RELIANT ENERGY INC
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from to

Commission file number: 1-16455

Reliant Energy, Inc.

(Exact Name of Registrant as Specified in Its Charter)

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

1000 Main Street
Houston, Texas 77002

(Address of Principal Executive Offices) (Zip Code)

(713) 497-3000

(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.
Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

As of October 31, 2006, the latest practicable date for determination, Reliant Energy, Inc. had 308,488,738 shares of common stock outstanding and no shares of treasury stock.

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FORWARD-LOOKING INFORMATION

Projections, estimates or assumptions about revenues, costs, income, cash flow and other future events are called forward-looking statements. These forward-looking statements are within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Act of 1934. In some cases, you can identify forward-looking statements by words like anticipate, estimate, believe, intend, may, expect or simi words. Forward-looking statements are not guarantees of future performance. Actual results may differ from forward-looking statements. Each forward-looking statement speaks only as of its date and we are under no obligation to update these statements. For information about factors that could cause our actual results to differ from forward-looking statements, see Risk Factors in Item 1A of Reliant Energy, Inc. s Annual Report on Form 10-K for the year ended December 31, 2005 (Form 10-K), note 14 to our interim financial statements in Item 1 of this Quarterly Report on Form 10-Q and Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 2 of this Quarterly Report on Form 10-Q.

PART I.
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

RELIANT ENERGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Thousands of Dollars, Except Per Share Amounts)

(Unaudited)

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Revenues:				
Revenues (including $(14,579), $(226,509), $187,320 and $(326,849) unrealized gains (losses) on energy derivatives)	$ 3,305,568	$ 2,963,021	$ 8,533,156	$ 7,111,730
Expenses:				
Purchased power, fuel and cost of gas sold (including $(340,886), $(127,367), $(467,288) and $235,483 unrealized gains (losses) on energy derivatives)	2,989,956	2,697,009	7,473,913	5,877,446
Operation and maintenance	220,460	178,393	635,990	556,106
Selling, general and administrative	116,465	99,085	278,895	241,982
Western states settlement	35,000	350,805	35,000	350,805
Gains on sales of assets and emission allowances, net	(3,457)	(91,874)	(159,787)	(115,793)
Depreciation and amortization	108,256	124,159	279,853	336,530
Total operating expense	3,466,680	3,357,577	8,543,864	7,247,076
Operating Loss	(161,112)	(394,556)	(10,708)	(135,346)
Other Income (Expense):				
Income of equity investments, net	1,268	27,029	3,655	23,185
Other, net	(163)	62	666	(22,817)
Interest expense	(100,840)	(99,774)	(312,446)	(293,680)
Interest income	6,889	3,228	22,784	15,280
Total other expense	(92,846)	(69,455)	(285,341)	(278,032)
Loss from Continuing Operations Before Income Taxes	(253,958)	(464,011)	(296,049)	(413,378)
Income tax benefit	(100,135)	(197,226)	(25,886)	(155,228)
Loss from Continuing Operations	(153,823)	(266,785)	(270,163)	(258,150)
Income (loss) from discontinued operations	(1,340)	(3,512)	(4,911)	61,655
Loss Before Cumulative Effect of Accounting Change	(155,163)	(270,297)	(275,074)	(196,495)
Cumulative effect of accounting change, net of tax			968	
Net Loss	$ (155,163)	$ (270,297)	$ (274,106)	$ (196,495)
Basic and Diluted Earnings (Loss) per Share:				
Loss from continuing operations	$ (0.50)	$ (0.88)	$ (0.88)	$ (0.86)
Income (loss) from discontinued operations		(0.01)	(0.01)	0.21

Loss before cumulative effect of accounting change	(0.50)	(0.89)	(0.89)	(0.65)
Cumulative effect of accounting change, net of tax				
Net loss	$ (0.50)	$ (0.89)	$ (0.89)	$ (0.65)

See Notes to our Unaudited Consolidated Interim Financial Statements

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

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 66,670	$ 88,397
Restricted cash	10,409	26,906
Accounts and notes receivable, principally customer, net of allowance of $52,602 and $34,054	1,390,954	1,171,673
Inventory	283,620	299,099
Derivative assets	448,755	725,964
Margin deposits	1,495,326	1,716,035
Accumulated deferred income taxes	333,879	361,547
Prepayments and other current assets	128,462	137,498
Current assets of discontinued operations	6,253	203,332
Total current assets	4,164,328	4,730,451
Property, plant and equipment, gross	7,160,153	7,112,684
Accumulated depreciation	(1,381,810)	(1,178,624)
Property, Plant and Equipment, net	5,778,343	5,934,060
Other Assets:		
Goodwill	386,594	386,594
Other intangibles, net	433,877	510,582
Derivative assets	258,872	527,799
Prepaid lease	279,085	259,412
Other	329,782	339,112
Long-term assets of discontinued operations		880,796
Total other assets	1,688,210	2,904,295
Total Assets	$ 11,630,881	$ 13,568,806
LIABILITIES AND EQUITY		
Current Liabilities:		
Current portion of long-term debt and short-term borrowings	$ 483,958	$ 789,325
Accounts payable, principally trade	794,934	886,965
Derivative liabilities	1,068,776	1,219,954
Margin deposits	15,200	15,588
Other	519,992	397,942
Current liabilities of discontinued operations	24,446	96,456
Total current liabilities	2,907,306	3,406,230
Other Liabilities:		
Derivative liabilities	567,009	812,695
Other	363,193	389,083
Long-term liabilities of discontinued operations		779,678
Total other liabilities	930,202	1,981,456
Long-term Debt	4,095,470	4,317,427
Commitments and Contingencies		
Temporary Equity Stock-based Compensation	1,330	
Stockholders Equity:		
Preferred stock; par value $0.001 per share (125,000,000 shares authorized; none outstanding)		
Common stock; par value $0.001 per share (2,000,000,000 shares authorized; 308,424,830 and 304,900,193 issued)	69	66
Additional paid-in capital	5,906,298	5,846,747
Retained deficit	(1,972,610)	(1,698,504)
Accumulated other comprehensive loss	(237,184)	(284,281)

Accumulated other comprehensive loss of discontinued operations		(335)
Total stockholders equity	3,696,573	3,863,693
Total Liabilities and Equity	$ 11,630,881	$ 13,568,806

