

RELIANT ENERGY INC
Form 10-K
March 02, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

(Mark One)

- ☐ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008**
- or**
- ☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from to**

Commission file number 1-16455

Reliant Energy, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
*(State or Other Jurisdiction of
Incorporation or Organization)*

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

**1000 Main Street
Houston, Texas 77002**
*(Address and Zip Code
of Principal Executive Offices)*

(713) 497-3000
*(Registrant's Telephone Number,
Including Area Code)*

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$.001 per share, and associated rights to purchase Series A Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
(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 Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was \$7,291,274,515 (computed by reference to the closing sale price of the registrant's common stock on the New York Stock Exchange on June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter).

As of February 13, 2009, the registrant had 350,362,189 shares of common stock outstanding and no shares of common stock were held by the registrant as treasury stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2009 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2008, are incorporated by reference into Part III of this Form 10-K.

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Forward-Looking Statement

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

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

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

Limitations on our ability to set rates at market prices;

Legislative, regulatory and/or market developments;

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

Interruption or breakdown of our generating equipment and processes;

Failure of third parties to perform contractual obligations;

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

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

Failure to meet our debt service, restrictive covenants, collateral postings or obligations related to our credit-enhanced retail structure or in connection with any unwind of that structure;

Ineffective hedging and other risk management activities;

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

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

Weather-related events or other events beyond our control;

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

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

Our ability to complete an unwind of our credit-enhanced retail structure or failure of such structure;

Financial market conditions and our access to capital; and

The outcome of our strategic alternatives review, including regulatory approvals for the sale of our Texas retail business.

Other factors that could cause our actual results to differ from our projected results are discussed or referred to in Item 1A of this report. 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 website at www.reliant.com.

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GLOSSARY OF TECHNICAL TERMS

BCFe	Billion cubic feet equivalent of natural gas.
C&I	Commercial, industrial and governmental/institutional.
Cal ISO	California Independent System Operator.
capacity	Energy that could have been generated at continuous full-power operation during the period.
capacity factor	The ratio of actual net electricity generated to capacity.
CenterPoint	CenterPoint Energy, Inc. and its subsidiaries, on and after August 31, 2002, and Reliant Energy, Incorporated and its subsidiaries, prior to August 31, 2002.
Channelview	Reliant Energy Channelview LP, Reliant Energy Channelview (Texas) LLC, Reliant Energy Channelview (Delaware) LLC and Reliant Energy Services Channelview LLC.
CO ₂	Carbon dioxide.
commercial capacity factor	Generation divided by economic generation.
contribution margin	Revenues less (a) cost of sales, (b) operation and maintenance, (c) selling and marketing and (d) bad debt expense.
EBITDA	Earnings (loss) before interest expense, interest income, income taxes, depreciation and amortization expense.
economic generation	Estimated generation at 100% plant availability based on an hourly analysis of when it is economical to generate based on the price of power, fuel, emission allowances and variable operating costs.
EITF	Emerging Issues Task Force.
EPA	United States Environmental Protection Agency.
ERCOT	Electric Reliability Council of Texas.
ERCOT ISO	ERCOT Independent System Operator.
ERCOT Region	The electric market operated by ERCOT.
FASB	Financial Accounting Standards Board.

FERC	Federal Energy Regulatory Commission.
GAAP	Accounting principles generally accepted in the United States of America.
gross margin	Revenues less cost of sales. Gross margin excludes depreciation, amortization, labor and other product costs.
GWh	Gigawatt hour.
ISO	Independent system operator.
LIBOR	London Inter Bank Offering Rate.
market usage adjustments	The revenues and the related energy supply costs in our retail energy segment include our estimates of customer usage based on initial usage information provided by the independent system operators and the distribution companies. We revise these estimates and

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	record any changes in the period as additional settlement information becomes available (collectively referred to as market usage adjustments).
mass	Residential and small business.
Merrill Lynch	Merrill Lynch & Co., Inc. and an affiliate.
MISO	Midwest Independent Transmission System Operator, which is an RTO.
MW	Megawatt.
MWh	Megawatt hour.
net generating capacity	The average of a facility's summer and winter generating capacities, net of auxiliary power.
NO _x	Nitrogen oxides.
NYMEX	New York Mercantile Exchange.
Orion Power	Orion Power Holdings, Inc. and its subsidiaries.
PEDFA	Pennsylvania Economic Development Financing Authority.
PJM	PJM Interconnection, LLC, which is an RTO.
PJM Market	The wholesale and retail electric market operated by PJM primarily in Delaware, the District of Columbia, Illinois, Maryland, New Jersey, Ohio, Pennsylvania, Virginia and West Virginia.
PUCT	Public Utility Commission of Texas.
REMA	Reliant Energy Mid-Atlantic Power Holdings, LLC and its subsidiaries.
RERH Holdings	RERH Holdings, LLC and its subsidiaries.
RPM	Model utilized by the PJM Interconnection, LLC to meet load serving entities' forecasted capacity obligations via a forward-looking commitment of capacity resources.
RTO	Regional transmission organization.
SEC	United States Securities and Exchange Commission.
SO ₂	Sulfur dioxide.

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PART I

Item 1. *Business.*

General

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

Wholesale energy provides electricity and energy services in the competitive wholesale energy markets in the United States through our ownership and operation or contracting for power generation capacity. We have over 14,000 MW of power generation capacity.

Retail energy provides electricity and energy services to approximately 1.8 million retail electricity customers primarily in Texas, including residential and small business (mass) customers and commercial, industrial and governmental/institutional (C&I) customers.

As discussed in Management's Discussion and Analysis of Financial Conditions and Results of Operations Business Overview and 2008 Significant Events in Item 7 of this Form 10-K, we are exploring a full range of possible strategic alternatives to enhance stockholder value, including, among other possibilities, the sale of all or substantially all of Reliant Energy, as well as the sale of some or all of our retail business. We are exiting the C&I portion of our retail energy business either through a wind down or sale of our C&I contracts. In late 2008, we sold all of our PJM market (excluding Illinois) and New York (collectively referred to as Northeast) C&I contracts.

Sale of Our Texas Retail Business. On February 28, 2009, we entered into several agreements related to the sale of our Texas retail business. We entered into a purchase agreement to sell our interests in the affiliates that operate our Texas retail mass and C&I business to a subsidiary (the buyer) of NRG Energy, Inc. (NRG) for \$287.5 million in cash plus the value of the net working capital. This sale includes the rights to our name. NRG has guaranteed the obligations of the buyer. Upon closing, our affiliates that are party to the credit sleeve and reimbursement agreement with Merrill Lynch will be owned by the buyer. We have agreed to pay Merrill Lynch a \$7.5 million fee and to increase the fees under the credit sleeve and reimbursement agreement by \$3 million per month until the close. The bulk of the fees payable to Merrill Lynch are payable only upon and at closing. When the sale closes, the litigation with Merrill Lynch against our affiliates that conduct our retail business related to the termination of the working capital facility supporting our retail business will be dismissed. We and Merrill Lynch have agreed to stay further proceedings in the litigation until June 1, 2009, or in the event regulatory approvals delay closing, July 1, 2009. The sale is subject to customary closing conditions, including the Hart-Scott-Rodino review. The buyer may terminate the agreement in connection with certain takeover proposals that it may receive prior to closing subject to the payment of a \$45 million termination fee. We expect to close in the second quarter of 2009. We will enter a one-year transition services agreement with the buyer in connection with the closing, which will include terms and conditions for information technology services, accounting services and human resources. NRG's guarantee will also apply to this transition services agreement. As required by our debt agreements, a par exchange offer will be made with the net proceeds to holders of our secured notes and PEDFA bonds.

For information about our corporate history, business segments and disposition activities, see notes 1, 18, 19, 20 and 21 to our consolidated financial statements and Selected Financial Data in Item 6 of this Form 10-K.

Wholesale Energy

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As of December 31, 2008, we owned, had an interest in or leased 36 operating electric power generation facilities with an aggregate net generating capacity of 14,580 MW in five regions of the United States. The net generating capacity of these facilities consists of approximately 38% base-load, 37% intermediate and 25% peaking capacity.

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We sell electricity and energy services from our generation portfolio in hour-ahead, day-ahead and forward markets in bilateral and ISO markets. We sell these products to investor-owned utilities, municipalities, cooperatives and other companies that serve end users or purchase power at wholesale for resale. For our power generation, we obtain transmission and distribution services from various RTOs, ISOs, utilities and municipalities. Because our facilities are not subject to traditional cost-based regulation, we can generally sell electricity at market-determined prices. The following table identifies the principal markets where we own, lease or have under contract wholesale generation assets:

Region	Principal Markets
PJM	Illinois, New Jersey and Pennsylvania
MISO	Illinois, western Pennsylvania and Ohio
Southeast	Florida, Mississippi and Texas (non-ERCOT)
West	California

Through the PJM Market's reliability pricing model auctions, we have committed approximately 6,400 MW of capacity through the planning year ending May 2012. We expect that a substantial portion of our capacity that clears a PJM auction will continue to be committed to the PJM Market up to three years in advance. Revenue from these capacity sales is determined by market rules designed to ensure regional reliability, encourage competition and reduce price volatility. The California Public Utility Commission and Cal ISO are considering possible enhancements to existing resource adequacy requirements, including alternatives similar to capacity markets designed in New England and PJM.

To ensure adequate fuel supplies, we contract for natural gas, coal and fuel oil for our generation facilities. For our natural gas-fired plants, we also arrange for, schedule and balance natural gas from our suppliers and through transporting pipelines. To perform these functions, we lease natural gas transportation and storage capacity.

In February 2006, we completed an evaluation of our wholesale energy segment's hedging strategy and use of capital. As a result of our evaluation, we substantially reduced hedging activity. See Quantitative and Qualitative Disclosures about Market Risk in Item 7A of this Form 10-K and notes 2(f) and 5 to our consolidated financial statements.

The following table describes our electric power generation facilities as of December 31, 2008:

Region	Number of Generation Facilities	Net Generating Capacity (MW)	Fuel Type	Dispatch Type
PJM⁽¹⁾	22	6,969	Coal/Gas/Oil/Dual	Base-load/Intermediate/Peaking
MISO	4	1,678	Coal/Gas/Oil	Base-load/Intermediate/Peaking
Southeast⁽²⁾⁽³⁾	5	2,541	Gas/Dual	Base-load/Intermediate/Peaking
West	5	3,392	Gas/Dual	Intermediate/Peaking
Total	36	14,580		

- (1) We lease a 100%, 16.67% and 16.45% interest in three Pennsylvania facilities having 572 MW, 1,711 MW and 1,712 MW of net generating capacity, respectively, through facility lease agreements expiring in 2026, 2034 and 2034, respectively. The table includes our net share of the capacity of these facilities.
- (2) We own a 50% interest in one of these facilities located in Texas (non-ERCOT) having a net generating capacity of 108 MW. An unaffiliated party owns the other 50%. The table includes our net share of the capacity of this facility.
- (3) We are party to a tolling agreement entitling us to 100% of the capacity of a Florida facility having 630 MW of net generating capacity. This tolling agreement expires in 2012 and is treated as an operating lease for accounting purposes.

