                                | 6           | (1)           |
| Other general and administrative   | \$ 77                            | \$ 95       | \$ (18)       |

*Western States Litigation and Similar Settlements.* See note 14(a) to our consolidated financial statements in our Form 10-K and note 11 to our interim financial statements.

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

|  | <b>Six Months Ended June 30,</b> |             |               |
|--|----------------------------------|-------------|---------------|
|  | <b>2008</b>                      | <b>2007</b> | <b>Change</b> |
|  | <b>(in millions)</b>             |             |               |
| Emission and exchange allowances                                   | \$ 27 <sup>(1)</sup>             | \$ 2        | \$ 25         |
| Investment in and receivables from Channelview                     | (5) <sup>(2)</sup>               |             | (5)           |
| Other, net   | 1                                |             | 1             |
| Gains on sales of assets and emission and exchange allowances, net | \$ 23                            | \$ 2        | \$ 21         |

(1) Includes gains of \$26 million related to sales of carbon dioxide exchange allowances.

(2) In the second quarter of 2008, we executed an agreement to sell the Channelview plant and assign related

contracts. This amount represents our estimated loss on the sale. See note 14 to our interim financial statements.

*Depreciation and Amortization.*

|                                     | <b>Six Months Ended June 30,</b> |             |                        |
|-------------------------------------|----------------------------------|-------------|------------------------|
|                                     | <b>2008</b>                      | <b>2007</b> | <b>Change</b>          |
|                                     | <b>(in millions)</b>             |             |                        |
| Depreciation on plants              | \$ 117                           | \$ 152      | \$ (35) <sup>(1)</sup> |
| Depreciation on information systems | 16                               | 18          | (2)                    |
| Other, net depreciation             | 3                                | 3           |                        |
| Depreciation                        | 136                              | 173         | (37)                   |
| Amortization of emission allowances | 39                               | 27          | 12 <sup>(2)</sup>      |
| Other, net amortization             | 2                                | 2           |                        |
| Amortization                        | 41                               | 29          | 12                     |
| Depreciation and amortization       | \$ 177                           | \$ 202      | \$ (25)                |

(1) Decrease primarily due to (a) early retirements of plant components when replacement components are installed for upgrades (from \$28 million in 2007 to \$4 million in 2008) and (b) the deconsolidation of Channelview on August 20, 2007.

(2)

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

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*Income of Equity Investment, Net.* This represents income, which did not change significantly, from our equity method investment in Sabine Cogen, LP.

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

*Interest Expense.*

|   | <b>Six Months Ended June 30,</b> |             |                     |
|---|----------------------------------|-------------|---------------------|
|   | <b>2008</b>                      | <b>2007</b> | <b>Change</b>       |
|   | <b>(in millions)</b>             |             |                     |
| Fixed-rate debt   | \$ 115                           | \$ 118      | \$ (3)              |
| Fees for MWh s delivered under credit-enhanced retail structure | 13                               | 12          | 1                   |
| Deferred financing costs  | 4                                | 45          | (41) <sup>(1)</sup> |
| Variable-rate debt  |                                  | 14          | (14) <sup>(2)</sup> |
| Channelview   |                                  | 13          | (13) <sup>(3)</sup> |
| Amortization of fair value adjustment of acquired debt          | (6)                              | (7)         | 1                   |
| Capitalized interest  | (7)                              | (2)         | (5)                 |
| Other, net  | 7                                | 16          | (9)                 |
| Interest expense  | \$ 126                           | \$ 209      | \$ (83)             |

(1) Decrease primarily due to \$39 million write-off due to early extinguishments of debt in the second quarter of 2007.

(2) Decrease primarily due to decrease in balances.

(3) Decrease due to the deconsolidation of Channelview on August 20, 2007.

*Interest Income.*

|  | <b>Six Months Ended June 30,</b> |             |               |
|--|----------------------------------|-------------|---------------|
|  | <b>2008</b>                      | <b>2007</b> | <b>Change</b> |
|  | <b>(in millions)</b>             |             |               |



|  |    |    |    |    |    |     |
|--|----|----|----|----|----|-----|
| Interest on temporary cash investments | \$ | 16 | \$ | 13 | \$ | 3   |
| Net margin deposits                    |    | 4  |    | 5  |    | (1) |
| Interest income                        | \$ | 20 | \$ | 18 | \$ | 2   |

*Income Tax Expense.* See note 9 to our interim financial statements.

*Income (Loss) from Discontinued Operations.* See note 16 to our interim financial statements.