See Notes to our Unaudited Consolidated Interim Financial Statements

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

	Nine Months Ended September 30, 2006	2005
Cash Flows from Operating Activities:		
Net loss	$ (274,106)	$ (196,495)
(Income) loss from discontinued operations	4,911	(61,655)
Net loss from continuing operations and cumulative effect of accounting change	(269,195)	(258,150)
Adjustments to reconcile net loss to net cash used in operating activities:		
Cumulative effect of accounting change	(968)	
Depreciation and amortization	279,853	336,530
Deferred income taxes	(58,324)	(177,844)
Net changes in energy derivatives	351,711	101,107
Amortization of deferred financing costs	12,101	11,208
Gains on sales of assets and emission allowances, net	(159,787)	(115,793)
Western states settlement	35,000	350,805
Income of equity investments, net	(3,655)	(23,185)
Other, net	12,657	24,960
Changes in other assets and liabilities:		
Accounts and notes receivable, net	(187,224)	(329,166)
Inventory	13,698	(21,224)
Margin deposits, net	220,321	(881,568)
Net derivative assets and liabilities	(127,512)	170,208
Western states and Cornerstone settlement payments	(159,885)	
Accounts payable	25,712	298,690
Other current assets	14,972	51,546
Other assets	(25,598)	(62,263)
Taxes payable/receivable	(8,141)	1,788
Other current liabilities	77,330	(21,140)
Other liabilities	(3,341)	23,949
Net cash provided by (used in) continuing operations from operating activities	39,725	(519,542)
Net cash provided by (used in) discontinued operations from operating activities	(45,093)	105,307
Net cash used in operating activities	(5,368)	(414,235)
Cash Flows from Investing Activities:		
Capital expenditures	(63,887)	(59,117)
Proceeds from sales of assets, net	1,417	149,345
Proceeds from sales of emission allowances	205,186	130,040
Purchases of emission allowances	(12,443)	(142,794)
Restricted cash	16,497	29,593
Other, net	5,750	2,500
Net cash provided by continuing operations from investing activities	152,520	109,567
Net cash provided by discontinued operations from investing activities	967,566	39,112
Net cash provided by investing activities	1,120,086	148,679
Cash Flows from Financing Activities:		
Payments of long-term debt	(331,028)	(42,164)
Increase (decrease) in short-term borrowings and revolving credit facilities, net	(189,364)	227,446
Proceeds from issuances of stock	21,947	25,975
Net cash provided by (used in) continuing operations from financing activities	(498,445)	211,257
Net cash used in discontinued operations from financing activities	(638,000)	
Net cash provided by (used in) financing activities	(1,136,445)	211,257
Net Change in Cash and Cash Equivalents	(21,727)	(54,299)
Cash and Cash Equivalents at Beginning of Period	88,397	105,054
Cash and Cash Equivalents at End of Period	$ 66,670	$ 50,755

Supplemental Disclosure of Cash Flow Information:				
Cash Payments:				
Interest paid (net of amounts capitalized) for continuing operations	$	279,232	$	254,560
Income taxes paid (net of income tax refunds received) for continuing operations	$	40,027	$	18,214

See Notes to our Unaudited Consolidated Interim Financial Statements

RELIANT ENERGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(1) Background and Basis of Presentation

(a) Background.

Reliant Energy refers to Reliant Energy, Inc. and we, us and our refer to Reliant Energy, Inc. and its consolidated subsidiaries. Our business consists primarily of two business segments, retail energy and wholesale energy. See note 12. Our consolidated interim financial statements and notes (interim financial statements) are unaudited, omit certain disclosures and should be read in conjunction with our audited consolidated financial statements and notes in our 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 price-to-beat rate and other regulations, timing of maintenance and other expenditures, dispositions, changes in interest expense and other factors. We have reclassified certain immaterial amounts reported in this Form 10-Q from prior periods to conform to the 2006 presentation. These reclassifications had no impact on reported earnings/losses. We reclassified net purchases of emission allowances of $57 million for the nine months ended September 30, 2005 from operating to investing cash flows.

Change in Estimate for Derivatives. See note 5 regarding a change in accounting estimate relating to our derivatives.

New Accounting Pronouncement Pension and Other Postretirement Plans. During September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. This statement requires recognition of the funded status of plans, measured as of fiscal year end. We are required to adopt the recognition provisions prospectively as of the end of 2006. We already use the required measurement date. Adopting this statement will increase our pension and postretirement liabilities, decrease other long-term assets, increase related deferred tax assets and increase accumulated other comprehensive loss. We are currently assessing the impact on our consolidated financial statements. As of December 31, 2005, the funded status of our pension and postretirement plans exceeded the amount recognized by $32 million.

New Accounting Pronouncement Fair Value. During September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement, which defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. This statement is applicable for us beginning in 2008. It applies under other accounting pronouncements that require or permit fair value measurements. During 2007, we plan to assess the impact on our consolidated financial statements.

SEC Staff Guidance Quantifying Financial Statement Misstatements. During September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, which discusses the process of quantifying financial statement misstatements. We are not currently aware of any impact that Staff Accounting Bulletin No. 108 will have on our consolidated financial statements; however, we plan to adopt the guidance during the fourth quarter of 2006.

(2) Stock-based Compensation

Overview of Plans. The Compensation Committee of the Board of Directors administers our stock-based incentive plans. The Reliant Energy, Inc. 2002 Long-Term Incentive Plan and the Reliant Energy, Inc. 2002 Stock Plan permit us to grant various stock-based incentive awards to officers, key employees and directors. Awards include stock options, restricted stock, restricted stock units, performance awards, cash awards and stock awards.

As of September 30, 2006, 36 million shares are authorized for issuance under our stock-based incentive plans, with no more than 25% of these shares available for grant as awards of restricted stock and non-restricted grants of common stock or units denominated in common stock. We generally issue new shares when stock options are exercised and for the issuance of our other equity-based awards.

Summary. Prior to January 1, 2006, we applied the intrinsic value method of accounting for employee stock-based incentive plans (APB No. 25). Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS No. 123R) (using the modified prospective method), which requires compensation costs related to share-based transactions to be recognized in the financial statements based on estimated fair values at the grant dates. Our financial statements as of and for the nine months ended September 30, 2006 reflect the impact of SFAS No. 123R; however, our financial statements for prior periods have not been restated to reflect, and do not include, the impact of the new standard. Our compensation expense for our stock-based incentive plans was:

	Nine Months Ended September 30, 2006	2005
	(in millions)	
Stock-based incentive plans compensation expense (pre-tax)	$ 26	$ 31
Income tax impact	(7)	(11)
After-tax expense	$ 19	$ 20

We did not capitalize any stock-based compensation costs as an asset during the nine months ended September 30, 2006 and 2005.

We recorded a cumulative effect of an accounting change of $2 million ($1 million, net of tax of $1 million) during the three months ended March 31, 2006 related to the adoption of SFAS No. 123R for the estimated future forfeitures on the compensation expense previously recognized in our consolidated financial statements for the unvested awards outstanding as of January 1, 2006.

By the end of 2006, we will assess the income tax impacts and adopt one of the methods allowed under the transition provisions of SFAS No. 123R to account for excess tax benefits, if any, available to absorb tax deficiencies recognized subsequent to the adoption. During the nine months ended September 30, 2006, the accounting change did not impact cash flows from operating and financing activities due to our tax net operating loss carryforwards.

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Valuation Data. Below is the description of the methods used during the indicated periods to estimate the fair value of our various awards.

	Prior to January 1, 2006 (APB No. 25)	**After January 1, 2006 (SFAS No. 123R)**
Award:		
Time-based stock options(1)	Intrinsic value on the grant date	Black-Scholes option-pricing model value on the grant date
Time-based restricted stock(2)	Market price of our common stock on the grant date	No change
Time-based cash(3)	Market price of our common stock on each reporting measurement date	No change
Key employee award program:		
Performance-based stock(1)	Market price of our common stock on each reporting measurement date	Market price of our common stock on each reporting measurement date until accounting grant date
Performance-based options(1)	Intrinsic value of option on each reporting measurement date	Black-Scholes option-pricing model value on each reporting measurement date until accounting grant date
Performance-based cash(1)(3)	Market price of our common stock on each reporting measurement date	No change
Employee stock purchase plan	No compensation expense recorded	Black-Scholes option-pricing model value on the first day of the offering period

(1) No awards were granted during the nine months ended September 30, 2006.

