RRI ENERGY INC
Form 10-Q
August 03, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from __________ to __________

Commission file number 1-16455
RRI Energy, Inc.
(Exact Name of Registrant as Specified in Its Charter)

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

1000 Main Street
Houston, Texas 77002
(Address of Principal Executive Offices) (Zip Code)
(713) 497-3000
(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

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

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

As of July 28, 2009, the latest practicable date for determination, RRI Energy, Inc. had 351,482,149 shares of common stock outstanding and no shares of treasury stock.

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FORWARD-LOOKING INFORMATION

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are statements that contain projections, assumptions or estimates about our revenues, income, capital structure and other financial items, our plans and objectives for future operations or about our future economic performance, economic and market conditions, possible transactions and dispositions, financings or offerings. In many cases, you can identify forward-looking statements by terminology such as anticipate, estimate, believe, continue, could, intend, ma potential, predict, should, will, expect, objective, projection, forecast, goal, guidance, outlook, similar words. However, the absence of these words does not mean that the statements are not forward-looking.

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

- Demand and market prices for electricity, 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 or collateral postings;
- 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; and
- Financial and economic market conditions and our access to capital.

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

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

Our filings and other important information are also available on our investor page at www.rrienergy.com.

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PART I.
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(thousands of dollars, except per share amounts)			
Revenues:				
Revenues (including $(21,842), $5,465, $(26,130) and $(6,737) unrealized gains (losses)) (including $0, $145,592, $0 and $253,001 from affiliates)	$ 389,777	$ 1,013,564	$ 855,961	$ 1,893,362
Expenses:				
Cost of sales (including $28,486, $62,051, $(10,969) and $105,053 unrealized gains (losses)) (including $0, $34,593, $0 and $70,306 from affiliates)	280,067	568,876	604,741	1,077,715
Operation and maintenance	156,964	165,733	314,110	321,178
General and administrative	27,645	32,627	56,659	61,841
Western states litigation and similar settlements				34,000
Gains on sales of assets and emission and exchange allowances, net	(1,241)	(22,312)	(20,171)	(22,923)
Depreciation and amortization	67,646	82,909	135,504	165,706
Total operating expense	531,081	827,833	1,090,843	1,637,517
Operating Income (Loss)	(141,304)	185,731	(234,882)	255,845
Other Income (Expense):				
Income (loss) of equity investment, net	(690)	988	(149)	1,195
Debt extinguishments gains (losses)	844		844	(1,353)
Other, net	160	90	211	26
Interest expense	(45,067)	(51,094)	(91,986)	(102,510)
Interest income	721	8,226	969	14,651
Total other expense	(44,032)	(41,790)	(90,111)	(87,991)
Income (Loss) from Continuing Operations Before Income Taxes	(185,336)	143,941	(324,993)	167,854
Income tax expense (benefit)	(81,644)	61,963	(115,520)	72,940
Income (Loss) from Continuing Operations	(103,692)	81,978	(209,473)	94,914
Income from discontinued operations	907,258	276,710	861,626	640,986
Net Income	$ 803,566	$ 358,688	$ 652,153	$ 735,900

Basic Earnings (Loss) per Share:				
Income (loss) from continuing operations	$ (0.30)	$ 0.24	$ (0.60)	$ 0.27
Income from discontinued operations	2.59	0.79	2.46	1.86
Net income	$ 2.29	$ 1.03	$ 1.86	$ 2.13
Diluted Earnings (Loss) per Share:				
Income (loss) from continuing operations	$ (0.30)	$ 0.23	$ (0.60)	$ 0.27
Income from discontinued operations	2.59	0.78	2.46	1.81
Net income	$ 2.29	$ 1.01	$ 1.86	$ 2.08