### **Liquidity and Capital Resources**

During the six months ended June 30, 2008, we generated \$182 million in operating cash flows from continuing operations, including the changes in margin deposits of \$55 million (cash outflow).

As of July 31, 2008, we had total available liquidity of \$1.5 billion, comprised of unused borrowing capacity, letters of credit capacity and cash and cash equivalents. Of this amount, \$300 million is available only to our retail business through our working capital facility agreement with Merrill Lynch. In addition, Merrill Lynch provides financial support that significantly reduces the liquidity requirements and substantially eliminates collateral postings for our retail business. See note 7 to our consolidated financial statements in our Form 10-K.

The \$300 million working capital facility includes a minimum adjusted EBITDA covenant for our retail business that may lead us to seek an amendment or we could decide to terminate the facility. We do not believe these events would be material to our liquidity or financial condition.

We expect to close on the sale of our Bighorn plant during the fourth quarter of 2008 with proceeds of approximately \$500 million. See note 15 to our interim financial statements for further discussion.

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.

**Table of Contents****Credit Risk**

By extending credit to our counterparties, we are exposed to credit risk. As of June 30, 2008, 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:

| <b>Credit Rating Equivalent</b>       | <b>Exposure Before Collateral<sup>(1)</sup></b> | <b>Credit Collateral Held</b> | <b>Exposure Net of Collateral (dollars in millions)</b> | <b>Number of Counterparties &gt;10%</b> | <b>Net Exposure of Counterparties &gt;10%</b> |
|---------------------------------------|---|-------------------------------|---|---|---|
| Investment grade                      | \$ 1,106  | \$ 22                         | \$ 1,084  | 1                                       | \$ 884  |
| Non-investment grade                  | 404   | 1                             | 403   | 1                                       | 201   |
| No external ratings:                  |   |                               |   |   |   |
| Internally rated Investment grade     | 70  |                               | 70  |   |   |
| Internally rated Non-investment grade | 49  | 4                             | 45  |   |   |
| <b>Total</b>                          | <b>\$ 1,629</b>                                 | <b>\$ 27</b>                  | <b>\$ 1,602</b>   | <b>2</b>                                | <b>\$ 1,085</b>                               |

(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 June 30, 2008, one investment grade counterparty represented 54% (\$884 million) of our credit exposure and one non-investment grade counterparty represented 12% (\$201 million) of our credit exposure. As of December 31, 2007, two non-investment grade counterparties represented 47% (\$206 million) of our credit exposure. As of June 30, 2008 and December 31, 2007, we held no collateral from these counterparties. There were no other counterparties representing greater than 10% of our credit exposure.

**Off-Balance Sheet Arrangements**

As of June 30, 2008, we have no off-balance sheet arrangements.

**Table of Contents****Historical Cash Flows***Cash Flows Operating Activities*

|  | <b>Six Months Ended June 30,</b> |                      |               |
|--|----------------------------------|----------------------|---------------|
|  | <b>2008</b>                      | <b>2007</b>          | <b>Change</b> |
|  | <b>(in millions)</b>             |                      |               |
| Operating income   | \$ 1,287                         | \$ 215               | \$ 1,072      |
| Depreciation and amortization  | 177                              | 202                  | (25)          |
| Gains on sales of assets and emission and exchange allowances, net               | (23)                             | (2)                  | (21)          |
| Net changes in energy derivatives  | (1,106) <sup>(1)</sup>           | (166) <sup>(2)</sup> | (940)         |
| Western states litigation and similar settlements                                | 34                               |                      | 34            |
| Western states litigation and similar settlements payments                       |                                  | (35)                 | 35            |
| Margin deposits, net   | (55)                             | 113                  | (168)         |
| Change in accounts and notes receivable and accounts payable, net                | 52                               | (7)                  | 59            |
| Net option premiums purchased  | (29)                             | (18)                 | (11)          |
| Settlements of exchange transactions prior to contractual period <sup>(3)</sup>  | (5)                              | (9)                  | 4             |
| Interest payments  | (128)                            | (206)                | 78            |
| Income tax payments, net of refunds  | (3)                              | (15)                 | 12            |
| Other, net   | (19)                             | (48)                 | 29            |
| Net cash provided by continuing operations from operating activities             | 182                              | 24                   | 158           |
| Net cash provided by (used in) discontinued operations from operating activities | 9                                | (3)                  | 12            |
| Net cash provided by operating activities  | \$ 191                           | \$ 21                | \$ 170        |

(1) Includes unrealized gains on energy derivatives of \$1.1 billion.