(2) Restricted stock and restricted stock units are referred to as restricted stock.

(3) These are liability-classified awards under SFAS No. 123R.

Time-Based Stock Options. We grant time-based stock options to officers, key employees and directors at an exercise price equal to the market value of our common stock on the grant date. Generally, options vest 33.33% per year for three years and have a term of 10 years. Beginning January 1, 2006, compensation expense is measured at fair value on the grant date, net of estimated forfeitures, and amortized to expense on a straight-line basis over the requisite service period for the entire award.

Summarized time-based option activity is:

	Nine Months Ended September 30, 2006		
	Options		Weighted Average Exercise Price
Beginning of period	11,646,667		$ 15.21
Granted			
Exercised	(1,538,777	)(1)	8.32
Forfeited	(20,638	)	3.51
Expired	(1,693,376	)	28.81
End of period	8,393,876		13.76
Weighted average grant date fair value	N/A		

(1) Received proceeds of $13 million. Intrinsic value was $6 million on the exercise date. No tax benefits are expected to be realized in 2006 due to our tax net operating loss carryforwards.

During the nine months ended September 30, 2005, we granted 30,000 time-based options with a weighted average grant date fair value of $7.18. During the nine months ended September 30, 2005, we received proceeds for

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the exercise of time-based options of $27 million for which the intrinsic value was $16 million. No tax benefits were realized during 2005 due to our tax net operating loss carryforwards.

For time-based options outstanding as of September 30, 2006:

	Options		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in millions)
Outstanding	8,393,876	(1)(2)	$ 13.76	4.5	$ 29
Exercisable	8,363,870		13.76	4.5	29

(1) We estimate that none of these will be forfeited.

(2) As of September 30, 2006, the total compensation cost related to nonvested time-based stock options not yet recognized and the weighted-average period over which it is expected to be recognized is $0.2 million and one year, respectively.

Time-Based Restricted Stock Awards. We grant time-based restricted stock awards to officers, key employees and directors. In general, these awards vest, subject to the participant s continued employment, three years from the grant date. Beginning January 1, 2006, compensation expense is measured at fair value on the grant date, net of estimated forfeitures, and amortized to expense on a straight-line basis over the requisite service period.

Summarized restricted stock award activity is:

	Nine Months Ended September 30, 2006		
	Shares		Weighted Average Grant Date Fair Value
Beginning of period	1,855,583		$ 6.96
Granted	343,409		11.59
Vested	(999,844	)(1)	5.08
Forfeited	(97,788	)	9.06
End of period	1,101,360	(2)	9.93

(1) Based on the market price of our common stock on the vesting date, $11 million in fair value vested.

(2) We estimate that 161,799 of these will be forfeited.

During the nine months ended September 30, 2005, $9 million in fair value of our time-based restricted stock vested based on the market price of our common stock on the vesting date. During the nine months ended September 30, 2005, the weighted average grant date fair value of time-based restricted stock activity was $12.61. As of September 30, 2006, the total compensation cost related to nonvested time-based restricted stock awards not yet recognized and the weighted-average period over which it is expected to be recognized is $4 million and 2 years, respectively.

Time-Based Cash Awards. We grant time-based cash awards (cash units with each cash unit having an equivalent fair market value of one share of our common stock on the vesting date) to officers and key employees. In general, these awards vest, subject to the participant s continued employment, three years from the grant date. Compensation expense is measured at fair value on each financial reporting measurement date, net of estimated forfeitures, and amortized to expense on a straight-line basis over the requisite service period. We have a liability recorded of $5 million for these time-based cash awards as of September 30, 2006.

During the nine months ended September 30, 2006 and 2005, no time-based cash awards vested and we did not pay cash for any stock-based liabilities. As of September 30, 2006, the total compensation cost related to nonvested time-based cash awards not yet recognized and the weighted-average period over which it is expected to be recognized is $4 million and 2 years, respectively.

Performance-Based Awards. We grant performance-based awards to officers and key employees. The number of performance-based awards earned is determined at the end of each performance period. All of the outstanding performance-based awards as of September 30, 2006 are for the 2004-2006 performance period, which is the requisite service period. Beginning January 1, 2006, compensation expense is measured at fair value, net of estimated forfeitures, at each reporting measurement date preceding the grant date for accounting purposes. We have broadly interpreted the criteria for determining if the service inception date precedes the grant date for our performance-based awards under SFAS No. 123R. For our performance-based cash unit awards, we have a liability recorded of $14 million as of September 30, 2006.

The Compensation Committee granted the 2004-2006 performance-based awards through the Key Employee Award Program (the Key Employee Program) established under the Reliant Energy, Inc. 2002 Long-Term Incentive Plan. Under the Key Employee Program, each performance-based award represents a targeted award of (a) 16,000 shares of performance-based stock, (b) 68,000 performance-based stock options and (c) 16,000 cash units with each cash unit having an equivalent fair market value of one share of our common stock on the vesting date. The Key Employee Program provides for a payout ranging from 0% to 140% of the targeted award level, as determined by the Compensation Committee in its sole discretion after considering various qualitative and quantitative performance criteria. These criteria include (a) reducing the ratio of our adjusted net debt to adjusted EBITDA to at least 3.5, (b) delivering superior customer value and (c) building a great company to work for, taking into consideration market conditions for each factor. The Compensation Committee has the discretion to weight the various performance objectives as it deems appropriate.

Summarized performance-based stock award activity of the Key Employee Program assuming a maximum payout (140%) is:

	Nine Months Ended September 30, 2006		
	Shares		Reporting Measurement Date Fair Value
Beginning of period	1,825,600		
Granted			
Vested			
Forfeited	(67,200	)	
End of period	1,758,400	(1)	$ 12.33

(1) We estimate no awards will be forfeited prior to vesting.

Summarized performance-based option activity of the Key Employee Program assuming a maximum payout (140%) is:

	Nine Months Ended September 30, 2006			
	Options		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
Beginning of period	7,758,800		$ 8.35	
Granted				
Exercised				
Forfeited	(285,600	)	8.14	
Expired				
End of period	7,473,200	(1)(2)	8.36	7.4
Exercisable at end of period				

(1) We estimate no awards will be forfeited prior to vesting.

(2) The aggregate intrinsic value is $30 million.

During the nine months ended September 30, 2005, we granted 78,400 performance-based stock awards with a weighted average grant date fair value of $12.63 and 333,200 performance-based stock options with a weighted average grant date fair value of $5.54. However, during the nine months ended September 30, 2005, no performance-based options were exercised.

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Our option awards under the Key Employee Program are based on the following weighted average assumptions and resulting fair values:

	Nine Months Ended September 30, 2006	
Expected term in years(1)	3.25	
Estimated volatility(2)	40.96	%
Risk-free interest rate	4.60	%
Dividend yield	0	%
Weighted-average fair value	$ 6.05	

(1) The expected term is based on a projection of exercise behavior considering the contractual terms and the participants of the option awards.

(2) We estimated volatility based on historical and implied volatility of our common stock.

During the nine months ended September 30, 2006, no performance-based awards vested. During the nine months ended September 30, 2005, $1 million in fair value of our performance-based awards for the 2002-2004 performance period vested based on the market price of our common stock on the vesting date. As of September 30, 2006, the total compensation cost related to nonvested performance based awards not yet recognized and the weighted-average period over which it is expected to be recognized is $6 million and 0.25 years, respectively.