Operations Data

See discussion of our wholesale energy strategy in Management's Discussion and Analysis of Financial Condition and Results of Operation Business Overview in Item 7 of this Form 10-K. See discussion of Competition and Seasonality below and a discussion of competition, weather events and other factors that

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could have an adverse effect on our wholesale energy business in Risk Factors in Item 1A of this Form 10-K.

	2008		2007		2006	
	GWh	% Economic ⁽¹⁾	GWh	% Economic ⁽¹⁾	GWh	% Economic ⁽¹⁾
Economic Generation⁽²⁾:						
PJM Coal	21,288.3	73%	23,886.2	82%	23,541.9	81%
MISO Coal	5,848.4	53%	7,998.3	73%	6,525.1	59%
PJM/MISO Gas	1,362.4	4%	1,584.2	5%	1,011.1	4%
West	2,553.9	10%	3,711.8	13%	2,833.3	11%
Other	74.5	1%	3,802.2	48%	5,731.1	86%
Total	31,127.5	30%	40,982.7	39%	39,642.5	39%
Commercial Capacity Factor:						
PJM Coal			86.6%		82.4%	82.9%
MISO Coal			85.3%		69.0%	85.5%
PJM/MISO Gas			90.6%		91.2%	91.9%
West			93.7%		95.5%	86.1%
Other			82.7%		91.9%	91.9%
Total			87.1%		82.2%	85.1%
Generation⁽²⁾:						
PJM Coal			18,437.8		19,677.1	19,522.3
MISO Coal			4,988.1		5,518.0	5,577.7
PJM/MISO Gas			1,234.8		1,444.0	929.3
West			2,393.2		3,543.9	2,439.0
Other			61.6		3,493.6	5,268.8
Total			27,115.5		33,676.6	33,737.1

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

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

Retail Energy

As a retail electricity provider, we arrange for the transmission and delivery of electricity to our customers, bill customers, collect payment for electricity sold and maintain call centers to provide customer service. We purchase the electricity we sell to customers from generation companies, utilities and power marketers and other retail energy companies in the wholesale market. We obtain our transmission and distribution services in Texas from entities

regulated by the PUCT and ERCOT.

Our retail business for residential and small business customers is in Texas. Based on metered locations, as of December 31, 2008, we had approximately 1.5 million residential and 150,000 small business customers, making us the second largest mass market electricity provider in Texas. Approximately 65% of our Texas customers are in the Houston area. We also have customers in other parts of Texas, including the Dallas, Ft. Worth and Corpus Christi areas.

We market electricity and energy services to C&I customers in Texas and, until the end of 2008, the Northeast. These customers include refineries, chemical plants, manufacturing facilities, hospitals, universities, governmental agencies, restaurants and other facilities. In connection with our intention to unwind our credit-enhanced retail structure with Merrill Lynch and to reduce our future collateral posting obligations, we decided to exit the C&I portion of our retail business over time. Except where we are contractually obligated to do so,

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we are no longer entering into contracts with new C&I customers and we do not expect to renew contracts with our current customers. We sold all of our Northeast C&I contracts and are actively seeking to sell our Illinois C&I contracts. For discussion of our agreement to sell our Texas retail business, see [General](#).

Under our supply strategy for our retail business, we structure our supply portfolio to match our load demands by procuring sufficient power prior to or concurrent with entering into retail sales commitments. See [Quantitative and Qualitative Disclosures about Market Risk](#) in Item 7A of this Form 10-K and notes 2(f) and 5 to our consolidated financial statements. Because of our credit-enhanced retail structure, we are not required to post collateral for our retail supply purchases. However, we intend to wind down this structure because, among other things, of disagreements with Merrill Lynch regarding the minimum adjusted retail EBITDA covenant in our working capital facility and ongoing turmoil in the financial markets has created uncertainty regarding our significant concentration of credit risk with Merrill Lynch. See discussion of the status of our credit-enhanced retail structure in [Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources](#) in Item 7 of this Form 10-K and related legal action in note 13(b) to our consolidated financial statements.

Operations Data

See discussion of our retail energy strategy in [Management's Discussion and Analysis of Financial Condition and Results of Operations - Business Overview](#) in Item 7 of this Form 10-K. See discussion of [Competition and Seasonality](#) below and a discussion of competition, weather events and other factors that could have an adverse effect on our retail energy business in [Risk Factors](#) in Item 1A of this Form 10-K.

	2008	2007	2006
	(gigawatt hours)		
Electricity Sales to End-Use Retail Customers:			
Mass:			
Residential:			
Houston	12,700	13,516	15,447
Non-Houston	8,081	8,361	7,955
Small Business:			
Houston	2,818	3,035	3,587
Non-Houston	1,416	1,433	1,375
Total Mass	25,015	26,345	28,364
C&I:			
ERCOT ⁽¹⁾	36,901	36,926	33,393
Non-ERCOT	6,300	4,680	5,572
Total C&I	43,201	41,606	38,965
Market usage adjustments	(47)	(67)	8
Total	68,169	67,884	67,337

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

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	2008	2007	2006
	(In thousands, metered locations)		
Weighted Average Retail Customer Count:			
Mass:			
Residential:			
Houston	992	1,056	1,164
Non-Houston	547	563	504
Small Business:			
Houston	108	116	132
Non-Houston	40	36	29
Total Mass	1,687	1,771	1,829
C&I ⁽¹⁾	91	89	75
Total	1,778	1,860	1,904

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

	December 31,	
	2008	2007
	(In thousands, metered locations)	
Retail Customers:		
Mass:		
Residential:		
Houston	975	1,016
Non-Houston	543	555
Small Business:		
Houston	107	109
Non-Houston	43	38
Total Mass	1,668	1,718
C&I ⁽¹⁾	86	93
Total	1,754	1,811

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

Regulation

Texas

We are certified by the PUCT to sell electricity to retail customers in Texas. Effective January 1, 2007, we began selling electricity in the competitive areas of ERCOT to customers at unregulated prices. Our activities in Texas are subject to standards and regulations adopted by the PUCT and ERCOT. See **Risk Factors** in Item 1A of this Form 10-K.

Until January 1, 2007, we were required to make electricity available to Houston area residential and small business customers at the PUCT-approved price-to-beat. Any residential price-to-beat customers who did not select an alternative product by December 31, 2006 continued being served under our residential services plan.

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Other States

We are licensed in several states outside ERCOT to supply C&I customers. As a result of our decision to exit the C&I portion of our retail business over time and the sale of our Northeast C&I contracts, in 2009 we will have C&I customers only in Texas and Illinois. Our C&I retail activities in Illinois are subject to standards and regulations adopted by PJM and the Illinois Commerce Commission.

We operate electric generation facilities in regions administered by PJM, Cal ISO and MISO. These ISOs operate under FERC-approved market rules. The market rules include price limits or caps applicable to all generators and numerous other FERC-approved requirements relative to the manner in which we must operate our generating facilities.

Federal Energy Regulatory Commission

A number of our subsidiaries are public utilities under the Federal Power Act and are subject to FERC rules and oversight regulations. As public utilities, these subsidiaries sell power at either market-based rates (if FERC has granted market-based rate authority) or cost-based rates. Each of these subsidiaries has been granted market-based rate authority, although a limited number of services sold by some of them is sold at cost-based rates.

Competition and Seasonality

The retail and wholesale energy industries are intensely competitive. Our competitors include merchant energy companies, utilities, retail electric service providers and other companies, including in recent years companies owned by investment banking firms, hedge funds and private equity funds. Our principal competitors in the retail electricity markets outside of Houston are typically incumbent retail electric providers, which have the advantage of long-standing relationships with customers. In general, competition in the retail energy markets is on the basis of price, service, brand image, product offerings and market perceptions of creditworthiness and competition in the wholesale energy markets is on the basis of price, service and market perceptions of creditworthiness. For additional information on the effect of competition and for a discussion of how seasonality impacts our business, see **Risk Factors** in Item 1A of this Form 10-K and note 17 to our consolidated financial statements.

Environmental Matters

We are subject to numerous federal, state and local requirements relating to the protection of the environment and the safety and health of personnel and the public. These requirements relate to a broad range of our activities, including the discharge of compounds into the air, water and soil; the proper handling of solid, hazardous and toxic materials and waste; noise and safety and health standards applicable to the workplace.

Based on existing regulations, our market outlook, and our current assessment of the costs of labor and materials and the state of evolving technologies, we estimate that we will invest approximately \$123 million in 2009, \$27 to \$52 million in 2010 and \$28 million to \$306 million in 2011 through 2014 on projects to reduce our emission levels and lessen the environmental impact of our operations. These amounts include \$45 million for future ash landfill expansions from 2009 through 2014. As described below, a significant amount of these expenditures relate to our election to upgrade the SO₂ emissions controls at some of our facilities.

In some cases, which are described below, environmental laws and regulations are pending, are under consideration, are in dispute or could be revised. Unless otherwise noted, we cannot predict the outcome or ultimate effect of these matters on our business. For additional information on how environmental matters may impact our business, including a January 2009 Notice of Violation from the EPA regarding New Source Review, see **Risk Factors** in Item 1A of this

Form 10-K and note 13(c) to our consolidated financial statements.

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Air Quality

Under the Clean Air Act, the EPA has implemented a number of emission control programs that affect industrial sources, including power plants, by limiting emissions of nitrogen oxides (NO_x) and sulfur dioxide (SO₂). NO_x and SO₂ are precursors to the formation of acid rain, fine particulate matter and regional haze. NO_x is also a precursor to the formation of ozone.