(2) Includes unrealized gains on energy derivatives of \$196 million.

(3) Represents exchange transactions financially

settled within  
three business  
days prior to the  
contractual  
delivery month.

*Cash Flows Investing Activities*

|   | <b>Six Months Ended June 30,</b> |                     |               |
|---|----------------------------------|---------------------|---------------|
|   | <b>2008</b>                      | <b>2007</b>         | <b>Change</b> |
|   | <b>(in millions)</b>             |                     |               |
| Capital expenditures                                    | \$ (117)                         | \$ (99)             | \$ (18)       |
| Proceeds from sales of emission and exchange allowances | 29 <sup>(1)</sup>                | 3                   | 26            |
| Purchases of emission allowances                        | (18) <sup>(2)</sup>              | (14) <sup>(2)</sup> | (4)           |
| Restricted cash   | (4)                              | 20                  | (24)          |
| Other, net  | 1                                | 2                   | (1)           |
| Net cash used in investing activities                   | \$ (109)                         | \$ (88)             | \$ (21)       |

(1) Includes  
\$26 million  
from sales of  
carbon dioxide  
exchange  
allowances.

(2) Includes  
\$14 million for  
purchases of  
SO<sub>2</sub> allowances.

**Table of Contents***Cash Flows Financing Activities*

|  | <b>Six Months Ended June 30,</b> |             |               |
|--|----------------------------------|-------------|---------------|
|  | <b>2008</b>                      | <b>2007</b> | <b>Change</b> |
|  | <b>(in millions)</b>             |             |               |
| Proceeds from issuance of senior unsecured notes | \$                               | \$ 1,300    | \$ (1,300)    |
| Payments of senior secured notes                 | (45)                             | (1,058)     | 1,013         |
| Payments of senior secured term loans            |                                  | (400)       | 400           |
| Proceeds from issuance of stock                  | 6                                | 29          | (23)          |
| Payments of financing costs                      |                                  | (30)        | 30            |
| Payments of debt extinguishments                 |                                  | (71)        | 71            |
| Other, net                                       |                                  | (1)         | 1             |
| Net cash used in financing activities            | \$ (39)                          | \$ (231)    | \$ 192        |

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

See notes 1 and 3 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.

On January 1, 2008, we adopted SFAS No. 157, which discusses fair value measurements. See note 3 to our interim financial statements.

**Table of Contents****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 June 30, 2008, the fair values of the contracts related to our net non-trading derivative assets and liabilities are:

| <b>Source of Fair Value</b>                                  | <b>Twelve<br/>Months<br/>Ending<br/>June<br/>30,<br/>2009</b> | <b>Remainder<br/>of 2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> | <b>2013<br/>and<br/>thereafter</b> | <b>Total<br/>fair<br/>value</b> |
|--|---|------------------------------|-------------|-------------|-------------|------------------------------------|---------------------------------|
|  | (in millions)   |                              |             |             |             |                                    |                                 |
| Prices actively quoted (Level 1)                             | \$ (30)   | \$ (5)                       | \$ (10)     | \$ (10)     | \$          | \$                                 | \$ (55)                         |
| Prices provided by other external sources (Level 2)          | 380   | 95                           | (12)        | (29)        | (8)         |                                    | 426                             |
| Prices based on models and other valuation methods (Level 3) | 471   | 42                           | (13)        | (18)        |             |                                    | 482                             |
| Total mark-to-market non-trading derivatives                 | \$ 821  | \$ 132                       | \$ (35)     | \$ (57)     | \$ (8)      | \$                                 | \$ 853                          |

During the second quarter of 2008, we made changes to the methodology used for grouping derivative instruments relative to the source of their fair value. Using the fair value hierarchy parameters from SFAS No. 157 (see note 3 to our interim financial statements) we have made the following reclassifications between categories:

Instruments whose fair value is based on adjusted quoted market prices in active markets, previously included under the category of *prices actively quoted*, are now included under *prices provided by other external sources*;

Instruments that are transacted in less liquid markets, such as contracts for power and coal, previously included under the category of *prices provided by other external sources*, are now included under *prices based on models and other valuation methods*; and

Valuation adjustments for liquidity and credit previously included under the category *prices based on models and other valuation methods* are now included in the category associated with the derivative instrument.