Employee Stock Purchase Plan. We have 18 million shares of authorized common stock reserved and approved for issuance under the Reliant Energy, Inc. Employee Stock Purchase Plan (ESPP). Under the ESPP, substantially all employees can purchase our common stock through payroll deductions of up to 15% of eligible compensation during semiannual offering periods commencing on January 1 and July 1 of each year. The share price paid by participants equals 85% of the lesser of the average market price on the first or last business day of each offering period.

Our employee stock purchase plan awards are based on the following weighted average assumptions and resulting fair values:

	Nine Months Ended September 30, 2006	2005(1)
Expected term in years	0.5	0.5
Estimated volatility(2)	46.42 %	33.56 %
Risk-free interest rate	4.62 %	2.84 %
Dividend yield	0 %	0 %
Weighted-average fair value	$ 3.07	$ 3.30

(1) Because we applied APB No. 25 during 2005, this was only used for pro-forma data.

(2) We estimated volatility based on the historical volatility of our common stock.

During the nine months ended September 30, 2006 and 2005, we issued 859,549 shares and 838,120 shares, respectively, under the ESPP and received $8 million each period from the sale of shares to employees. Approximately 10.7 million reserved unissued shares were available under the ESPP as of September 30, 2006.

Pro-forma Data for 2005. If employee stock-based compensation costs had been expensed based on the fair value (determined using the Black-Scholes model and market price of our common stock) method of accounting applied to all stock-based awards, our pro forma results would be:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
	(in millions, except per-share amounts)	
Net loss, as reported	$ (270)	$ (196)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	15	20
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(7)	(17)
Pro forma net loss	$ (262)	$ (193)
Loss per share:		
Basic, as reported	$ (0.89)	$ (0.65)
Basic, pro forma	$ (0.87)	$ (0.64)
Diluted, as reported	$ (0.89)	$ (0.65)
Diluted, pro forma	$ (0.87)	$ (0.64)

Classification. Through December 31, 2005, our accruals for our stock-based incentive awards were recorded as liabilities. Beginning January 1, 2006, for stock-based equity awards, we reclassified our accrual of $23 million to equity, of which $5 million was classified as temporary equity stock-based compensation based on the redemption amount of the award as of the grant date, and the remainder was classified as additional paid-in capital in stockholders equity. Some of our stock-based equity awards provide for the settlement of the award in cash by us pursuant to change of control provisions and we do not believe it is probable these awards will become redeemable.

Other. We did not use cash to settle equity instruments granted under stock-based compensation plans during the nine months ended September 30, 2006 and 2005. During the nine months ended September 30, 2006 and 2005, there were no significant modifications to our outstanding stock-based awards.

(3) Comprehensive Loss

The components of total comprehensive loss are:

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(in millions)		(in millions)	
Net loss	$ (155)	$ (270)	$ (274)	$ (196)
Other comprehensive income (loss), net of tax:				
Deferred loss from cash flow hedges	(23)	(73)	(134)	(188)
Reclassification of net deferred (gain) loss from cash flow hedges realized in net income/loss	110	16	181	(15)
Comprehensive income resulting from discontinued operations		3		4
Comprehensive loss	$ (68)	$ (324)	$ (227)	$ (395)

(4) Goodwill

2006 Annual Goodwill Impairment Tests. We completed our annual goodwill impairment tests for our wholesale energy and retail energy reporting units effective April 1, 2006. No impairments occurred.

Estimation of Our Wholesale Energy Reporting Unit s Fair Value. We updated a number of subjective factors and significant assumptions to estimate fair value in our April 2006 test compared to our September 2005 test,

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including (a) appropriate weighting of valuation approaches (income approach, market approach and comparable public company approach), (b) projections about future power generation margins, (c) estimates of our future cost structure, (d) required level of working capital and (e) assumed EBITDA multiple for terminal values, which changed from 8.0 to 7.5 primarily due to market factors affecting public company comparisons. See note 4(a) to our consolidated financial statements in our Form 10-K.

(5) Derivative Instruments

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

	Three Months Ended September 30, 2006 (in millions)	2005	Nine Months Ended September 30, 2006	2005
Energy derivatives:				
Hedge ineffectiveness	$ 5	$ 54	$ (65)	$ 54
Other net unrealized losses	(360)	(408)	(215)	(145)
Interest rate derivatives:				
Other net unrealized losses	(3)	(4)	(8)	(12)
Total(1)(2)	$ (358)	$ (358)	$ (288)	$ (103)

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

(2) During the three months ended September 30, 2006 and 2005, $0 and during the nine months ended September 30, 2006 and 2005, $3 million and $0, respectively, were recognized in our results of continuing operations as a result of the discontinuance of cash flow hedges because it was probable that the forecasted transaction would not occur.

During the three months ended June 30, 2006, we refined our methodology for estimating fair value of derivative instruments cleared and settled through brokers by modifying our discounting assumptions to be consistent with discounting assumptions used in estimating fair value of exchange-traded futures contracts. This change in accounting estimate had an impact during the nine months ended September 30, 2006 as follows (income (loss)):

	Nine Months Ended September 30, 2006 Income/Loss from Continuing Operations before Income Taxes (in millions)	Net Income/Loss
Cash flow hedges(1)	$	$
Mark-to-market derivatives	(32)(2)	(20)
Total	$ (32)	$ (20)(3)

(1) The impact relating to cash flow hedges was an increase in our net derivative liabilities of $9 million and a $5 million increase in accumulated other comprehensive loss, net of income taxes.

(2) This amount represented an increase in our net derivative liabilities and an increase in net unrealized losses on energy derivatives, which were recorded $(1) million in revenues and $(31) million in purchased power, fuel and cost of gas sold.

(3) This represents a $0.07 impact on loss per share for the nine months ended September 30, 2006.

Our derivative portfolio, excluding cash flow hedges, is $577 million (net liability) and $308 million (net liability) as of September 30, 2006 and December 31, 2005, respectively. Our cash flow hedges are valued at $351 million (net liability) and $471 million (net liability) as of September 30, 2006 and December 31, 2005, respectively.

As of September 30, 2006 and December 31, 2005, the maximum length of time we were hedging our exposure to the variability in future cash flows that may result from changes in commodity prices was six years and seven years, respectively. As of September 30, 2006 and December 31, 2005, accumulated other comprehensive loss from derivatives was $237 million and $284 million, respectively. As of September 30, 2006, we expect $130 million of accumulated other comprehensive loss to be reclassified into our results of operations during the period from October 1, 2006 to September 30, 2007. However, the actual amount reclassified into earnings will vary from the amounts recorded as of September 30, 2006, due to future changes in market prices.