NO_x and SO₂ Emissions

In March 2005, the EPA finalized the Clean Air Interstate Rule (CAIR), to further reduce emissions of NO_x and SO₂ in the Eastern United States in two phases. The first phase, which takes effect in 2009 for NO_x and 2010 for SO₂, requires overall reductions within the area of approximately 50% in NO_x and SO₂ emissions on an annual basis. The second phase, which takes effect in 2015, requires additional reductions of approximately 10% for a 60% total reduction in NO_x and approximately 15% for a 65% reduction in SO₂. The EPA regulations include the use of cap-and-trade programs to achieve these reductions. These regulations require us to provide an allowance for each ton of NO_x and SO₂ that we emit under a cap-and-trade program. We maintain emission allowances that at a minimum correspond with forward power sales. In general, we do not have emission allowances for all of our generation. We purchase emission allowances, as needed, to correspond with our generation of electricity.

In July 2008, the District of Columbia Circuit Court of Appeals ruled that CAIR was legally flawed, vacated CAIR in its entirety and remanded CAIR to the EPA for revision of CAIR consistent with the Court's opinion. On rehearing, in December 2008, the Court decided that CAIR will remain in effect pending EPA's modification to cure the defects identified by the Court. The Court's most recent decision will reinstate CAIR's proposed annual allowance-based NO_x program beginning in 2009 and the increased surrender rate for SO₂ allowances beginning in 2010. The existing ozone season NO_x program and the SO₂ allowance requirements under the Clean Air Act's acid rain program will continue to be in force.

We have undertaken studies to evaluate possible impacts of CAIR and similar legislative and regulatory proposals, which will primarily affect our coal-fired facilities in the Eastern United States. Based on an economic analysis that includes plant operability, changes in the emission allowances market, potential impact of state-imposed regulations and our estimates at this time of capital expenditures, we have elected to invest \$64 million in 2009 and up to an estimated \$304 million in 2010 through 2013 to principally reduce our emissions of SO₂.

Mercury Emissions

In December 2000, the EPA found that regulation of mercury emissions from power plants is appropriate and necessary, triggering the requirement to regulate such emissions using the Maximum Achievable Control Technology standard (MACT) of the Clean Air Act. However, the EPA pursued an alternate market-based approach for regulating mercury emissions from power plants, known as the Clean Air Mercury Rule (CAMR). In February 2008, the D.C. Circuit Court of Appeals struck down CAMR. The EPA appealed, but in February 2009, it withdrew the appeal and stated its intent to proceed with rulemaking under the MACT standard. This approach considers the most effective control technologies in operation, without regard to cost effectiveness. Despite the EPA's statement of regulatory intent, there are multiple legal actions pending with respect to regulation of mercury from power plants.

While the EPA was pursuing CAMR, a number of states, including Pennsylvania, pursued mercury regulations that were more stringent than CAMR. The Pennsylvania rule generally requires mercury reductions on a facility basis in two phases, with 80% reductions in 2010 and 90% reductions in 2015. This rule is the subject of current litigation, and a state court declared Pennsylvania's rule unlawful in January 2009.

Our capital investment plan is based on compliance with the Pennsylvania rule. Our estimate of capital expenditures to comply primarily with the first phase of Pennsylvania's mercury control program is \$49 million in 2009. However, we are continuing to evaluate our plan given that regulation of mercury from power plants at both federal and state levels is uncertain.

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Air Particulates

In September 2006, the EPA issued revised national ambient air quality standards for fine particulate matter with an aerodynamic diameter less than or equal to 2.5 microns, or PM_{2.5}. In December 2008, the EPA identified geographic areas that are not in compliance with the revised standard (nonattainment areas). Ten of our 11 coal-fired power generation facilities are located in nonattainment areas. States must develop emission reduction plans by April 2012 that bring nonattainment areas into compliance by 2014. These plans may be state-specific or regional in scope. The EPA has estimated that the power generation sector SO₂ and NO_x emissions reductions required by CAIR will allow many of the nonattainment areas to achieve compliance with the revised PM_{2.5} standard. However, states are not precluded from developing plans that would require further reductions in NO_x and SO₂ emissions.

Greenhouse Gas Emissions

There is an increased focus within the United States over the direction of domestic climate change policy. Several states in the northeast, midwest and west are increasingly active in developing state-specific or regional regulatory initiatives to stimulate CO₂ emission reductions in the electric power generation industry and other industries. The United States Congress is considering legislation that would impose mandatory limitation of CO₂ and other greenhouse gas emissions for the domestic power generation sector. The specific impact on our business will depend upon the form of emissions-related legislation or regulations ultimately adopted by the federal government or states in which our facilities are located.

Ten northeastern states, including New Jersey and Maryland, have formed the Regional Greenhouse Gas Initiative, or RGGI, which requires power generators to reduce CO₂ emissions by ten percent by 2019, beginning in 2009. California adopted legislation designed to reduce greenhouse gas emissions to 25% below 1990 levels by 2020, beginning in 2012. In July 2008, the Pennsylvania Climate Change Act was adopted. This legislation requires development of reports of the impacts of climate change in Pennsylvania and potential economic opportunities resulting from mitigation strategies. It also requires development of an annual greenhouse gas emissions inventory and establishment of cost-effective strategies for reducing or offsetting greenhouse gases.

In addition, the EPA has announced plans to consider regulations to address CO₂ emissions as part of the Clean Air Act's New Source Review program. Individual states may also begin to take into account CO₂ emissions when considering permits to construct or modify significant sources of emissions.

In September 2007, we joined the Chicago Climate Exchange, a voluntary greenhouse gas registry, reduction and trading system. By joining the exchange, we have committed to reduce our greenhouse gas emissions to six percent below the average of our 1998-2001 levels by 2010. We expect to satisfy our reduction targets through previously implemented unit retirements and capacity factor reductions, ongoing heat rate improvement efforts and transacting on the exchange.

Water Quality

In July 2007, the EPA suspended its 2004 regulations relating to cooling water intake structures at large existing power plants pending further rulemaking. This action was in response to the Second Circuit Court of Appeals' January 2007 remand of the 2004 regulations. The EPA retained interim requirements that plant intakes employ best technology available controls as determined on a plant-by-plant, best professional judgment basis. The Supreme Court is reviewing the Second Circuit's decision and is expected to rule in 2009.

Other

As a result of their age, many of our facilities contain significant amounts of asbestos insulation, other asbestos containing materials, as well as lead-based paint. Existing state and federal rules require the proper management and disposal of these potentially toxic materials. We believe we properly manage and dispose of such materials in compliance with these state and federal rules. See note 13(c) to our consolidated financial statements.

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We do not believe we have any material liabilities or obligations under the Comprehensive Environmental Response Corporation and Liability Act of 1980 or similar state laws. These laws impose clean up and restoration liability on owners and operators of facilities from or at which there has been a release or threatened release of hazardous substances, together with those who have transported or arranged for the disposal of those substances.

Employees

As of December 31, 2008, we had 3,816 full-time and part-time employees. Of these employees, 1,125 are covered by collective bargaining agreements, which expire on various dates from March 31, 2009 through October 31, 2013. The following table sets forth the number of our employees as of December 31, 2008:

Wholesale energy	1,950
Retail energy	1,208
Other operations	658
Total	3,816

Executive Officers

Name	Age⁽¹⁾	Present Position
Mark M. Jacobs	46	President and Chief Executive Officer
Brian Landrum	46	Executive Vice President and Chief Operating Officer
Rick J. Dobson	50	Executive Vice President and Chief Financial Officer
Charles S. Griffey	49	Senior Vice President, Market Design and Regulatory Affairs
D. Rogers Herndon	40	Senior Vice President, Strategic Planning and Business Development
Michael L. Jines	50	Senior Vice President, General Counsel and Corporate Secretary
Suzanne L. Kupiec	42	Senior Vice President, Chief Risk and Compliance Officer
Thomas C. Livengood	53	Senior Vice President and Controller
Albert H. Myres	45	Senior Vice President, Government and Public Affairs
Karen D. Taylor	51	Senior Vice President, Human Resources and Chief Diversity Officer

(1) Age is as of February 1, 2009.

Mark M. Jacobs has served as our President and Chief Executive Officer since May 2007. Prior to that, he served as our Executive Vice President and Chief Financial Officer from July 2002 to October 2007.

Brian Landrum has served as our Executive Vice President and Chief Operating Officer since May 2007. Prior to that, he served as our Executive Vice President, Operations from February 2006 to May 2007. He was Senior Vice President, Commercial and Retail Operations, IT from February 2005 to February 2006; Senior Vice President,

Customer Operations and Information Technology from January 2004 to February 2005; President, Reliant Energy Retail Services from June 2003 to January 2004.

Rick J. Dobson has served as our Executive Vice President and Chief Financial Officer since October 2007. Prior to that, he served as Senior Vice President and Chief Financial Officer of Novelis Inc., an international aluminum rolling and recycling company, from July 2006 to August 2007 and Senior Vice

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President and Chief Financial Officer of Aquila, Inc., an electric and natural gas distribution company that also owns and operates generation assets, from October 2002 to July 2006.

Charles S. Griffey has served as our Senior Vice President, Market Design and Regulatory Affairs since December 2007. Prior to that, he was Senior Vice President, Regulatory Affairs from February 2003 to December 2007.

D. Rogers Herndon has served as our Senior Vice President, Strategic Planning and Business Development since November 2007. He was Senior Vice President, Commercial Operations and Origination from May 2006 to November 2007. Prior to that, he was a Managing Director for PSEG Energy Resources and Trade from April 2003 to December 2005.

Michael L. Jines has served as our Senior Vice President, General Counsel and Corporate Secretary since May 2003.

Suzanne L. Kupiec has served as our Senior Vice President, Chief Risk and Compliance Officer since July 2007. She served as our Senior Vice President, Risk and Structuring from January 2004 to June 2007. She was our Vice President and Chief Risk and Corporate Compliance Officer from June 2003 to January 2004.

Thomas C. Livengood has served as our Senior Vice President and Controller since May 2005. Prior to that, he served as our Vice President and Controller from August 2002 to May 2005.

Albert H. Myres has served as our Senior Vice President, Government and Public Affairs since December 2007. He served as Shell Oil Corporation's Chief of Staff and Senior Advisor to the President and Country Chairman from August 2005 to December 2007 and Senior Advisor, Government Affairs from June 2002 to August 2005.

Karen D. Taylor has served as our Senior Vice President, Human Resources since December 2003. In November 2005, she was appointed as our Chief Diversity Officer.

Available Information

Our principal offices are at 1000 Main, Houston, Texas 77002 (713-497-7000). The following information is available free of charge on our website (<http://www.reliant.com>):

Our corporate governance guidelines and standing board committee charters;

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports; and

Our business ethics policy.