Under the new methodology, the fair values of the contracts related to our net non-trading derivative assets and liabilities as of March 31, 2008 would have been:

| <b>Source of Fair Value</b> | <b>Twelve<br/>Months<br/>Ending<br/>March<br/>31,<br/>2009</b> | <b>Remainder<br/>of 2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> | <b>2013<br/>and<br/>thereafter</b> | <b>Total<br/>fair<br/>value</b> |
|-----------------------------|--|------------------------------|-------------|-------------|-------------|------------------------------------|---------------------------------|
|                             | (in millions)  |                              |             |             |             |                                    |                                 |

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|  |         |        |         |         |         |    |         |
|--|---------|--------|---------|---------|---------|----|---------|
| Prices actively quoted                             | \$ (27) | \$ (2) | \$ (4)  | \$ (4)  | \$      | \$ | \$ (37) |
| Prices provided by other external sources          | 11      | 18     | (26)    | (31)    | (10)    |    | (38)    |
| Prices based on models and other valuation methods | 349     | (4)    | (10)    | (8)     |         |    | 327     |
| Total mark-to-market non-trading derivatives       | \$ 333  | \$ 12  | \$ (40) | \$ (43) | \$ (10) | \$ | \$ 252  |



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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 | Earnings Impact of Other Derivatives (in millions) | Total Potential Loss in Fair Value |
|-------------------|---------------|--------------------------------|--|------------------------------------|
| June 30, 2008     | 10% decrease  | \$                             | \$ (513)   | \$ (513)                           |
| December 31, 2007 | 10% decrease  |                                | (353)  | (353)                              |

**Interest Rate Risk**

We remain subject to the benefits or losses associated with movements in market interest rates related to certain variable-rate debt, cash, cash equivalents 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 June 30, 2008.

We assess interest rate risks using a sensitivity analysis that measures the potential change in our interest expense/income 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 June 30, 2008 and December 31, 2007 by \$1 million and \$4 million, respectively, and our interest income, net of interest expense would have increased/decreased by \$6 million and \$2 million, respectively.

We estimated these amounts by considering the impact of hypothetical changes in interest rates on our variable-rate debt, cash and cash equivalents and net margin deposits based on average balances throughout the respective periods. If interest rates decreased by one percentage point from their June 30, 2008 and December 31, 2007 levels, the fair market values of our fixed-rate debt would have increased by \$191 million and \$201 million, respectively.

**Trading Market Risks**

As of June 30, 2008, 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 Months Ending June 30, 2009 |                   | 2010 - 2012 |      |      |               | 2013 and thereafter | Total fair value |
|--|------------------------------------|-------------------|-------------|------|------|---------------|---------------------|------------------|
|  | June 30, 2009                      | Remainder of 2009 | 2010        | 2011 | 2012 | (in millions) |                     |                  |
| Prices actively quoted (Level 1)                             | \$ (67)                            | \$ (7)            | \$ (4)      | \$   | \$   | \$            | \$ (78)             |                  |
| Prices provided by other external sources (Level 2)          | 76                                 |                   |             |      |      |               | 76                  |                  |
| Prices based on models and other valuation methods (Level 3) |                                    |                   |             |      |      |               |                     |                  |
| Total  | \$ 9                               | \$ (7)            | \$ (4)      | \$   | \$   | \$            | \$ (2)              |                  |



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During the second quarter of 2008, we made changes to the methodology used for grouping derivative instruments relative to the source of their fair value; however, these changes did not have a material impact in the presentation of information for our legacy trading positions.

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

|            | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|------------|------------------------------------|-------------|----------------------------------|-------------|
|            | <b>2008</b>                        | <b>2007</b> | <b>2008</b>                      | <b>2007</b> |
|            | <b>(in millions)</b>               |             |                                  |             |
| Realized   | \$ 2                               | \$ (7)      | \$ 9                             | \$ 3        |
| Unrealized | (15)                               | 7           | (26)                             | (3)         |
| Total      | \$ (13)                            | \$          | \$ (17)                          | \$          |

An analysis of these net derivative assets and liabilities is:

|  | <b>Six Months Ended June 30,</b> |                    |
|--|----------------------------------|--------------------|
|  | <b>2008</b>                      | <b>2007</b>        |
|  | <b>(in millions)</b>             |                    |
| Fair value of contracts outstanding, beginning of period                     | \$ 19                            | \$ 9               |
| Contracts realized or settled  | (15) <sup>(1)</sup>              | (5) <sup>(2)</sup> |
| Changes in fair values attributable to market price and other market changes | (6)                              | 3                  |
| Fair value of contracts outstanding, end of period                           | \$ (2)                           | \$ 7               |

(1) Amount includes realized gain of \$(10) million and deferred settlements of \$(5) million.

