

RRI ENERGY INC  
Form 10-Q  
May 06, 2010

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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 March 31, 2010**

**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**

**RRI 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)

**(832) 357-3000**

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 April 27, 2010, the latest practicable date for determination, RRI Energy, Inc. had 353,413,315 shares of common stock outstanding and no shares of treasury stock.



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**SAFE HARBOR-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, possible transactions, dispositions, financings or offerings, and overview of economic and market conditions. In many cases, you can identify forward-looking statements by terminology such as anticipate, estimate, believe, continue, could, intend, may, plan, potential, predict, should, will, expect, objective, projection, forecast, goal, effort, target and other similar words. 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, capacity, fuel and emission allowances
- The timing and extent of changes in commodity prices
- Limitations on our ability to set rates at market prices
- Legislative, regulatory and/or market developments
- Changes in environmental regulations that constrain our operations or increase our compliance costs
- Competition in the wholesale power markets
- Operating without long-term power sales agreements
- Ineffective hedging activities
- Our ability to obtain adequate fuel supply and/or transmission services
- Interruption or breakdown of our plants
- Failure of third parties to perform contractual obligations
- Failure to meet our debt service obligations or restrictive covenants
- Changes in the wholesale power market or in our evaluation of our plants
- The outcome of pending or threatened lawsuits, regulatory proceedings, tax proceedings and investigations
- Weather-related events or other events beyond our control
- Financial and economic market conditions and our access to capital and
- The successful and timely completion of the proposed merger with Mirant Corporation, which could be materially and adversely affected by, among other things, the following:
  - obtaining mutually acceptable debt financing
  - resolving any litigation brought in connection with the proposed merger
  - the timing and terms and conditions of required governmental and regulatory approvals
  - the ability to maintain relationships with employees, suppliers or customers as well as the ability to integrate the businesses and realize cost savings

Other factors that could cause our actual results to differ from our projected results are discussed or referred to in the Risk Factors sections of this report and 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. Our filings and other important information are also available on our investor page at [www.rrienergy.com](http://www.rrienergy.com).



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

**ITEM 1. FINANCIAL STATEMENTS**

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(thousands of dollars, except per share amounts)</b>	
<b>Revenues:</b>		
Revenues (including \$105,840 and \$(4,288) unrealized gains (losses))	\$ 604,710	\$ 466,184
<b>Expenses:</b>		
Cost of sales (including \$21,263 and \$(39,455) unrealized gains (losses))	266,801	324,674
Operation and maintenance	160,415	157,146
General and administrative	20,718	29,014
Western states litigation and similar settlements	17,000	
Gains on sales of assets and emission and exchange allowances, net	(417)	(18,930)
Long-lived assets impairments	247,715	
Depreciation and amortization	62,320	67,858
Total operating expense	774,552	559,762
<b>Operating Loss</b>	<b>(169,842)</b>	<b>(93,578)</b>
<b>Other Income (Expense):</b>		
Interest expense	(46,041)	(46,919)
Interest income	216	248
Other, net	1,560	592
Total other expense	(44,265)	(46,079)
<b>Loss from Continuing Operations Before Income Taxes</b>	<b>(214,107)</b>	<b>(139,657)</b>
Income tax expense (benefit)	62,084	(33,876)
<b>Loss from Continuing Operations</b>	<b>(276,191)</b>	<b>(105,781)</b>
Loss from discontinued operations	(515)	(45,632)
<b>Net Loss</b>	<b>\$ (276,706)</b>	<b>\$ (151,413)</b>
<b>Basic/Diluted Loss per Share:</b>		
Loss from continuing operations	\$ (0.78)	\$ (0.30)
Loss from discontinued operations		(0.13)
Net loss	\$ (0.78)	\$ (0.43)





**Table of Contents****RRI ENERGY, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2010</b>	<b>December 31,</b>
	<b>(thousands of dollars, except per share amounts)</b>	
	<b>(unaudited)</b>	
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 1,124,069	\$ 943,440
Restricted cash	28,835	24,093
Accounts and notes receivable, principally customer, net	114,453	152,569
Inventory	293,066	331,584
Derivative assets	201,626	132,062
Margin deposits	166,364	198,582
Prepayments and other current assets	90,914	86,844
Current assets of discontinued operations (\$40,530 and \$55,855 of margin deposits)	88,748	108,476
<b>Total current assets</b>	<b>2,108,075</b>	<b>1,977,650</b>
Property, plant and equipment, gross	5,924,765	6,330,879
Accumulated depreciation	(1,611,547)	(1,728,566)
<b>Property, Plant and Equipment, net</b>	<b>4,313,218</b>	<b>4,602,313</b>
<b>Other Assets:</b>		
Other intangibles, net	300,390	305,913
Derivative assets	91,656	53,138
Prepaid lease	282,700	277,370
Other (\$29,212 and \$33,793 accounted for at fair value)	190,673	239,078
Long-term assets of discontinued operations	5,224	5,232
<b>Total other assets</b>	<b>870,643</b>	<b>880,731</b>
<b>Total Assets</b>	<b>\$ 7,291,936</b>	<b>\$ 7,460,694</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Current Liabilities:</b>		
Current portion of long-term debt and short-term borrowings	\$ 401,090	\$ 404,505
Accounts payable, principally trade	118,251	142,787
Derivative liabilities	132,441	151,461
Margin deposits	67,590	2,860
Other	253,673	169,898
Current liabilities of discontinued operations (\$13,309 and \$11,000 of margin deposits)	62,494	58,452