You can request a free copy of these documents by contacting our investor relations department. It is our intention to disclose amendments to, or waivers from, our business ethics policy on our website. No information on our website is incorporated by reference into this Form 10-K. In addition, certain of these materials are available on the SEC's website at (<http://www.sec.gov>) or at its public reference room: 100 F Street, NE, Room 1580, Washington, D.C. 20549 (1-800-SEC-0330).

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Certifications

We will timely provide the annual certification of our Chief Executive Officer to the New York Stock Exchange. We filed last year's certification in June 2008. In addition, our Chief Executive Officer and Chief Financial Officer each have signed and filed the certifications under Section 302 of the Sarbanes-Oxley Act of 2002 with this Form 10-K.

Item 1A. Risk Factors.

Risks Related to the Wholesale and Retail Energy Businesses

The financial results of our wholesale and retail energy segments are subject to market risks beyond our control.

Our results of operations, financial condition and cash flows are significantly impacted by the prevailing demand and market prices for electricity, purchased power, fuel and emission allowances over which we have no control. Market prices can fluctuate dramatically in response to many factors, including weather conditions; changes in the prices of related commodities; changes in law and regulation; regulatory intervention (including the imposition of price limitations, bidding rules or similar mechanisms); market illiquidity; transmission constraints; environmental limitations; generation unit outages; fuel supply issues; national and world-wide economic conditions; and other events. Current national and world-wide conditions may result in ongoing reduced demand for electricity, commodity price volatility, changes in law or regulation and other events.

The markets in which we operate are relatively immature markets that are characterized by elements of both deregulated and regulated markets. Changes in the regulatory environment in which we operate could adversely affect our ability to set rates, or the cost, manner or feasibility of conducting our business.

We operate in a regulatory environment that is undergoing varying restructuring initiatives. In many instances, the regulatory structures governing the electricity markets are still evolving, creating gaps in the regulatory framework and associated uncertainty. In addition, existing regulations may be revised or reinterpreted and new laws and regulations may be adopted or become applicable to our facilities or our commercial activities. We cannot predict the future direction of these initiatives or the ultimate effect that this changing regulatory environment will have on our business. Consequently, future regulatory restrictions, regulatory or political intervention or changes in laws and regulations, may constrain our ability to set rates at market prices or otherwise have an adverse effect on our business. See "Business Regulation" in Item 1 of this Form 10-K.

The tightening of the supply and demand balance for electricity may result in significant long- and short-term price volatility in both our wholesale and retail businesses. Price volatility may result in legislative, regulatory or judicial initiatives intended to mitigate the impact of such volatility.

The permitting and construction of new generation facilities is a lengthy process. Additionally, the progressive tightening of environmental regulatory requirements and their reflection in permits and regulations may result in generation facilities being removed from service prior to their end of useful life or derated permanently or temporarily. As a result, there may be periods when the supply of electricity is reduced or constrained relative to the demand for electricity. During these periods the wholesale price and retail price of electricity may increase significantly. In response to this, legislators, regulators, consumers and others may seek legislative, regulatory or judicial relief in an attempt to control or limit the wholesale price and/or the retail price of electricity.

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We depend on sources, facilities and systems that we do not own or control for our fuel and fuel supply and to deliver electricity to and bill our customers. Any disruption in these sources, facilities or systems could have an adverse effect on our business.

We depend on fuel sources and fuel supply facilities owned and operated by third parties to supply our generation plants. We depend on power transmission and distribution facilities and metering systems owned and operated by third parties to deliver electricity to our customers and provide energy usage data. If these sources, facilities or systems fail, are disrupted or become unavailable to us, we may be unable to generate and/or provide electricity, our cost of doing so may significantly increase and/or we may be subject to contractual or other penalties. In addition, inaccurate or untimely information from third parties could hinder our ability to bill customers and collect amounts owed. We also participate in regional power pools, reliability councils and transmission organizations and changes in the rules governing such groups and/or in the composition of such groups may have an adverse effect on our business. Participation in RTOs is voluntary, and transmission owning companies may exit an RTO so long as they do so in compliance with the applicable FERC tariffs and agreements and FERC approval.

The operation of generation facilities involves significant risks that could interrupt operations and increase our costs.

Ownership of generation assets exposes us to risks relating to the breakdown of equipment or processes; fuel supply or transportation interruptions; construction delays or cost overruns; shortages of or delays in obtaining equipment, material and labor; operational restrictions resulting from environmental limitations and governmental interventions; as well as other risks. In addition, many of our facilities are old and require significant maintenance expenditures. We are party to collective bargaining agreements with labor unions at several of our plants. If our workers were to engage in a strike, work stoppage or other slowdown, other employees were to become unionized or the terms and conditions in future labor agreements were renegotiated, we could experience a significant disruption in our operations and higher ongoing labor costs. Similarly, we have an aging workforce at a number of our plants creating potential knowledge and expertise gaps as those workers retire. If we are unable to secure fuel, we will not be able to run our generation units. Construction delays could cause extended and/or unplanned outages of our generation facilities. If a generation unit fails or is unavailable, we may have to purchase replacement power from third parties at higher prices. We have insurance, subject to limits and deductibles, covering some types of physical damage and business interruption related to our generation units. However, this insurance may not always be available on commercially reasonable terms. In addition, there is no assurance that insurance proceeds will be sufficient to cover all losses, insurance payments will be timely made or the policies themselves will be free of substantial deductibles.

Our business operations expose us to the risk of loss if third parties fail to perform their contractual obligations.

We may incur losses if third parties default on their contractual obligations, such as obligations to pay us money; buy or sell electricity, fuel, emission allowances and other commodities; or provide us with fuel transportation services, power transmission or distribution services. For additional information about third party default risk, including our efforts to mitigate against this risk, see Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Credit Risk in Item 7 of this Form 10-K and note 2(g) to our consolidated financial statements.

Our costs of compliance with environmental laws are significant and can affect our future financial results.

Our wholesale energy business is subject to extensive and evolving environmental regulations, particularly our coal- and oil-fired generation facilities. We incur significant costs in complying with these regulations and, if we fail to comply, could incur significant penalties. Our cost estimates for compliance with environmental regulations are based on our current assessment of the cost of labor and materials and the state of evolving technologies. Changes to the

preceding factors, revisions of environmental regulations, litigation and new

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legislation and/or regulations (including new climate change legislation and regulations), as well as other factors, could cause our actual costs to vary outside the range of our estimates. In addition, failure to comply with environmental requirements could require us to shut down or reduce production on our generation facilities or create liability exposure. New environmental laws or regulations may be adopted that would further constrain our operations or increase our environmental compliance costs. We also may be responsible for the environmental liabilities associated with generation facilities even if a prior owner caused the liabilities. We are required to surrender emission allowances equal to emissions of specific substances to operate our facilities. Surrender requirements may require purchase of allowances which may be unavailable or only available at costs that would make it uneconomical to operate our generating assets. See **Business Environmental Matters** in Item 1 of this Form 10-K and note 13(c) to our consolidated financial statements.

Failure to obtain or maintain any required permits or approvals could prevent or limit us from operating our business.

To operate our generating facilities and retail electric business, we must obtain and maintain various permits, licenses, approvals and certificates from governmental agencies. In some jurisdictions, we must also meet minimum requirements for customer service and comply with local consumer protection and other laws. Our failure to obtain or maintain any necessary governmental permits or licenses or to satisfy these legal requirements, including environmental compliance provisions, could limit our ability to operate our business or create liability exposure.

We could be liable for a share of the payment defaults of other market participants.

If a market participant defaults on its payment obligations to an ISO, we, together with other market participants, are liable for a portion of the default obligation that is not otherwise covered by the defaulting market participant. Each ISO establishes credit requirements applicable to market participants and the basis for allocating payment default amounts to market participants. In ERCOT, the allocation is based on share of the total load. As of December 31, 2008, we would have been liable for approximately 21% of any defaulted amount in ERCOT. In PJM, MISO and Cal ISO, the methods of allocating the share of defaults differ, and our exposure from these markets is currently relatively small.

Significant events beyond our control, such as hurricanes and other weather-related problems or acts of terrorism, could have a material adverse effect on our business.

The uncertainty associated with events beyond our control, such as significant weather events and the risk of future terrorist activity, may affect our results of operations and financial condition in unpredictable ways. These events could result in adverse changes in the insurance markets and disruptions of power and fuel markets. In addition, significant weather events or terrorist actions could damage or shut down our generation facilities or the fuel and fuel supply facilities or the power transmission and distribution facilities upon which our generation and retail businesses are dependent. Power supply may be sold at a loss if these events cause a significant loss of retail customer load. We do not have business interruption insurance related to our retail energy business. These events could also adversely affect the United States economy, create instability in the financial markets and, as a result, have an adverse effect on our ability to access capital on terms and conditions acceptable to us.

Risks Relating to Our Retail Business

Merrill Lynch, credit support provider for our retail business, contends we have violated the terms of the credit support agreement.

Under the terms of our credit-enhanced retail structure entered into in December 2006, Merrill Lynch provides guarantees and posts collateral for the supply purchases and related transactions of our retail energy business. Merrill Lynch contends that we violated the credit sleeve and reimbursement agreement (the agreement) when we terminated our working capital facility with them in December 2008, and has filed an

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action in a New York Court seeking a judgment declaring an event of default under the agreement. If Merrill Lynch is successful with its claim, it could seek to exercise remedies under the agreement. There is a range of possible remedies available to Merrill Lynch under the agreement, including, without limitation:

declaring an unwind of the agreement, which would result in Merrill Lynch ceasing to provide credit support for new retail supply and hedging transactions;

delivering notice to our retail supply counterparties that future transactions will not have Merrill Lynch collateral support; and

seeking to foreclose on its collateral, the assets comprising our retail energy business.

Depending on the specific remedy that Merrill Lynch may elect to pursue, cross defaults could occur under our June 2007 credit facilities. Although we would seek a waiver from the lenders to avoid any cross defaults, such waiver may not be available on commercially reasonable terms and we may choose to terminate the June 2007 credit facilities. If we were to do so, we may be required to post cash for outstanding letters of credit. For these credit facilities, as of December 31, 2008, we have \$0 outstanding in debt, \$296 million outstanding as letters of credit and \$454 million as available liquidity. There are a number of events, including non-payments of obligations and a non-investment-grade credit rating that could cause Merrill Lynch to default under our credit-enhanced retail structure. Furthermore, if Merrill Lynch experiences downgrades in its credit rating or credit outlook, our suppliers may require other credit support or cease doing business with us pursuant to the credit-enhanced retail structure. If any of these events occurs, our ability to operate our retail business could be impaired and our liquidity, cash flows and results of operations could be adversely affected. See Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources in Item 7 of this Form 10-K and notes 7 and 13(b) to our consolidated financial statements.