See Notes to our Unaudited Consolidated Interim Financial Statements

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

	June 30, 2009	December 31, 2008
	(thousands of dollars, except per share amounts)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,486,965	$ 1,004,367
Restricted cash	2,778	2,721
Accounts and notes receivable, principally customer	127,479	249,871
Inventory	303,984	314,999
Derivative assets	157,023	161,340
Margin deposits	18,078	32,676
Investment in and receivables from Channelview, net	24,569	58,703
Prepayments and other current assets	105,146	124,449
Current assets of discontinued operations ($152,000 and $295,477 of margin deposits)	271,538	2,506,340
Total current assets	2,497,560	4,455,466
Property, plant and equipment, gross	6,510,780	6,417,268
Accumulated depreciation	(1,722,634)	(1,597,479)
Property, Plant and Equipment, net	4,788,146	4,819,789
Other Assets:		
Other intangibles, net	373,773	380,554
Derivative assets	84,004	78,879
Prepaid lease	264,893	273,374
Other ($31,888 and $29,012 accounted for at fair value)	238,142	219,552
Long-term assets of discontinued operations	25,717	494,781
Total other assets	986,529	1,447,140
Total Assets	$ 8,272,235	$ 10,722,395
LIABILITIES AND EQUITY		
Current Liabilities:		
Current portion of long-term debt and short-term borrowings	$ 410,799	$ 12,517
Accounts payable, principally trade	137,239	156,604
Derivative liabilities	234,906	202,206
Margin deposits	28,000	93,000
Other	206,698	199,026
Current liabilities of discontinued operations ($42,250 and $0 of margin deposits)	187,391	2,375,895

Total current liabilities		1,205,033		3,039,248
Other Liabilities:				
Derivative liabilities		115,596		140,493
Other		305,407		272,079
Long-term liabilities of discontinued operations		29,872		873,190
Total other liabilities		450,875		1,285,762
Long-term Debt		2,160,501		2,610,737
Commitments and Contingencies				
Temporary Equity Stock-based Compensation		4,934		9,004
Stockholders Equity:				
Preferred stock; par value $0.001 per share (125,000,000 shares authorized; none outstanding)				
Common stock; par value $0.001 per share (2,000,000,000 shares authorized; 350,711,802 and 349,812,537 issued)		112		111
Additional paid-in capital		6,248,060		6,238,639
Accumulated deficit		(1,723,048)		(2,375,201)
Accumulated other comprehensive loss		(74,232)		(85,905)
Total stockholders equity		4,450,892		3,777,644
Total Liabilities and Equity	$	8,272,235	$	10,722,395

See Notes to our Unaudited Consolidated Interim Financial Statements

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

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(thousands of dollars)	
Cash Flows from Operating Activities:		
Net income	$ 652,153	$ 735,900
Income from discontinued operations	(861,626)	(640,986)
Net income (loss) from continuing operations	(209,473)	94,914
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	135,504	165,706
Deferred income taxes	(115,850)	71,419
Net changes in energy derivatives	37,099	(98,316)
Amortization of deferred financing costs	4,292	4,206
Gains on sales of assets and emission and exchange allowances, net	(20,171)	(22,923)
Western states litigation and similar settlements		34,000
Other, net	7,450	(1,268)
Changes in other assets and liabilities:		
Accounts and notes receivable, net	126,059	(158,758)
Changes in notes, receivables and payables with affiliate, net	(1,230)	(5,440)
Inventory	12,610	(42,445)
Margin deposits, net	(50,402)	(54,644)
Net derivative assets and liabilities	(21,965)	(9,519)
Accounts payable	(7,453)	88,399
Other current assets	3,759	(6,819)
Other assets	9,073	19,190
Taxes payable/receivable	(4,936)	19,971
Other current liabilities	(4,207)	(8,100)
Other liabilities	3,322	(1,242)
Net cash provided by (used in) continuing operations from operating activities	(96,519)	88,331
Net cash provided by discontinued operations from operating activities	508,602	102,531
Net cash provided by operating activities	412,083	190,862
Cash Flows from Investing Activities:		
Capital expenditures	(114,964)	(102,930)
Proceeds from sales of assets, net	35,931	
Proceeds from sales of emission and exchange allowances	19,175	28,420
Purchases of emission allowances	(5,662)	(17,644)
Restricted cash	(57)	(3,835)
Other, net	1,500	1,435
Net cash used in continuing operations from investing activities	(64,077)	(94,554)
Net cash provided by (used in) discontinued operations from investing activities	299,004	(14,200)