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Total current liabilities	1,035,539	929,963
<b>Other Liabilities:</b>		
Derivative liabilities	56,229	61,436
Other	259,931	260,547
Long-term liabilities of discontinued operations	13,556	13,700
Total other liabilities	329,716	335,683
<b>Long-term Debt</b>	1,949,744	1,949,771
<b>Commitments and Contingencies</b>		
<b>Temporary Equity Stock-based Compensation</b>	5,132	6,890
<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; 353,413,315 and 352,785,985 issued)	114	114
Additional paid-in capital	6,264,565	6,259,248
Accumulated deficit	(2,249,342)	(1,972,389)
Accumulated other comprehensive loss	(43,532)	(48,586)
Total stockholders equity	3,971,805	4,238,387
<b>Total Liabilities and Equity</b>	<b>\$ 7,291,936</b>	<b>\$ 7,460,694</b>

See Notes to our Unaudited Consolidated Interim Financial Statements

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(thousands of dollars)</b>	
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (276,706)	\$ (151,413)
Loss from discontinued operations	515	45,632
Loss from continuing operations	(276,191)	(105,781)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	62,320	67,858
Deferred income taxes	62,134	(33,771)
Net changes in energy derivatives	(125,805)	43,743
Gains on sales of assets and emission and exchange allowances, net	(417)	(18,930)
Western states litigation and similar settlements	17,000	
Long-lived assets impairments	247,715	
Other, net	(1,850)	4,800
Changes in other assets and liabilities:		
Accounts and notes receivable, net	37,219	86,831
Inventory	38,518	21,219
Margin deposits, net	96,948	105,783
Net derivative assets and liabilities	875	(10,298)
Accounts payable	(22,217)	2,287
Other current assets	(536)	(5,102)
Other assets	(8,486)	(4,221)
Taxes payable/receivable	1,190	(2,689)
Other current liabilities	43,757	40,076
Other liabilities	3,412	7,271
Net cash provided by continuing operations from operating activities	175,586	199,076
Net cash provided by discontinued operations from operating activities	25,922	289,161
Net cash provided by operating activities	201,508	488,237
<b>Cash Flows from Investing Activities:</b>		
Capital expenditures	(17,997)	(55,472)
Proceeds from sales of emission and exchange allowances	7	12,798
Purchases of emission allowances		(5,358)
Restricted cash	(4,742)	(3,801)
Other, net	1,400	
Net cash used in continuing operations from investing activities	(21,332)	(51,833)
Net cash used in discontinued operations from investing activities	(803)	(15,728)
Net cash used in investing activities	(22,135)	(67,561)

**Cash Flows from Financing Activities:**

Proceeds from issuances of stock	1,881	2,163
Net cash provided by financing activities	1,881	2,163
<b>Net Change in Cash and Cash Equivalents, Total Operations</b>	181,254	422,839
<b>Less: Net Change in Cash and Cash Equivalents, Discontinued Operations</b>	625	16,891
<b>Cash and Cash Equivalents at Beginning of Period, Continuing Operations</b>	943,440	1,004,367
<b>Cash and Cash Equivalents at End of Period, Continuing Operations</b>	\$ 1,124,069	\$ 1,410,315

**Supplemental Disclosure of Cash Flow Information:**

## Cash Payments:

Interest paid (net of amounts capitalized) for continuing operations	\$ (504)	\$ (4,745)
Income taxes paid (net of income tax refunds received) for continuing operations	(20)	3,762

See Notes to our Unaudited Consolidated Interim Financial Statements

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

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

***(a) Background.***

RRI Energy refers to RRI Energy, Inc. and we, us and our refer to RRI Energy, Inc. and its consolidated subsidiaries. We provide energy, capacity, ancillary and other energy services to wholesale customers in competitive energy markets in the United States through our ownership and operation of and contracting for power generation capacity. Our business consists of four reportable segments. See note 16. 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. See note 18 for discussion of our proposed merger with Mirant Corporation (Mirant).

***(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 amounts of assets, liabilities and equity
- the reported amounts of revenues and expenses
- our disclosure of contingent assets and liabilities at the date of the financial statements

Actual results could differ from those estimates.

We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which we believe to be reasonable under the circumstances. We adjust such estimates and assumptions when facts and circumstances dictate.

*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, and changes in regulations, timing of maintenance and other expenditures, dispositions, changes in interest expense and other factors.

*Inventory.* We value fuel inventories at the lower of average cost or market. We reduce these inventories as they are used in the production of electricity or sold. During the three months ended March 31, 2010 and 2009, we recorded \$2 million and \$24 million, respectively, for lower of average cost or market valuation adjustments in cost of sales.