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

	Three Months Ended September 30, 2006 (in millions)	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Revenues	$	$ (9)	$	$ (10)
Purchased power, fuel and cost of gas sold	9	(30)	19	(45)
Total	$ 9	$ (39)	$ 19	$ (55)

(6) Debt

Our outstanding debt is:

	September 30, 2006 Weighted Average Stated Interest Rate(1)	Long-term	Current	December 31, 2005 Weighted Average Stated Interest Rate(1)	Long-term	Current
	(in millions, except interest rates)					
Banking or Credit Facilities, Bonds and Notes:						
Reliant Energy:						
Senior secured revolver due 2009	10.13 %	$ 189	$	8.40 %	$ 383	$
Senior secured term loans (B1) due 2010(2)	7.71	232	2	6.09	240	313
Senior secured term loans (B2) due 2010	7.66	294	3	6.91	296	3
Senior secured notes due 2010	9.25	550		9.25	550	
Senior secured notes due 2013	9.50	550		9.50	550	
Senior secured notes due 2014	6.75	750		6.75	750	
Convertible senior subordinated notes due 2010 (unsecured)	5.00	275		5.00	275	
Subsidiary Obligations:						
Orion Power Holdings, Inc. senior notes due 2010 (unsecured)	12.00	400		12.00	400	
PEDFA(3) fixed-rate bonds for Seward plant due 2036	6.75	500		6.75	500	
Reliant Energy Channelview LP(4):						
Term loans and revolving working capital facility:						
Floating rate debt due 2006 to 2024	6.93	249	19	6.04	259	14
Fixed rate debt due 2014 to 2024	9.55	75		9.55	75	
RE Retail Receivables, LLC facility due 2007	5.80		450	4.71		450
Total facilities, bonds and notes		4,064	474		4,278	780
Other:						
Adjustment to fair value of debt(5)		31	10		39	9
Total other debt		31	10		39	9
Total debt		$ 4,095	$ 484		$ 4,317	$ 789

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(1) The weighted average stated interest rates are for borrowings outstanding as of September 30, 2006 or December 31, 2005.

(2) As of December 31, 2005, we classified $638 million as discontinued operations. See note 15.

(3) PEDFA is defined as Pennsylvania Economic Development Financing Authority.

(4) We have obtained a waiver from the lenders, which expires on May 1, 2007, relating to insurance requirements specified in the credit agreement.

(5) Included in interest expense during the three months ended September 30, 2006 and 2005 is amortization of $3 million and $2 million, respectively, and included in interest expense during the nine months ended September 30, 2006 and 2005 is amortization of $7 million and $6 million, respectively, for valuation adjustments for debt.

Amounts borrowed and available for borrowing under our senior secured revolver as of September 30, 2006 are:

	Total Committed Credit	Drawn Amount	Letters of Credit	Unused Amount
	(in millions)			
Reliant Energy senior secured revolver due 2009	$ 1,700	$ 189	$ 473	$ 1,038

RE Retail Receivables, LLC Facility. We have a receivables facility arrangement to sell an undivided interest in accounts receivable from our retail business to financial institutions on an ongoing basis. The assets of the special purpose subsidiary that purchases the receivables and then resells receivables under the facility are available first and foremost to satisfy the claims of its creditors. The special purpose subsidiary is a separate entity, which we consolidate. We have extended this facility through January 31, 2007.

See note 14 for discussion of our plans related to the credit-enhanced retail structure.

(7) Earnings Per Share

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

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(in millions)			
Loss from continuing operations (basic)	$ (154)	$ (267)	$ (270)	$ (258)
Plus: Interest expense on 5.00% convertible senior subordinated notes, net of tax	(1)	(1)	(1)	(1)
Loss from continuing operations (diluted)	$ (154)	$ (267)	$ (270)	$ (258)

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

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(in millions)			
Basic and Diluted Weighted Average Shares	307,975 (1)	303,043 (1)	306,804 (1)	301,587 (1)

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

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

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(shares in thousands, dollars in millions)			
Shares excluded from the calculation of diluted loss per share	36,180 (1)	36,926 (1)	35,832 (1)	36,920 (1)
Shares excluded from the calculation of diluted loss per share because the exercise price exceeded the average market price	2,561 (2)	4,204 (2)	2,647 (2)	4,562 (2)

Interest expense that would be added to income if 5.00% convertible senior subordinated notes were dilutive	$ 2	$ 2	$ 6	$ 6

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

(2) Relates to stock options.

(8) Income Taxes

(a) Tax Rate Reconciliation.

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

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(in millions, except percentages)			
Loss from continuing operations before income taxes	$ (254)	$ (464)	$ (296)	$ (413)
Federal statutory rate	35 %	35 %	35 %	35 %
Income tax benefit at statutory rate	(89)	(162)	(104)	(145)
Net addition (reduction) in taxes resulting from:				
Federal tax reserves	8	(1)	9	1
Federal valuation allowance	(30)	(45)	60	(39)
Non-deductible compensation	1	2	3	2
Settlement of shareholder class action lawsuits				2
State income taxes, net of federal income taxes	9	(9)	5	2
Other, net	1	18 (1)	1	22 (1)
Total	(11)	(35)	78	(10)
Income tax benefit from continuing operations	$ (100)	$ (197)	$ (26)	$ (155)
Effective rate	39 %	43 %	Not Meaningful	38 %

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(1) Primarily includes revisions in estimates for taxes accrued in prior periods.

(b) Valuation Allowances.

We assess quarterly our future ability to use federal, state and foreign net operating losses, capital losses and other deferred tax assets. As a result of our recent history of losses and the change in our net federal deferred tax assets, we recorded a federal valuation allowance during 2006.

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
	(in millions)	
Balance, beginning of period	$ 90	$
Income tax expense (benefit)	(30)	60
Balance, September 30, 2006	$ 60	$ 60

(c) Tax Contingencies.

Our income tax returns, including years when we were included in CenterPoint Energy, Inc. s (CenterPoint) consolidated tax group, for the 1997 to 2004 tax reporting periods are under audit by federal and state taxing authorities. These audits may result in additional taxes, interest and penalties or revisions of the timing of tax payments. We evaluate the need for contingent tax liabilities on a quarterly basis and record any estimable and probable tax exposures in our results of operations.

We have received proposed tax assessments from certain taxing authorities, which are currently at varying stages of appeals. The issues primarily relate to temporary differences and include deductions for plant abandonments, bad debts, capitalization of costs to plant and inventory, depreciation and various other matters. It could take several years to resolve these contingencies.

As of September 30, 2006 and December 31, 2005, we have accrued contingent federal and state tax liabilities related to our continuing operations of $49 million and $46 million, respectively. These balances are primarily classified in other long-term liabilities. We do not believe these contingencies will be resolved within the next 12 months.

As of September 30, 2006 and December 31, 2005, we have accrued contingent federal tax liabilities related to our discontinued European energy operations of $11 million included in other long-term liabilities in continuing operations. We reserved these amounts for potential future federal income tax assessments on certain income from our former European subsidiaries. If sustained, these assessments would increase our capital loss carryforwards by $45 million and reduce our tax net operating loss carryforwards by the same amount.

We believe that the substantial majority of certain payments and charges are deductible for income tax purposes; however, no assurance can be given that the Internal Revenue Service would not assert, or that a court would not sustain, a contrary position. These payments and/or charges include:

- $177 million to CenterPoint during 2004 related to our residential customers. See note 13(d) to our consolidated financial statements in our Form 10-K.

- $68 million during 2005 to settle the class action lawsuits against us for claims alleging violations of securities laws. See note 13(c) to our consolidated financial statements in our Form 10-K.

- A pre-tax charge of $351 million during 2005 to settle certain civil litigation and claims relating to the Western states energy crisis. See note 13(a) to our consolidated financial statements in our Form 10-K.

- A pre-tax charge of $35 million during the third quarter of 2006 for the tentative settlement of certain class action natural gas cases relating to the Western states energy crisis. See note 10(a).