We may have to post significant amounts of collateral, which could adversely affect our liquidity, financial position and business.

In connection with any unwind of our credit-enhanced retail structure with Merrill Lynch, we will have to post collateral for new retail supply and hedging transactions. Our levels of collateral postings would be determined and impacted by the terms and timing of the unwind, the nature and volume of our commodity hedging agreements, commodity prices and other strategic alternatives that we may undertake. Depending on the specific timing and the movement in underlying commodity prices, we could incur significant collateral posting obligations that may require us to seek additional sources of liquidity, including additional debt. The covenants in our credit agreements and our agreement with Merrill Lynch restrict our ability to, among other things, obtain additional financing. If we were unable to generate sufficient cash flows from operations or raise cash from other sources, we may not be able to meet our collateral posting obligations. These situations could result from further adverse developments in the energy, fuel or capital markets, a disruption in our operations or those of third parties or other events adversely affecting our cash flows and financial performance. We cannot make any assurances that we would be able to obtain such additional liquidity on commercially reasonable terms or at all.

Volatile power supply costs and demand for power could adversely affect the financial performance of our retail business.

We purchase substantially all of our supply requirements from third parties. As a result, our financial performance depends on our ability to obtain adequate supplies of electric generation from third parties at prices below the prices we charge our customers. Our earnings and cash flows could be adversely affected in any period in which our power supply costs rise at a greater rate than our rates charged to customers. The price of our power supply purchases

associated with our energy commitments can be different than that reflected in the rates charged to customers due to, among other factors:

varying supply procurement contracts used and the timing of entering into related contracts;

subsequent changes in the overall price of natural gas;

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daily, monthly or seasonal fluctuations in the price of natural gas relative to the 12-month forward prices;
transmission constraints and our ability to move power to our customers; and
changes in market heat rate (i.e., the relationship between power and natural gas prices).

Our earnings and cash flows could also be adversely affected in any period in which the demand for power significantly varies from our forecasted supply, which could occur due to, among other factors, weather events, competition and economic conditions.

We may lose further market share in the Houston retail electricity market.

In recent years, we have experienced declines in our share of the Houston retail electricity market, which represents approximately 65% of our residential and small business customer base. This trend could continue. The new competitive market has attracted a number of new participants. Competitors are putting downward pressure on our Houston sales volumes and may put downward pressure on our margins over time. See Management's Discussion and Analysis of Financial Condition and Results of Operations Business Overview in Item 7 of this Form 10-K.

Violations of market power standards may negatively impact the wholesale cost of power.

In 2006, the PUCT implemented a new rule on resource adequacy and market power in the ERCOT Region. In this rule, the PUCT increased the current price cap applicable to generation offers into the ERCOT energy market, eliminated current market power mitigation measures and adopted new market power standards. If a market participant violates the market power standards and it is not adequately mitigated, such violation could have the impact of increasing the wholesale cost of power, which could adversely impact our gross margins in the Texas retail market.

We depend on the ISOs to communicate operating and system information in a timely and accurate manner. Information that is not accurate or timely can have an impact on our current and future reported financial results.

Each ISO communicates information relating to a customer's choice of retail electric provider and other data needed for servicing of customer accounts to utilities and retail electric providers. Any failure to perform these tasks will result in delays and other problems in enrolling, switching and billing customers. Some of the ISOs are also responsible for settling all electricity supply volumes in their region. Information that is not accurate or timely may result in incorrect estimates of our settled volumes and supply costs that would need to be corrected when such information is received. See Management's Discussion and Analysis of Financial Condition and Results of Operations New Accounting Pronouncements, Significant Accounting Policies and Critical Accounting Estimates Critical Accounting Estimates in Item 7 of this Form 10-K.

Risks Related to Our Company

Our borrowing levels, debt service obligations and restrictive covenants may adversely affect our business. We may be vulnerable to reductions in our cash flow.

As of December 31, 2008, we had total debt of \$2.9 billion:

We must dedicate a portion of our cash flows to pay debt service requirements, which reduces the amount of cash available for other business purposes;

The covenants in our debt agreements and in our agreement with Merrill Lynch restrict our ability to, among other things, obtain additional financing, make investments or acquisitions, create additional liens on our assets and take other actions to react to changes or opportunities in our business;

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If we do not comply with the payment and other material covenants under our debt agreements and our agreement with Merrill Lynch, we could be required to repay our debt immediately and, in the case of our revolving credit facilities, terminate their commitment to lend us money; and

Our debt levels and credit ratings may affect the evaluation of our creditworthiness by suppliers or customers, which could put us at a competitive disadvantage to competitors with less debt or investment grade credit ratings.

If we were unable to generate sufficient cash flows, access funds from operations or raise cash from other sources, we would not be able to meet our debt service and other obligations. These situations could result from adverse developments in the energy, fuel or capital markets, a disruption in our operations or those of third parties or other events adversely affecting our cash flows and financial performance. See further discussion of risks related to our credit-enhanced retail structure under **Risks Related to our Retail Business**.

Our hedging and other risk management activities may not work as planned.

Our hedges may not be effective as a result of basis price differences, transmission issues, price correlation, volume variations or other factors, including margins being compressed as a result of market prices behaving differently than expected. See **Quantitative and Qualitative Disclosures About Market Risk** in Item 7A of this Form 10-K.

Changes in the wholesale energy market or changes in our evaluation of generation assets could result in impairments.

If our outlook for the wholesale energy market changes negatively, or if our ongoing evaluation of our wholesale energy segment results in decisions to mothball, retire or dispose of generation assets, we could have impairment charges related to our fixed assets. See note 2(i) to our consolidated financial statements.

Lawsuits, regulatory proceedings and tax proceedings could adversely affect our future financial results.

From time to time, we are named as a party to, or our property is the subject of, lawsuits, regulatory proceedings or tax proceedings. These proceedings involve highly subjective matters with complex factual and legal questions. Their outcome is uncertain. Any claim that is successfully asserted against us could result in significant damage claims and other losses. Even if we prevail, any proceedings could be costly and time-consuming and would divert the attention of our management and key personnel from our business operations, which could adversely affect our financial condition, results of operations or cash flows. See notes 11, 13 and 14 to our consolidated financial statements.

We have entered into outsourcing arrangements with third party service providers. In addition, our operations are highly dependent on computer and other operating systems, including telecommunications systems. Any interruptions in these arrangements or systems could significantly disrupt our business operations.

In recent years, we have entered into outsourcing arrangements, such as information technology production software, infrastructure and development and certain functions within customer operations, with third party service providers. If these service providers do not perform their obligations, we may incur significant costs and experience interruptions in our business operations in connection with switching to other service providers or assuming these obligations ourselves. We are also highly dependent on our specialized computer and communications systems, the operation of which could be interrupted by fire, flood, power loss, computer viruses or similar disruptions. There is no guarantee that our backup systems and disaster recovery plans will be effective.

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If we acquire or develop additional generation assets, or dispose of existing generation assets, we may incur additional costs and risks.

We may seek to purchase or develop additional generation facilities or dispose of existing generation facilities. There is no assurance that these efforts will be successful. In any sale, we may be required to indemnify a purchaser against liabilities. To finance future acquisitions, we may be required to issue additional equity securities or incur additional debt. We cannot make any assurances that we would be able to obtain such additional liquidity on commercially reasonable terms or at all.

Our process of exploring strategic alternatives may not be successful.

On October 6, 2008, we announced that our Board of Directors authorized the exploration of strategic alternatives to enhance stockholder value. There can be no assurance that the exploration of strategic alternatives will result in a transaction, or that the benefits of any strategic alternative pursued will in fact be realized. The pendency of this process may create uncertainties with current and potential customers, employees, suppliers and business partners. In addition, the market price of our stock may be volatile as we explore strategic alternatives, and volatility may persist or be increased if and when a decision to pursue an alternative is announced or we announce that we are no longer exploring strategic alternatives.

Other Risks

For other company risks, see **Business** in Item 1 and **Management's Discussion and Analysis of Financial Condition and Results of Operations** in Item 7 of this Form 10-K.

Item 1B. *Unresolved Staff Comments.*

None.

Item 2. *Properties.*

Our principal executive offices are leased through 2018, subject to two five-year renewal options. Our principal generation facilities are described under **Business Wholesale Energy** in Item 1 of this Form 10-K. We believe that our properties are adequate for our present needs. We have satisfactory title, rights and possession to our owned facilities, subject to exceptions, which, in our opinion, would not have a material adverse effect on the use or value of the facilities.

Item 3. *Legal Proceedings.*

For a description of our material pending legal and regulatory proceedings and settlements, see notes 13 and 14 to our consolidated financial statements.

Item 4. *Submission of Matters to a Vote of Security Holders.*

None.

Table of Contents**PART II****Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

Our common stock trades on the New York Stock Exchange under the ticker symbol RRI. On February 13, 2009, we had 34,659 stockholders of record.

The closing price of our common stock on December 31, 2008 was \$5.78.

	Market Price	
	High	Low
2008:		
First Quarter	\$ 26.74	\$ 18.06
Second Quarter	\$ 28.06	\$ 20.47
Third Quarter	\$ 24.15	\$ 4.94
Fourth Quarter	\$ 7.60	\$ 2.77
2007:		
First Quarter	\$ 21.70	\$ 13.52
Second Quarter	\$ 27.79	\$ 20.37
Third Quarter	\$ 30.69	\$ 22.72
Fourth Quarter	\$ 28.74	\$ 24.11

We have never paid dividends. Some of our debt agreements restrict the payment of dividends. See note 6 to our consolidated financial statements.

Stock Price Performance Graph. The following line graph compares the yearly percentage change in our cumulative total stockholder return on common stock with cumulative total return of a broad equity market index (Standard & Poor's 500 Stock Index) and the cumulative total return of a group of our peer companies comprised of Calpine Corporation, Constellation Energy Group, Inc., Dominion Resources, Inc., Dynegy Inc., Exelon Corporation, Mirant Corporation, NRG Energy, Inc., Sempra Energy and TXU Corp. TXU Corp. has been excluded from the graph for 2007 and 2008 because it was acquired and is no longer a publicly-traded company.

This stock price performance graph is furnished in this Form 10-K and is not filed, as permitted by 17 CFR 229.201(e).