*New Accounting Pronouncement - Improving Disclosures about Fair Value Measurements.* Effective for the first quarter of 2010, this guidance requires disclosures of significant transfers in and out of Levels 1 and 2. In addition, it clarifies existing disclosure requirements regarding inputs and valuation techniques as well as the appropriate level of disaggregation for fair value measurements disclosures. See note 3. Effective for the first quarter of 2011 financial statements, this guidance requires separate presentation of purchases, sales, issuances and settlements within the Level 3 reconciliation.

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in millions)</b>	
Stock-based incentive plans compensation expense (pre-tax) <sup>(1)</sup>	\$ 2	\$ 3

(1) See note 10 to our consolidated financial statements in our Form 10-K for information about our stock-based incentive plans compensation expense/income.

During March 2010, the compensation committee of our board of directors granted (a) 917,746 time-based restricted stock options (exercise price of \$4.28 per share which vest in three equal installments during March 2011, 2012 and 2013), (b) 462,500 time-based restricted stock options (exercise price of \$4.20 per share which vest in three equal installments during March 2011, 2012 and 2013), (c) 909,423 time-based restricted stock units (which vest during March 2013), (d) 317,890 time-based cash units (which vest during March 2013) and (e) 690,123 performance-based cash units (which vest during March 2013) to employees under our stock and incentive plans. The performance-based cash units, which are liability-classified awards, are each payable into a cash amount equal to the market value of one share of our common stock based on the three-year average total shareholder return for the period beginning March 3, 2010 and ending March 3, 2013 compared to the relative three-year average total shareholder return for the same period of a group of our peer companies. The Monte Carlo simulation valuation model is used, on each reporting measurement date, to estimate the fair value of these performance-based cash awards.

No tax benefits related to stock-based compensation were realized during the three months ended March 31, 2010 and 2009 due to our net operating loss carryforwards.

**(3) Fair Value Measurements**

*Fair Value Hierarchy and Valuation Techniques.* We apply recurring fair value measurements to our financial assets and liabilities. In determining fair value, we generally use a 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 financial 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 primarily includes our energy derivative instruments that are exchange-traded or that are cleared and settled through the exchange. Our cash equivalents and available-for-sale and trading securities are also valued using Level 1 inputs.

**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, forwards and options.

**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 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 coal contracts, longer term natural gas contracts and options valued using implied or internally developed inputs.



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The fair value measurements of these derivative assets and liabilities are based largely on unadjusted indicative quoted prices from independent brokers in active markets who regularly facilitate our transactions. An active market is considered to have transactions with sufficient frequency and volume to provide pricing information on an ongoing basis. Derivative instruments for which fair value is calculated using quoted prices that are deemed not active or that have been extrapolated from quoted prices in active markets are classified as Level 3. For certain natural gas and power contracts, we adjust seasonal or calendar year quoted prices based on historical observations to represent fair value for each month in the season or calendar year, such that the average of all months is equal to the quoted price. A derivative instrument that has a tenor that does not span the quoted period is considered an unobservable Level 3 measurement.

We evaluate and validate the inputs we use to estimate fair value by a number of methods, including validating against market published prices and daily broker quotes obtainable from multiple pricing services. For OTC derivative instruments classified as Level 2, indicative quotes obtained from brokers in liquid markets generally represent fair value of these instruments. We believe these price quotes are executable. Adjustments to the quotes are adjustments to the bid or ask price depending on the nature of the position to appropriately reflect exit pricing and are considered a Level 3 input to the fair value measurement. In less liquid markets such as coal, in which a single broker's view of the market is used to estimate fair value, we consider such inputs to be unobservable Level 3 inputs. We do not use third party sources that determine price based on market surveys or proprietary models.

We value some of our OTC, complex or structured derivative instruments using a variety of valuation models, which utilize inputs that may not be corroborated by market data and vary in complexity depending on the contractual terms of, and inherent risks in, the instrument being valued. We use both industry-standard models as well as internally developed proprietary valuation models that consider various assumptions, such as market prices for power and fuel, price shapes, volatilities and correlations as well as other relevant factors. 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. See note 6 for discussion of our fair value measurements for some non-financial assets.

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*Fair Value of Derivative Instruments and Certain Other Assets.* We apply recurring fair value measurements to our financial assets and liabilities. Fair value measurements of our financial assets and liabilities by class are as follows:

	<b>March 31, 2010</b>				<b>Total Fair Value</b>
	<b>Level 1<sup>(1)</sup></b>	<b>Level 2<sup>(1)</sup></b>	<b>Level 3 (in millions)</b>	<b>Reclassifications<sup>(2)</sup></b>	
Derivative assets:					
Power	\$ 83	\$ 57	\$ 10	\$	\$ 150
Power basis		3	7		10
Capacity energy			3		3
Natural gas	66		1		67
Natural gas basis	47				47
Coal			14		14
Other				2	2
Total derivative assets	\$ 196	\$ 60	\$ 35	\$ 2	\$ 293
Derivative liabilities:					
Power	\$ 10	\$ 117	\$ 7	\$	\$ 134
Power basis		9			9
Natural gas			5		5
Natural gas basis	30				30
Coal			7		7
Emissions		1			1
Other					