(d) Changes in Accounting for Income Taxes or Tax Laws.

The FASB recently issued guidance clarifying the accounting for uncertainty in income taxes. Pursuant to the new guidance, which becomes effective for us in 2007, tax benefits are only recorded for positions where it is more-likely-than-not that our reported tax return treatment would be sustained if audited by relevant taxing authorities. Additional rules are provided for interest, penalties, changes in benefit recognition and other related matters. We cannot currently predict the effect this interpretation will have on our consolidated financial statements.

In May 2006, the State of Texas enacted substantial changes to its tax system. Effective January 1, 2007, the current Texas franchise tax comprised of taxable capital and earned surplus components will be replaced with a revised franchise tax based on modified gross revenue. As a result of the Texas law change, during the nine months ended September 30, 2006, we decreased our net deferred state tax liabilities by $9 million to reflect the estimated cumulative change to deferred tax items. We will continue to revise our estimate as additional information becomes available through December 31, 2006.

(9) Guarantees and Indemnifications

We have guaranteed some non-qualified benefits of CenterPoint s existing retirees at September 20, 2002. The estimated maximum potential amount of future payments under the guarantee was approximately $57 million as of September 30, 2006. We believe the likelihood that we would incur any significant losses under this guarantee is remote and, therefore, have not recorded a liability in our consolidated balance sheet as of September 30, 2006.

We also guarantee the $500 million PEDFA bonds, which are included in our consolidated balance sheet as outstanding debt. Our guarantees are secured by guarantees from all of our subsidiaries that guarantee the December 2004 credit facilities and the collateral that secures our senior secured notes. The guarantees require us to comply with covenants substantially identical to those in the senior secured notes indentures. The PEDFA bonds will become secured by certain assets of Seward if the collateral supporting both the senior secured notes and our guarantees is 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 is approximately $21 million as of September 30, 2006. We secured a portion of the guarantee with letters of credit. We have not recorded a liability in our consolidated balance sheet for this guarantee.

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.

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

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

We are unable to estimate our maximum potential exposure under these provisions until an event triggering payment under these provisions occurs. Based on current information, we consider the likelihood of making any material payments under these provisions to be remote.

(10) Contingencies

(a) Legal Proceedings.

We are parties to many legal proceedings, some of which may involve substantial amounts. Unless otherwise noted, we cannot predict the outcome of these proceedings.

Pending Electricity and Natural Gas Litigation

The following proceedings relate to alleged conduct in the electricity and natural gas markets. In 2005, we settled a number of these proceedings that were pending in California and other western states; however, many other proceedings remain pending. See note 13 to our consolidated financial statements in our Form 10-K.

Electricity Actions. We are party to two remaining lawsuits relating to our participation in alleged conduct to increase electricity prices in violation of antitrust laws, unfair competition laws and similar laws. The lawsuits seek treble damages, restitution and expenses. These lawsuits are on appeal from orders of the United States District Court, Western District of Washington and the United States District Court, District of Oregon, respectively, that dismissed these cases in our favor. A third related case was recently dismissed in our favor from the Superior Court of California Santa Clara County. The other electricity lawsuits were settled as part of our 2005 settlement. While there are certain issues on appeal in these other cases, we do not believe the appeals will materially impact the underlying settlement.

Natural Gas Actions. We are party to 39 lawsuits, a number of which are class action lawsuits, including an action brought by the Nevada Attorney General on behalf of gas consumers in Nevada, in state and federal courts in California, Colorado, Kansas, Missouri, Nevada and Tennessee relating to alleged conduct to increase natural gas prices in violation of antitrust and similar laws. The lawsuits seek treble damages, restitution and/or expenses. The lawsuits also name our subsidiary, Reliant Energy Services, Inc. (Reliant Energy Services), and a number of unaffiliated energy companies as parties.

In October 2006, we reached a tentative settlement of the 12 class action natural gas cases pending in state court in California. The settlement would require us to pay $35 million, which we expensed during the third quarter of 2006, and would not include similar cases filed by individual plaintiffs, which we continue to vigorously defend. The settlement will be subject to a fairness hearing and court approval, which we expect to occur in the first quarter of 2007. We have not admitted wrongdoing or liability and we continue to deny the plaintiff s allegations.

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

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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).

Another of the natural gas cases is a lawsuit filed in October 2006 by the Missouri Public Service Commission in the Circuit Court of Jackson County, Missouri at Kansas City relating to alleged conduct to increase natural gas prices in violation of antitrust and similar laws from January 2000 through October 2002. The lawsuit, which has not been served on us, seeks treble damages and expenses and also names our subsidiary, Reliant Energy Services, as a party. The case has been removed to the Western District of Missouri, Western Division.

Criminal Proceeding Reliant Energy Services. In April 2004, a California federal grand jury indicted Reliant Energy Services and some of its former and current employees for alleged violations of the Commodity Exchange Act, wire fraud and on conspiracy charges. The indictment claims Reliant Energy Services manipulated prices by curtailing electricity generation in California on two days in June 2000. We believe the actions alleged in the indictment did not violate laws in effect during this period and are contesting the indictment vigorously. In February 2006, the judge denied the motions to dismiss that were filed by Reliant Energy Services and some of its former and current employees in this proceeding. This case has been set for trial in March 2007 in the United States District Court for the Northern District of California. If convicted, our subsidiary could be assessed statutory penalties equal to twice the alleged benefit to us from the conduct or twice the alleged harm to the market from the conduct. The indictment alleges that the conduct could have resulted in harm to the market of up to $32 million. In addition, a criminal conviction of Reliant Energy Services could result in potential suspension or debarment from government contracting. We do not believe that the indictment will have any material adverse impact on our business operations.

Montana Attorney General. In June 2003, the Montana Attorney General sued Reliant Energy Services and unaffiliated energy companies in Montana state court alleging an unlawful conspiracy to artificially increase electricity and natural gas prices between 2000 and 2001. The lawsuit, which has never been served on us, seeks injunctive relief, treble damages, restitution of overpayments, disgorgement of unlawful profits and legal expenses.

United States Attorney Investigation

Investigation of Natural Gas Price Reporting Issues. The United States Attorney for the Southern District of Texas has been investigating natural gas price reporting issues. The issues relate to the alleged submission of false data to various energy publications and reporting services. In November 2004, a grand jury indicted a former employee of Reliant Energy Services for alleged misreporting of gas prices and the employee subsequently pled guilty and was sentenced. The investigation could result in civil or criminal actions being brought against us, certain of our subsidiaries or other current and former employees; however, it has been several months since we last received an information request from the United States Attorney s office.

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 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.

(b) Environmental Matters.

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

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

Remediation Obligations. We are responsible for environmental costs related to site contamination investigations and remediation requirements at four power plants in New Jersey. Based on our evaluations with assistance from third-party consultants and engineers, we recorded the estimated liability for the remediation costs of $7 million as of September 30, 2006 and December 31, 2005.