Table of Contents**Item 6. Selected Financial Data.**

	2008 (1)(2)(3)(4)(5)(6)	2007 (1)(2)(6)(7)(8)	2006 (1)(2)(6)(9)(10) (in millions)	2005 (1)(2)(6)(11)	2004 (1)(2)(6)
Statements of Operations Data:					
Revenues	\$ 12,553	\$ 11,209	\$ 10,877	\$ 9,712	\$ 8,098
Operating income (loss)	(659)	876	(24)	(321)	(13)
Income (loss) from continuing operations	(748)	358	(327)	(441)	(276)
Cumulative effect of accounting changes, net of tax			1	(1)	7
Net income (loss)	(740)	365	(328)	(331)	(29)

	2008 (1)(2)(3)(4)(5)(6)	2007 (1)(2)(6)(7)(8)	2006 (1)(6)(9)(10)	2005 (1)(6)(11)	2004 (1)(6)
Diluted Earnings (Loss) per Share:					
Income (loss) from continuing operations	\$ (2.15)	\$ 1.01	\$ (1.06)	\$ (1.46)	\$ (0.93)

	2008 (1)(2)(3)(4)(5)(12)(13)	2007 (1)(2)(7)(8)(10)(12)(13)	2006 (1)(9)(11)(12)(13) (in millions)	2005 (1)(12)(13)	2004 (1)(12)(13)(14)
Statements of Cash Flow Data:					
Cash flows from operating activities	\$ 183	\$ 762	\$ 1,276	\$ (917)	\$ 106
Cash flows from investing activities	216	(179)	1,057	306	900
Cash flows from financing activities	(45)	(292)	(1,957)	594	(1,047)

	2008 (1)(2)(15)	2007 (1)(2)	December 31, 2006 (1) (in millions)	2005 (1)(16)	2004 (1)(16)
Balance Sheet Data:					
Net margin deposits	\$ 235	\$ 140	\$ 436	\$ 1,700	\$ 487
Total assets	10,636	10,192	11,768	13,569	12,194
Current portion of long-term debt and short-term borrowings	13	52	355	789	619
Long-term debt	2,871	2,903	3,178	4,317	3,939
Stockholders equity	3,778	4,477	3,950	3,864	4,386

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- (1) We sold or transferred the following operations, which have been classified as discontinued operations. Desert Basin, European energy, Orion Power's hydropower plants, Liberty, Ceredo and Orion Power's New York plants. We sold the following operations, which are included in continuing operations: REMA hydropower plants in April 2005, landfill-gas fueled power plants in July 2005, our El Dorado investment in July 2005 and our Bighorn plant in October 2008.
- (2) We deconsolidated Channelview on August 20, 2007 and sold its assets in July 2008.
- (3) During 2008, we recorded and paid \$66 million for costs related to the unwind of the credit-enhanced retail structure (included in selling, general and administrative expenses).
- (4) During 2008, we recorded a goodwill impairment charge of \$305 million related to our wholesale energy segment. This charge is non-cash.
- (5) During 2008, we recorded \$37 million in expenses and paid \$34 million for Western states litigation and similar settlements relating to natural gas cases.
- (6) During 2008, 2007, 2006, 2005 and 2004, we had net gains on sales of assets and emission and exchange allowances of \$156 million, \$26 million, \$159 million, \$168 million and \$20 million, respectively.
- (7) During 2007, we recorded and paid a \$22 million charge related to resolution of a 2004 indictment for alleged violations of the Commodity Exchange Act, wire fraud and conspiracy charges.
- (8) During 2007, we recorded \$73 million in debt extinguishments expenses and expensed \$41 million of deferred financing costs related to accelerated amortization for refinancings and extinguishments.
- (9) During 2006, we recorded \$37 million in debt conversion expense.
- (10) During 2006, we recorded a \$35 million charge (paid in 2007) related to a settlement of certain class action natural gas cases relating to the Western states energy crisis.
- (11) During 2005, we recorded charges of \$359 million relating to various settlements associated with the Western states energy crisis, which were paid during 2006.
- (12) During 2008, 2007, 2006, 2005 and 2004, we had net cash proceeds from sales of assets of \$538 million, \$82 million, \$1 million, \$149 million and \$11 million, respectively.
- (13) During 2008, 2007, 2006, 2005 and 2004, we had net proceeds from sales of (purchases of) emission and exchange allowances of \$(19) million, \$(85) million, \$183 million, \$89 million and \$(65) million, respectively.
- (14) During 2004, 2003 and 2002, we recorded charges of \$2 million, \$47 million and \$128 million, respectively, relating to a payment made to CenterPoint in 2004 of \$177 million.
- (15) See note 13 to our consolidated financial statements for discussion of our contingencies.
- (16) The balance sheet data for total assets as of December 31, 2005 and 2004 has not been restated for the adoption of FIN 39-1 as it was impracticable to reasonably retrieve and reconstruct the historical information due to migration of data driven by a system conversion.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Business Overview

Financial Flexibility. Given the ongoing turmoil in the financial markets and the uncertainty in the overall economic outlook, our focus has been and continues to be on our liquidity and financial flexibility. We are regularly assessing the impact on our business of a wide variety of economic and commodity price scenarios. We believe we have the ability to operate through a significant downturn.

Review of Strategic Alternatives. In October 2008, our Board of Directors initiated a process to review strategic alternatives and formed a special committee to oversee this process. We are exploring a full range of possible strategic alternatives to enhance stockholder value, including, among other possibilities, the sale of all or substantially all of Reliant Energy, as well as the sale of some or all of our retail business. For discussion of our agreement to sell our Texas retail business, see *Business General* in Item 1 of this Form 10-K.

Ongoing Operations. Our objective is to be a leader in delivering the benefits of competitive electricity markets to customers. Our business focuses on the competitive mass retail and wholesale electricity markets. We are committed to delivering superior returns from competitive markets through insights into the fundamentals of our core markets and a commitment to risk-weighted investments whose return on invested capital exceeds our weighted-average cost of capital.

Company-wide. We are focusing on the following value-creation levers:

Establishing and maintaining a flexible capital structure to achieve a competitive cost of capital;

Building a highly disciplined return on invested capital focus; and

Continuing to develop innovative structures and transactions that improve returns and reduce risk.

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We also believe that stockholder value is enhanced through the development of a highly motivated and customer-focused work force. We continue to focus on:

- communicating openly with our employees;
- fostering company pride among our employees;
- providing a satisfying and safe work environment;
- recognizing and rewarding employee contributions and capabilities; and
- motivating our employees to be collaborative leaders committed to our future.

Wholesale Energy. The wholesale energy segment is a capital-intensive, cyclical business. Earnings are significantly impacted by spark and dark spreads and capacity prices. Our margins are driven by a number of factors, including the prices of power, natural gas, coal and fuel oil, the cost of emissions, transmission, weather and global macro-economic factors, none of which we control and many of which are volatile. The factor that we have the most control over is the percentage of time that our generating assets are available to run when it is economical for them to do so (commercial capacity factor). The key earnings drivers in the wholesale energy segment are the amount of time our power plants are economical to operate (economic generation) and commercial capacity factor, which both determine the amount of electricity we generate, the margin we earn for each unit of electricity sold, the availability of our generating assets to meet demand and capacity revenues (other margin) and operating costs. These earnings drivers are impacted by various factors including:

Economic generation

- Supply and demand fundamentals
- Spark spreads (difference between power prices and natural gas fuel costs)
- Dark spreads (difference between power prices and coal fuel costs)
- Generation asset fuel type and efficiency

Commercial capacity factor

- Operations excellence
- Maintenance practices

Unit margin

- Supply and demand fundamentals
- Commodity prices
- Generation asset fuel type and efficiency

Hedging strategy

Other margin

Capacity prices

Power purchase agreements sold to others

Ancillary services

Operating costs

Operating efficiencies

Maintenance practices

Generation asset fuel type

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We are focusing on the following value-creation levers:

Maximizing cash flow from our existing portfolio of assets while minimizing collateral requirements;

Achieving operating and commercial excellence in order to reliably and economically meet customer needs; and

Proactively monitor environmental regulations and respond to changes to maximize the value of our portfolio of assets.

For a discussion of our plans for investment to comply with existing environmental regulations, see Business Regulation Environmental Matters in Item 1 of this Form 10-K and Liquidity and Capital Resources below. For a discussion of pending and contingent matters related to environmental regulations, see note 13(c) to our consolidated financial statements.

Retail Energy. The retail energy segment is an electricity resale business. We earn a margin by selling electricity to end-user customers, meeting the service needs of such customers and acquiring supply for the estimated demand. The key earnings drivers in the retail energy segment are the volume of electricity we sell to customers, the unit margins received on those sales and the cost of acquiring and serving those customers (operating costs). These earnings drivers are impacted by various factors including:

Volume of electricity sales

Local weather patterns

Number and type of customers

Energy consumption behaviors

Macro-economic factors affecting demand

Unit margins

Revenue rate charged compared to cost of supply, which includes

Commodity price volatility when actual and estimated demand differ

Load-related charges

Transmission congestion

Hedging costs

Competitive tactics of other retailers in the market

Incremental value-added services

Operating costs

Collateral costs

Operating efficiencies

Cost to acquire and retain customers

Ability to collect

We are focusing on the following value-creation levers:

Improving our operating cost effectiveness;

Reducing risk of extreme earnings volatility through increased supply hedging;

Managing the capital commitment (collateral obligations) to supply our customers; and

Supporting the competitive electricity market in Texas and providing innovative and value-enhancing services to our customers.

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To reduce the risk of extreme earnings variability in our retail energy segment, we have designed and are implementing changes in our hedging approach such as matching supply and load by geographic zone, buying heat rate and fixed-price call options for volumes significantly above expected levels and considering the use of gas, power and weather options to mitigate extreme events. These changes will result in higher expected supply costs over time. We are reviewing our core processes that support the business to ensure that we have the right people, skills and systems.

For a discussion of our ongoing plan to exit the C&I portion of our retail business over time and the related reduction in our long-term capital requirements for collateral, see [2008 Significant Events](#) and [Liquidity and Capital Resources](#) below.

Our ability to achieve these objectives and execute these actions is subject to a number of factors, some of which we may not be able to control. See [Cautionary Statement Regarding Forward-Looking Information](#) and [Risk Factors](#) in Item 1A of this Form 10-K.

2008 Significant Events

ERCOT. The Houston area experienced thirty-year record heat in late May and early June 2008. As a result, load demand in Houston and south Texas was greater than we expected. Additionally, transmission constraints limited the ability to move power into the Houston and south Texas zones, which caused some of our power supply to be unavailable to meet expected demand. In response, we purchased power in Houston and south Texas to meet our increased load at market prices. This extraordinary event negatively impacted our retail contribution margin by approximately \$150 million during primarily the second quarter of 2008.