(2) Amount includes realized gain of \$(3) million and deferred settlements of \$(2) million.

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

| <b>2008<sup>(1)</sup></b> | <b>2007</b> |
|---------------------------|-------------|
| <b>(in millions)</b>      |             |

|                             |    |    |    |   |
|-----------------------------|----|----|----|---|
| As of June 30               | \$ | 11 | \$ | 5 |
| Three months ended June 30: |    |    |    |   |
| Average                     |    | 5  |    | 3 |
| High                        |    | 13 |    | 5 |
| Low                         |    | 1  |    | 2 |
| Six months ended June 30:   |    |    |    |   |
| Average                     |    | 3  |    | 3 |
| High                        |    | 13 |    | 5 |
| Low                         |    |    |    | 2 |

(1) The major parameters for calculating daily value-at-risk remain the same during 2008 as disclosed in Quantitative and Qualitative Disclosures About Market Risk in Item 7A of our Form 10-K.

**Table of Contents****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 June 30, 2008, 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 June 30, 2008, 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 June 30, 2008, 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 11 to our interim financial statements in this Form 10-Q.

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

In the second quarter of 2008, we issued 1,847,119 shares of unregistered common stock pursuant to cashless warrant exercises and 31,933 shares of unregistered common stock for \$162,539 in 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

We held our annual meeting of our stockholders on May 20, 2008. Our stockholders voted on the following proposals:

1. To elect nine directors to our Board to serve until the next annual meeting of stockholders; and
2. To ratify the Audit Committee's selection of KPMG LLP as our independent auditors for fiscal year 2008.

The voting results were:

E. William Barnett was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 267,294,056 | 19,489,043 | 359,029 |

Donald J. Breeding was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 267,147,408 | 19,601,198 | 393,522 |

Kirbyjon H. Caldwell was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 265,251,227 | 21,497,541 | 393,361 |

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Mark M. Jacobs was elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 267,516,897 | 19,286,292 | 338,939 |

Steven L. Miller was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 267,336,168 | 19,381,978 | 423,983 |

Laree E. Perez was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 267,368,986 | 19,386,763 | 386,380 |

Evan J. Silverstein was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 267,369,719 | 19,359,716 | 412,693 |

Joel V. Staff was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 265,317,238 | 21,457,421 | 367,469 |

William L. Transier was re-elected to serve as a director:

|             |            |         |
|-------------|------------|---------|
| For         | Against    | Abstain |
| 260,109,186 | 26,159,926 | 873,016 |

The Audit Committee's selection of KPMG LLP as our independent auditors for the fiscal year ended December 31, 2008 was ratified:

|             |           |         |
|-------------|-----------|---------|
| For         | Against   | Abstain |
| 284,489,337 | 2,311,230 | 341,562 |

We did not receive any broker non-votes on the proposals.

**ITEM 6. EXHIBITS**

Exhibits.

See Index of Exhibits.

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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)

**August 5, 2008**

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

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**Table of Contents****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.

| <b>Exhibit Number</b> | <b>Document Description</b>  | <b>Report or Registration Statement</b>  | <b>SEC File or Registration Number</b> | <b>Exhibit Reference</b> |
|-----------------------|--|--|--|--------------------------|
| +2.1                  | Asset Purchase Agreement by and among Reliant Energy Channelview LP, Reliant Energy Services Channelview LLC and GIM Channelview Cogeneration, LLC entered into June 9, 2008 and dated as of April 3, 2008   |  |  |                          |
| +2.2                  | Amendment No. 1 to Asset Purchase Agreement for Bighorn power plant by and among Reliant Energy Wholesale Generation, LLC, Reliant Energy Asset Management, LLC and Nevada Power Company, dated as of May 12, 2008   |  |  |                          |
| 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 |  |  |                          |
| +10.1                 | Amendment No. 1 to Amended and Restated Credit Sleeve and Reimbursement Agreement, dated as of September 18, 2007 (Portions of this  |  |  |                          |



Exhibit have been omitted pursuant to a request for confidential treatment)

- +10.2 Amendment No. 2 to Amended and Restated Credit Sleeve and Reimbursement Agreement, dated as of April 22, 2008
- +10.3 Amendment No. 3 to Amended and Restated Credit Sleeve and Reimbursement Agreement, dated as of May 8, 2008 (Portions of this Exhibit have been omitted pursuant to a request for confidential treatment)
- +31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- +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