Environmental Class Action. We received notice of a class action lawsuit filed in Superior Court in Ontario, Canada in June 2005 against us and approximately 20 other utility and power generation companies alleging various claims relating to environmental emissions from coal-fired power plants in the United States and Canada. The lawsuit alleges damages of approximately $42.1 billion, with continuing damages in the amount of approximately $3.5 billion annually. The lawsuit also claims entitlement to punitive and exemplary damages in the amount of $860 million. We converted Canadian dollars to United States dollars using an exchange rate as of December 31, 2005. The complaint was not timely served on us under Canadian law, but the plaintiffs may ask the court to extend the time of service or they may commence a new lawsuit. We do not know whether the plaintiffs will proceed with the lawsuit and are not in a position at this time to assess what impact, if any, an adverse decision might have on our results of operations, financial condition and cash flows; however, we are confident that we have operated and continue to operate our coal-fired plants in material compliance with all applicable federal and state environmental regulations.

Elrama Consent Order. In September 2006, Orion MidWest entered into a consent order and agreement with the Commonwealth of Pennsylvania Department of Environmental Protection regarding alleged air pollution violations at its power plant in Elrama, Pennsylvania. Pursuant to the consent order and agreement, Orion MidWest agreed to pay a civil penalty of $20,000 in settlement of past violations and to pay up to an additional $90,000 for violations occurring during the term of the consent order. Orion MidWest has also agreed to take various investigatory and remedial actions at the plant, including an upgrade of its scrubber system.

(11) Supplemental Guarantor Information

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

Condensed Consolidating Statements of Operations.

	Three Months Ended September 30, 2006 Reliant Energy (in millions)	Guarantors	Non-Guarantors	Adjustments (1)	Consolidated
Revenues	$	$ 3,344	$ 434	$ (473)	$ 3,305
Purchased power, fuel and cost of gas sold		3,231	222	(463)	2,990
Operation and maintenance		118	111	(10)	219
Selling, general and administrative		96	21		117
Western states settlement		35			35
(Gain) loss on sales of receivables		27	(27)		
Gains on sales of assets and emission allowances, net		(2)	(1)		(3)
Depreciation and amortization		47	61		108
Total		3,552	387	(473)	3,466
Operating income (loss)		(208)	47		(161)
Income of equity investments, net		2			2
Other, net		(1)			(1)
Loss of equity investments of consolidated subsidiaries	(187)	(4)		191	
Interest expense	(68)	(9)	(24)		(101)
Interest income		7			7
Interest income (expense) affiliated companies, net	82	(53)	(29)		
Total other expense	(173)	(58)	(53)	191	(93)
Loss from continuing operations before income taxes	(173)	(266)	(6)	191	(254)
Income tax benefit(2)	(18)	(81)	(1)		(100)
Loss from continuing operations	(155)	(185)	(5)	191	(154)
Loss from discontinued operations			(1)		(1)
Net loss	$ (155)	$ (185)	$ (6)	$ 191	$ (155)

	Three Months Ended September 30, 2005 Reliant Energy (in millions)	Guarantors	Non-Guarantors	Adjustments (1)	Consolidated
Revenues	$	$ 3,042	$ 552	$ (631)	$ 2,963
Purchased power, fuel and cost of gas sold		3,053	267	(623)	2,697
Operation and maintenance		94	93	(8)	179
Selling, general and administrative		68	30		98
Western states settlement		351			351
(Gain) loss on sales of receivables		20	(20)		

Gains on sales of assets and emission allowances, net			(92)		(92)
Depreciation and amortization		56	68		124
Total		3,642	346	(631)	3,357
Operating income (loss)		(600)	206		(394)
Income of equity investments, net		27			27
Income (loss) of equity investments of consolidated subsidiaries	(232)	84		148	
Interest expense	(69)	(10)	(21)		(100)
Interest income		3			3
Interest income (expense) affiliated companies, net	36	(9)	(27)		
Total other income (expense)	(265)	95	(48)	148	(70)
Income (loss) from continuing operations before income taxes	(265)	(505)	158	148	(464)
Income tax expense (benefit)	8	(257)	24	28	(197)
Income (loss) from continuing operations	(273)	(248)	134	120	(267)
Income (loss) from discontinued operations	3	96	(161)	59	(3)
Net loss	$ (270)	$ (152)	$ (27)	$ 179	$ (270)

	Nine Months Ended September 30, 2006 Reliant Energy (in millions)	Guarantors	Non-Guarantors	Adjustments (1)	Consolidated
Revenues	$	$ 8,640	$ 1,116	$ (1,223)	$ 8,533
Purchased power, fuel and cost of gas sold		8,049	625	(1,200)	7,474
Operation and maintenance		318	340	(23)	635
Selling, general and administrative		222	57		279
Western states settlement		35			35
(Gain) loss on sales of receivables		64	(64)		
Gains on sales of assets and emission allowances, net		(20)	(139)		(159)
Depreciation and amortization		140	140		280
Total		8,808	959	(1,223)	8,544
Operating income (loss)		(168)	157		(11)
Income of equity investments, net		4			4
Income (loss) of equity investments of consolidated subsidiaries	(186)	3		183	
Interest expense	(216)	(28)	(68)		(312)
Interest income	1	20	2		23
Interest income (expense) affiliated companies, net	193	(116)	(77)		
Total other expense	(208)	(117)	(143)	183	(285)
Income (loss) from continuing operations before income taxes	(208)	(285)	14	183	(296)
Income tax expense (benefit)(2)	61	(101)	14		(26)
Loss from continuing operations	(269)	(184)		183	(270)
Income (loss) from discontinued operations	(5)	(3)	3		(5)
Cumulative effect of accounting change, net of tax		1			1
Net income (loss)	$ (274)	$ (186)	$ 3	$ 183	$ (274)

	Nine Months Ended September 30, 2005 Reliant Energy (in millions)	Guarantors	Non-Guarantors	Adjustments (1)	Consolidated
Revenues	$	$ 7,190	$ 1,247	$ (1,325)	$ 7,112
Purchased power, fuel and cost of gas sold	(1)	6,531	655	(1,307)	5,878
Operation and maintenance		270	304	(18)	556
Selling, general and administrative		163	79		242
Western states settlement		351			351
(Gain) loss on sales of receivables		43	(43)		
Gains on sales of assets and emission allowances, net		(3)	(116)	3	(116)
Depreciation and amortization		166	170		336
Total	(1)	7,521	1,049	(1,322)	7,247
Operating income (loss)	1	(331)	198	(3)	(135)
		23			23

Income of equity investments, net					
Income (loss) of equity investments of consolidated subsidiaries	(114)	72		42	
Other, net		(23)			(23)
Interest expense	(203)	(29)	(61)		(293)
Interest income		14	1		15
Interest income (expense) affiliated companies, net	100	(31)	(69)		
Total other income (expense)	(217)	26	(129)	42	(278)
Income (loss) from continuing operations before income taxes	(216)	(305)	69	39	(413)
Income tax benefit	(12)	(162)	(9)	28	(155)
Income (loss) from continuing operations	(204)	(143)	78	11	(258)
Income (loss) from discontinued operations	8	130	(135)	59	62
Net loss	$ (196)	$ (13)	$ (57)	$ 70	$ (196)

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

(2) During the three and nine months ended September 30, 2006, we recorded (reversed) federal valuation allowances of $(20) million and $70 million, respectively, related to our net federal deferred tax assets. These amounts are reflected in the Reliant Energy column. See note 8.

Condensed Consolidating Balance Sheets.