Hurricane Ike Stranded Supply Costs. In September 2008, Hurricane Ike struck the upper Texas coast, which left over 2.1 million electric consumers (more than 90 percent of the metered electric consumers in the Houston-Galveston area) without power. More than 1.0 million electric consumers were without power for at least six days and more than 500,000 customers remained without power ten days after the storm. Retail contribution margin was negatively impacted by approximately \$75 million as a result of the effects of Hurricane Ike, including reduced sales volumes and the sale of excess supply at a loss.

Hurricane Ike, Higher Supply Costs and Pricing Decisions. Due to a substantial increase in natural gas prices, we incurred much higher supply costs in the second and third quarters of 2008 compared to 2007. Natural gas prices declined rapidly in the third quarter and after Hurricane Ike, we decided to not take pricing actions that would have immediately and fully offset the higher supply costs at that time. The combination of increased supply costs and the associated pricing decisions lowered 2008 retail contribution margin by approximately \$250 million.

Merrill Lynch. The results in our retail energy segment in 2008 were substantially below our expectations as a result of a variety of factors, including the record heat in the Houston area and ERCOT transmission constraints experienced in late May and early June, the devastating impact of Hurricane Ike on the Gulf Coast and the significant volatility in commodity prices experienced in 2008. As a consequence, we concluded that terminating our \$300 million retail working capital facility agreement with Merrill Lynch would be appropriate in order to address any issue that might be asserted regarding the minimum adjusted retail EBITDA covenant in that facility. In December 2008, we terminated the working capital facility and Merrill Lynch contends that we did not have this right. See further discussion of Merrill Lynch's claim and related legal actions in [Liquidity and Capital Resources](#) below and note 13(b) to our consolidated financial statements.

Exit from C&I Portion of Our Retail Business. Prior to our decision to exit the C&I portion of our retail energy business either through a wind down or sale of our C&I contracts, roughly 70% of our retail collateral posting obligations were associated with C&I. In contrast, C&I represented only approximately 30% of the contribution margin associated with our retail business. Without the Merrill Lynch credit support under the credit sleeve and reimbursement agreement, we do not believe that the C&I margins covered our cost of capital associated with this business. As a result, we decided to exit the C&I portion of our retail business. Except where we are contractually obligated to do so, we are no longer entering into contracts with new C&I customers and we do not expect to renew contracts with our current customers. In December 2008, we sold all

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of our Northeast C&I contracts. The Northeast C&I activity was (a) \$505 million of our consolidated revenues (or 4%) and (b) \$18 million of our consolidated gross margin, excluding unrealized gains/losses on energy derivatives (or 1%) during 2008. We expect that approximately 13,000 MW (36%), 7,000 MW (19%) and 15,000 MW (45%) of our remaining contracted volumes for the C&I activity will roll off during 2009, 2010 and thereafter, respectively.

The following details the C&I activity in our consolidated results of operations:

	2008		2007		2006	
	Dollars	Percentages ⁽¹⁾	Dollars	Percentages ⁽¹⁾	Dollars	Percentages ⁽¹⁾
Revenues from C&I customers ⁽²⁾	\$ 4,283	34%	\$ 3,709	33%	\$ 3,345	31%
Gross margin from C&I customers ⁽³⁾	106	6%	244	12%	208	12%

(1) These percentages represent the C&I portion of the business as compared to our consolidated results.

(2) Amounts exclude (a) unrealized gains/losses on energy derivatives and (b) market usage adjustments.

(3) Amounts exclude (a) unrealized gains/losses on energy derivatives, (b) sale of Northeast C&I derivative liability and (c) market usage adjustments and contract terminations.

Disposition of Generation Facilities. In July 2008, Channelview completed the sale of its plant for \$500 million. In October 2008, we sold our Bighorn plant for \$500 million. See notes 19 and 20 to our consolidated financial statements.

Consolidated Results of Operations

The following discussion includes non-GAAP financial measures, which are not standardized; therefore, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. These non-GAAP financial measures, which are discussed below, reflect an additional way of viewing aspects of our operations that, when viewed with our GAAP results, may provide a more complete understanding of factors and trends affecting our business segments. Investors should review our consolidated financial statements and publicly filed reports in their entirety and not rely on any single financial measure.

2008 Compared to 2007 and 2007 Compared to 2006

We reported \$740 million consolidated net loss, or \$2.13 loss per share, for 2008 compared to \$365 million consolidated net income, or \$1.04 diluted income per share, for 2007 and \$328 million consolidated net loss, or \$1.07 loss per share, for 2006.

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	2008	2007	2006 (in millions)	Change from 2007 to 2008	Change from 2006 to 2007
Wholesale energy contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives ⁽¹⁾	\$ 877	\$ 524	\$ 146	\$ 353	\$ 378
Retail energy contribution margin including unrealized gains/losses on energy derivatives and sale of Northeast C&I derivative liability ⁽¹⁾	(789)	942	250	(1,731)	692
Other contribution margin	1	1	1		
Other general and administrative	(225)	(171)	(172)	(54)	1
Western states litigation and similar settlements	(37)	(22)	(35)	(15)	13
Gains on sales of assets and emission and exchange allowances, net	156	26	159	130	(133)
Wholesale energy goodwill impairment	(305)			(305)	
Depreciation and amortization	(337)	(424)	(373)	87	(51)
Income of equity investment, net	1	5	6	(4)	(1)
Debt extinguishments and conversions	(1)	(73)	(37)	72	(36)
Other, net	5			5	
Interest expense	(248)	(349)	(428)	101	79
Interest income	29	34	34	(5)	
Income tax (expense) benefit	125	(135)	122	260	(257)
Income (loss) from continuing operations	(748)	358	(327)	(1,106)	685
Income (loss) from discontinued operations	8	7	(2)	1	9
Cumulative effect of accounting change, net of tax			1		(1)
Net income (loss)	\$ (740)	\$ 365	\$ (328)	\$ (1,105)	\$ 693

(1) These represent our segment measures. See the tables below under Wholesale Energy Margins and Retail Energy Margins.

Wholesale Energy Segment.

In analyzing the results of our wholesale energy segment and in communications with investors, analysts, rating agencies, banks and other parties, we use the non-GAAP financial measures open energy gross margin, open wholesale gross margin and open wholesale contribution margin, which exclude the items described below, as well as our wholesale energy segment profit and loss measure, contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives. Open energy gross margin, open wholesale gross margin and open wholesale contribution margin should not be relied upon without considering the GAAP financial measures.

Wholesale Hedges. We exclude the recurring effect of certain wholesale hedges that were entered into primarily to mitigate certain operational risks at our generation assets. These amounts primarily relate to settlements of fuel

hedges, long-term natural gas transportation contracts and storage contracts. We also exclude the effect of our wholesale energy segment's 2008 sale of natural gas contracts to our retail energy segment. We entered into this intersegment transaction to reduce Merrill Lynch's collateral posting obligations. The wholesale hedges described above are derived based on methodology consistent with the calculation of open energy gross margin. We also exclude the recurring effect of certain historical wholesale hedges that were entered into in order to hedge the economics of a portion of our wholesale operations. These amounts primarily relate to settlements of forward power hedges, long-term tolling purchases, long-term natural gas transportation contracts not serving our generation assets and our legacy energy trading. We believe that it is

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useful to us, investors, analysts and others to show our results in the absence of hedges. The impact of these hedges on our financial results is not a function of the operating performance of our generation assets, and excluding the impact better reflects the operating performance of our generation assets based on prevailing market conditions. We previously referred to these hedges as Historical and Operational Wholesale Hedges.

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

Our wholesale energy segment's contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives was \$877 million in 2008 compared to \$524 million in 2007. The \$353 million increase was primarily due to reduced negative effect of wholesale hedges of \$339 million partially offset by net change in unrealized gains/losses on energy derivatives of \$24 million. Open wholesale contribution margin increased \$38 million primarily due to \$48 million decrease in operation and maintenance expense partially offset by \$8 million decrease in open wholesale gross margin. Our wholesale energy segment's contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives was \$524 million in 2007 compared to \$146 million in 2006. The \$378 million increase was primarily due to (a) reduced negative effect of wholesale hedges of \$272 million partially offset by net change in unrealized gains/losses on energy derivatives of \$49 million. Open wholesale contribution margin increased \$155 million primarily due to \$196 million increase in open wholesale gross margin partially offset by \$40 million increase in operation and maintenance expense. See Wholesale Energy Margins below for explanations.

Wholesale Energy Revenues.

	2008	2007	2006	Change from 2007 to 2008	Change from 2006 to 2007
	(in millions)				
Wholesale energy third-party revenues	\$ 3,138	\$ 2,877	\$ 2,487	\$ 261 ⁽¹⁾	\$ 390 ⁽²⁾
Wholesale energy revenues intersegment	208	394	571	(186) ⁽³⁾	(177) ⁽⁴⁾
Subtotal	3,346	3,271	3,058	75	213
Revenues affiliated ⁽⁵⁾	253 ⁽⁵⁾	127 ⁽⁵⁾		126	127
	(1)	32	192	(33) ⁽⁶⁾	(160) ⁽⁷⁾

Unrealized gains (losses) on energy derivatives

Total wholesale energy revenues	\$ 3,598	\$ 3,430	\$ 3,250	\$ 168	\$ 180
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- (1) Increase primarily due to (a) higher power and natural gas sales prices and (b) higher capacity payments. This increase was partially offset by (a) lower natural gas and power sales volumes and (b) lower steam sales due to the deconsolidation of Channelview on August 20, 2007.
- (2) Increase primarily due to (a) higher power sales prices and (b) higher power sales volumes. These increases were partially offset by lower natural gas sales volumes.
- (3) Decrease primarily due to (a) lower power sales volumes and (b) lower natural gas sales volumes related to a contract that ended in October 2007. This decrease was partially offset by higher power sales prices.

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- (4) Decrease primarily due to lower power sales volumes. This decrease was partially offset by (a) higher power sales prices and (b) higher natural gas sales volumes related to a tolling agreement.
- (5) We deconsolidated Channelview on August 20, 2007. These revenues represent sales of fuel to Channelview.
- (6) See footnote 21 under Wholesale Energy Margins.
- (7) See footnote 22 under Wholesale Energy Margins.

Wholesale Energy Cost of Sales.

	2008	2007	2006 (in millions)	Change from 2007 to 2008	Change from 2006 to 2007
Wholesale energy third-party costs	\$ 1,942	\$ 2,138	\$ 2,371	\$ (196) ⁽¹⁾	\$ (233) ⁽²⁾
Cost of sales intersegment ⁽³⁾	(30)			(30)	
Cost of sales affiliate ⁽⁴⁾	201	105		96	105
Unrealized losses on energy derivatives	135	25	136	110 ⁽⁵⁾	(111) ⁽⁶⁾
Unrealized gains on energy derivatives intersegment ⁽⁷⁾	(119)			(119) ⁽⁷⁾	
Total wholesale energy cost of sales	\$ 2,129	\$ 2,268	\$ 2,507	\$ (139)	\$ (239)

- (1) Decrease primarily due to lower natural gas volumes purchased. This decrease was partially offset by higher prices paid for natural gas and coal.
- (2) Decrease primarily due to (a) lower purchased natural gas and power volumes and (b) lower purchased capacity.
- (3) Relates to an internal 40 BCFe hedge that extends to December 2010 between the wholesale energy and retail energy segments associated with the unwind of our credit-enhanced retail structure. The realized and unrealized gains/losses on this internal hedge are included in cost of sales for our retail energy and wholesale energy segments and eliminate in consolidation.
- (4) We deconsolidated Channelview on August 20, 2007. These cost of sales represent purchases of power from Channelview.
- (5) See footnote 21 under Wholesale Energy Margins.
- (6) See footnote 22 under Wholesale Energy Margins.
- (7) Relates to unrealized gains on the internal 40 BCFe hedge. See footnote 3 above.

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	2008	2007	2006	Change from 2007 to 2008	Change from 2006 to 2007
	(in millions)				
Open energy gross margin ⁽¹⁾ :					
PJM Coal	\$ 608	\$ 617	\$ 526	\$ (9)	\$ 91 ⁽²⁾
MISO Coal	111	161	121	(50) ⁽³⁾	40 ⁽⁴⁾
PJM/MISO Gas	42	50	44	(8)	6
West	(1)	20	12	(21) ⁽⁵⁾	8
Other	1	24	4	(23) ⁽⁶⁾	20 ⁽⁷⁾
Total	761	872	707	(111)	165
Other margin ⁽⁸⁾ :					
PJM Coal	120	56	29	64 ⁽⁹⁾	27 ⁽¹⁰⁾
MISO Coal	19	14	8	5	6
PJM/MISO Gas	145	109	49	36 ⁽¹¹⁾	60 ⁽¹²⁾
West	167	141	155	26 ⁽¹³⁾	(14) ⁽¹⁴⁾
Other	35	63	111	(28) ⁽¹⁵⁾	(48) ⁽¹⁶⁾
Total	486	383	352	103	31
Open wholesale gross margin	1,247	1,255	1,059	(8)	196
Operation and maintenance	(591)	(639)	(599)	48 ⁽¹⁷⁾	(40) ⁽¹⁸⁾
Bad debt expense	(1)	1	2	(2)	(1)
Open wholesale contribution margin	655	617	462	38	155
Wholesale hedges	239	(100)	(372)	339 ⁽¹⁹⁾	272 ⁽²⁰⁾
Unrealized gains (losses) on energy derivatives	(17)	7	56	(24) ⁽²¹⁾	(49) ⁽²²⁾
Total wholesale energy contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives⁽²³⁾	\$ 877	\$ 524	\$ 146	\$ 353	\$ 378

(1) Open energy gross margin is calculated using the power sales prices received by the plants less delivered spot fuel prices. This figure excludes the effects of other margin, our wholesale hedges and unrealized gains/losses on energy derivatives.

(2)

Increase primarily due to (a) higher open energy unit margins (higher power prices partially offset by higher fuel costs) and (b) higher economic generation.

- (3) Decrease primarily due to (a) lower open energy unit margins (higher fuel costs partially offset by higher power prices) and (b) lower economic generation. This decrease was partially offset by increased commercial capacity factor due to lower planned and unplanned outages in 2008.
- (4) Increase primarily due to (a) higher open energy unit margins (higher power prices) and (b) higher economic generation. These increases were partially offset by lower commercial capacity factor primarily due to higher planned outages in 2007.
- (5) Decrease primarily due to (a) lower open energy unit margins (higher fuel costs partially offset by higher power prices) and (b) lower economic generation.
- (6) Decrease primarily due to lower economic generation related to the deconsolidation of Channelview on August 20, 2007.
- (7) Increase primarily due to higher open energy unit margins (higher power prices partially offset by higher fuel costs). This increase was partially offset by lower economic generation due primarily to the deconsolidation of Channelview on August 20, 2007.
- (8) Other margin represents power purchase agreements, capacity payments, ancillary services revenues and selective commercial hedge strategies.
- (9) Increase primarily due to higher RPM capacity payments.
- (10) Increase primarily due to (a) higher RPM capacity payments and (b) ancillary services revenues.
- (11) Increase primarily due to higher RPM capacity payments. This increase was partially offset by lower revenue from purchase power agreements.
- (12) Increase primarily due to higher RPM capacity payments.
- (13) Increase primarily due to higher capacity payments.

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- (14) Decrease primarily due to (a) a decrease in selective commercial hedge activities and (b) lower revenue from power purchase agreements. These decreases were partially offset by higher capacity payments.
- (15) Decrease primarily due to (a) the deconsolidation of Channelview on August 20, 2007 and (b) loss on selective commercial hedge activity.
- (16) Decrease primarily due to (a) the deconsolidation of Channelview on August 20, 2007 and (b) lower revenue from power purchase agreements.
- (17) Decrease primarily due to (a) the deconsolidation of Channelview on August 20, 2007 and (b) \$19 million decrease in planned outages and maintenance spending.
- (18) Increase primarily due to (a) \$21 million increase in planned outages and maintenance spending and (b) \$19 million increase in services and support primarily due to strategic initiatives for improving plant performance (\$16 million). These increases were partially offset by decreases due to the deconsolidation of Channelview on August 20, 2007.
- (19) Increase primarily due to (a) \$191 million in increased gains on fuel hedges and (b) \$137 million decrease in losses on closed power hedges.
- (20) Increase primarily due to (a) \$134 million increase on hedges of natural gas transportation and storage contracts, (b) \$120 million decrease in losses on closed power hedges and (c) \$11 million increased gains on fuel hedges.
- (21) Decrease primarily due to (a) \$64 million loss from changes in prices on our energy derivatives marked to market and (b) \$78 million reversal of previously recognized unrealized gains on energy derivatives settled during the period, partially offset by \$119 million gain on the internal 40 BCFe hedge. See footnote 3 under Wholesale Energy Cost of Sales.
- (22) Decrease primarily due to \$75 million reversal of previously recognized unrealized gains on energy derivatives which settled during the period, partially offset by \$14 million gain due to change in prices on our derivatives marked to market.
- (23) Wholesale energy segment profit and loss measure.

Retail Energy Segment.

In analyzing the results of our retail energy segment and in communications with investors, analysts, rating agencies, banks and other parties, we use the non-GAAP financial measures retail gross margin and retail contribution margin, which exclude the items described below, as well as our retail energy segment profit and loss measure, contribution margin, including unrealized gains/losses on energy derivatives and sale of Northeast C&I derivative liability. Retail gross margin and retail contribution margin should not be relied upon without considering the GAAP financial measures.

Unrealized Gains/Losses on Energy Derivatives. We use derivative instruments to manage operational or market constraints and to execute our retail energy segment's supply procurement strategy. We are required to record in our consolidated statement of operations non-cash gains/losses related to future periods based on current changes in forward commodity prices for derivative instruments receiving mark-to-market accounting treatment. We refer to

these gains and losses prior to settlement, as well as ineffectiveness on cash flow hedges, as unrealized gains/losses on energy derivatives. In substantially all cases, the underlying transactions being hedged receive accrual accounting treatment, resulting in a mismatch of accounting treatments. Since the application of mark-to-market accounting has the effect of pulling forward into current periods non-cash gains/losses relating to and reversing in future delivery periods, analysis of results of operations from one period to another can be difficult. We believe that excluding these unrealized gains/losses on energy derivatives provides a more meaningful representation of our economic performance in the reporting period and is therefore useful to us, investors, analysts and others in facilitating the analysis of our results of operations from one period to another.

Sale of Northeast C&I Derivative Liability. In December 2008, we sold our C&I contracts in the Northeast and recognized a gain of \$63 million. In connection with this sale, we assigned contracts accounted for as derivatives that had a liability balance of \$56 million at the time of the sale. This \$56 million liability represents the realized loss on the derivatives sold in the sale of Northeast C&I contracts. We exclude this realized loss since it is more than offset by the gain on the sale of the sold contracts, which is not included in retail gross margin or retail contribution margin. When analyzing margins for our ongoing retail energy business, management does not consider the effect of this \$56 million realized loss. We believe that excluding this item provides a more meaningful representation of our economic performance in the reporting period and is therefore useful to us, investors, analysts and others in facilitating the analysis of our results of operations from one period to another.

Our retail energy segment's contribution margin, including unrealized gains/losses on energy derivatives and sale of Northeast C&I derivative liability was \$(789) million in 2008 compared to \$942 million in 2007. The \$1.7 billion decrease was primarily due to the net change in unrealized gains/losses on energy derivatives

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of \$1.2 billion and a \$501 million decrease in retail gross margin. Our retail energy segment's contribution margin, including unrealized gains/losses on energy derivatives was \$942 million in 2007 compared to \$250 million in 2006. The \$692 million increase was primarily due to the net change in unrealized gains/losses on energy derivatives of \$725 million, partially offset by a \$32 million decrease in retail gross margin. See "Retail Energy Margins" below for explanations.

Retail Energy Revenues.

	2008	2007	2006 (in millions)	Change from 2007 to 2008	Change from 2006 to 2007
Retail energy revenues from end-use retail customers:					
Mass:					
Residential:					
Houston	\$ 1,971	\$ 2,057	\$ 2,466	\$ (86) ⁽¹⁾	\$ (409) ⁽²⁾
Non-Houston	1,175	1,175	1,109		66 ⁽³⁾
Small Business:					
Houston	457	493	593	(36) ⁽⁴⁾	(100) ⁽⁵⁾
Non-Houston	205	203	189	2	14
Total Mass	3,808	3,928	4,357	(120)	(429)
C&I:					
ERCOT	3,712	3,334	2,964	378 ⁽⁶⁾	370 ⁽⁷⁾
Non-ERCOT	571	375	381	196 ⁽⁸⁾	(6)
Total C&I	4,283	3,709	3,345	574	