	September 30, 2006 Reliant Energy (in millions)	Guarantors	Non-Guarantors	Adjustments (1)	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	$ 6	$ 49	$ 12	$	$ 67
Restricted cash			10		10
Accounts and notes receivable, principally customer, net		296	1,101	(6)	1,391
Accounts and notes receivable affiliated companies	2,535	1,769	1,438	(5,742)	
Inventory		145	139		284
Derivative assets		440	9		449
Other current assets		1,956	106	(105)	1,957
Current assets of discontinued operations		5	1		6
Total current assets	2,541	4,660	2,816	(5,853)	4,164
Property, Plant and Equipment, net		3,134	2,644		5,778
Other Assets:					
Goodwill		84	184	119	387
Other intangibles, net		141	293		434
Notes receivable affiliated companies	2,539	770	94	(3,403)	
Equity investments of consolidated subsidiaries	1,763	466		(2,229)	
Derivative assets		253	6		259
Other long-term assets(2)	83	416	408	(298)	609
Total other assets	4,385	2,130	985	(5,811)	1,689
Total Assets	$ 6,926	$ 9,924	$ 6,445	$ (11,664)	$ 11,631
LIABILITIES AND EQUITY					
Current Liabilities:					
Current portion of long-term debt and short-term borrowings	$ 5	$	$ 479	$	$ 484
Accounts payable, principally trade	6	742	47		795
Accounts and notes payable affiliated companies		3,758	1,984	(5,742)	
Derivative liabilities		1,033	36		1,069
Other current liabilities	147	417	82	(111)	535
Current liabilities of discontinued operations		5	19		24
Total current liabilities	158	5,955	2,647	(5,853)	2,907
Other Liabilities:					
Notes payable affiliated companies		2,635	768	(3,403)	
Derivative liabilities		448	119		567
Other long-term liabilities(2)	231	215	216	(298)	364
Total other liabilities	231	3,298	1,103	(3,701)	931
Long-term Debt	2,839	501	755		4,095
Commitments and Contingencies					
Temporary Equity Stock-based Compensation	1				1
Total Stockholders Equity(2)	3,697	170	1,940	(2,110)	3,697
Total Liabilities and Equity	$ 6,926	$ 9,924	$ 6,445	$ (11,664)	$ 11,631

	December 31, 2005 Reliant Energy (in millions)	Guarantors	Non-Guarantors	Adjustments (1)	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	$ 3	$ 40	$ 45	$	$ 88
Restricted cash			27		27
Accounts and notes receivable, principally customer, net		348	840	(16)	1,172
Accounts and notes receivable affiliated companies	802	1,395	1,096	(3,293)	
Inventory		161	138		299
Derivative assets		639	87		726
Other current assets	1	2,129	91	(6)	2,215
Current assets of discontinued operations	2	46	157	(2)	203
Total current assets	808	4,758	2,481	(3,317)	4,730
Property, Plant and Equipment, net		3,246	2,688		5,934
Other Assets:					
Goodwill		84	184	119	387
Other intangibles, net		182	329		511
Notes receivable affiliated companies	2,506	812	2	(3,320)	
Equity investments of consolidated subsidiaries	3,721	364		(4,085)	
Derivative assets		521	7		528
Other long-term assets	188	180	380	(150)	598
Long-term assets of discontinued operations	720		873	(712)	881
Total other assets	7,135	2,143	1,775	(8,148)	2,905
Total Assets	$ 7,943	$ 10,147	$ 6,944	$ (11,465)	$ 13,569
LIABILITIES AND EQUITY					
Current Liabilities:					
Current portion of long-term debt and short-term borrowings	$ 316	$	$ 473	$	$ 789
Accounts payable, principally trade	8	848	31		887
Accounts and notes payable affiliated companies		1,826	1,467	(3,293)	
Derivative liabilities		1,081	139		1,220
Other current liabilities	62	305	69	(22)	414
Current liabilities of discontinued operations		49	49	(2)	96
Total current liabilities	386	4,109	2,228	(3,317)	3,406
Other Liabilities:					
Notes payable affiliated companies		2,512	808	(3,320)	
Derivative liabilities		657	156		813
Other long-term liabilities	11	262	266	(150)	389
Long-term liabilities of discontinued operations	638		854	(712)	780
Total other liabilities	649	3,431	2,084	(4,182)	1,982
Long-term Debt	3,044	501	772		4,317
Commitments and Contingencies					
Total Stockholders Equity	3,864	2,106	1,860	(3,966)	3,864
Total Liabilities and Equity	$ 7,943	$ 10,147	$ 6,944	$ (11,465)	$ 13,569

(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) See footnote (2) above under condensed consolidating statements of operations.

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Condensed Consolidating Statements of Cash Flows.

	Nine Months Ended September 30, 2006				
	Reliant Energy(1) (in millions)	**Guarantors**(1)(2)	**Non-Guarantors**(2)	**Adjustments**(3)	**Consolidated**
Cash Flows from Operating Activities:					
Net cash provided by (used in) continuing operations from operating activities	$ 9	$ (31)	$ 62	$	$ 40
Net cash provided by (used in) discontinued operations from operating activities	3	(8)	(40)		(45)
Net cash provided by (used in) operating activities	12	(39)	22		(5)
Cash Flows from Investing Activities:					
Capital expenditures		(21)	(43)		(64)
Investments in, advances to and from and distributions from subsidiaries, net (4)	410	12	(203)	(219)	
Proceeds from sales of assets, net			1		1
Net proceeds from sales of emission allowances		64	129		193
Restricted cash			17		17
Other, net		6			6
Net cash provided by (used in) continuing operations from investing activities	410	61	(99)	(219)	153
Net cash provided by discontinued operations from investing activities	712		968	(712)	968
Net cash provided by investing activities	1,122	61	869	(931)	1,121
Cash Flows from Financing Activities:					
Payments of long-term debt	(320)		(11)		(331)
Increase (decrease) in short-term borrowings and revolving credit facilities, net	(194)		5		(189)
Changes in notes with affiliated companies, net (5)		(13)	(206)	219	
Proceeds from issuances of stock	21				21
Net cash used in continuing operations from financing activities	(493)	(13)	(212)	219	(499)
Net cash used in discontinued operations from financing activities	(638)		(712)	712	(638)
Net cash used in financing activities	(1,131)	(13)	(924)	931	(1,137)
Net Change in Cash and Cash Equivalents	3	9	(33)		(21)
Cash and Cash Equivalents at Beginning of Period	3	40	45		88
Cash and Cash Equivalents at End of Period	$ 6	$ 49	$ 12	$	$ 67

	Nine Months Ended September 30, 2005				
	Reliant Energy	**Guarantors**	**Non-Guarantors**	**Adjustments**(3)	**Consolidated**
	(in millions)				
Cash Flows from Operating Activities:					
Net cash provided by (used in) continuing operations from operating activities	$ (76)	$ (532)	$ 89	$	$ (519)
Net cash provided by discontinued operations from operating activities	7		98		105
Net cash provided by (used in) operating activities	(69)	(532)	187		(414)
Cash Flows from Investing Activities:					
Capital expenditures		(40)	(19)		(59)
Investments in, advances to and from and distributions from subsidiaries, net (4)	11	(10)	(188)	187	
Proceeds from sales of assets, net		104	45		149
Net proceeds from sales (purchases) of emission allowances		(131)	118		(13)
Restricted cash			30		30
Other, net		3			3
Net cash provided by (used in) continuing operations from investing activities	11	(74)	(14)	187	110
Net cash provided by (used in) discontinued operations from investing activities	18	51	(12		