Net cash provided by (used in) investing activities	234,927	(108,754)
Cash Flows from Financing Activities:		
Payments of long-term debt	(44,780)	(45,193)
Payments of debt extinguishments expenses		(423)
Proceeds from issuances of stock	2,309	5,769
Net cash used in continuing operations from financing activities	(42,471)	(39,847)
Net cash used in discontinued operations from financing activities	(225,300)	
Net cash used in financing activities	(267,771)	(39,847)
Net Change in Cash and Cash Equivalents, Total Operations	379,239	42,261
Less: Net Change in Cash and Cash Equivalents, Discontinued Operations	(103,359)	(325)
Cash and Cash Equivalents at Beginning of Period, Continuing Operations	1,004,367	524,070
Cash and Cash Equivalents at End of Period, Continuing Operations	$ 1,486,965	$ 566,656
Supplemental Disclosure of Cash Flow Information:		
Cash Payments:		
Interest paid (net of amounts capitalized) for continuing operations	$ 95,105	$ 104,797
Income taxes paid (net of income tax refunds) for continuing operations	3,582	(13,449)

See Notes to our Unaudited Consolidated Interim Financial Statements

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

(1) Background and Basis of Presentation

(a) Background.

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

On May 1, 2009, we sold our interests in the affiliates that operated our Texas retail business. In connection with this sale, we changed our name to RRI Energy, Inc. from Reliant Energy, Inc. effective May 2, 2009. See note 15.

(b) Basis of Presentation.

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

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

We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which we believe to be reasonable under the circumstances. We adjust such estimates and assumptions when facts and circumstances dictate. We have evaluated subsequent events for recording and disclosure to August 3, 2009, the date the interim financial statements were issued.

Adjustments and Reclassifications. The interim financial statements reflect all normal recurring adjustments necessary, in management s opinion, to present fairly our financial position and results of operations for the reported periods. Amounts reported for interim periods, however, may not be indicative of a full year period due to seasonal fluctuations in demand for electricity and energy services, changes in commodity prices, and changes in regulations, timing of maintenance and other expenditures, dispositions, changes in interest expense and other factors. We have reclassified certain amounts reported in these interim financial statements from prior periods to conform to the 2009 presentation. We reclassified amounts on our December 31, 2008 consolidated balance sheet relating primarily to continuing versus discontinued margin deposits, which increased our total assets and total liabilities by $93 million. These reclassifications had no impact on reported earnings/losses.

Deconsolidation of Channelview. On August 20, 2007, four of our wholly-owned subsidiaries, RRI Energy Channelview LP (Channelview LP), RRI Energy Channelview (Texas) LLC, RRI Energy Channelview (Delaware) LLC and RRI Energy Services Channelview LLC (collectively, Channelview), filed for reorganization under Chapter 11 of the Bankruptcy Code. As Channelview is currently subject to the supervision of the bankruptcy court, we deconsolidated Channelview s financial results beginning August 20, 2007 and began reporting our investment in Channelview using the cost method. The Channelview plant was sold on July 1, 2008. See note 14 for further discussion of Channelview.

Inventory. We value fuel inventories at the lower of average cost or market. We reduce these inventories as they are used in the production of electricity or sold. We recorded $35 million and $1 million during the three months ended June 30, 2009 and 2008, respectively, for lower of average cost or market adjustments in cost of sales and recorded $59 million and $1 million during the six months ended June 30, 2009 and 2008, respectively.

FASB Codification. The Financial Accounting Standards Board s (FASB) Accounting Standards Codification became effective for us in the third quarter of 2009. The Codification brings together in one place all authoritative GAAP and substantially retains existing GAAP. This change will not affect our consolidated financial statements.

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New Accounting Pronouncement Adopted Interim Disclosures about Fair Value of Financial Instruments. The FASB issued FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, which is effective for our June 30, 2009 interim financial statements. The FSP amends Statement of Financial Accounting Standards (SFAS) No. 107, Disclosures about Fair Value of Financial Instruments and requires us to provide information about the fair value of our financial instruments, including methods and significant assumptions used to estimate the fair value, in interim financial statements. See note 3.

New Accounting Pronouncement Adopted Fair Value Measurements. The FASB issued FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly, which is effective for our June 30, 2009 interim financial statements. The FSP provides guidance on how to determine the fair value of assets and liabilities under SFAS No. 157, Fair Value Measurements when there has been a significant decrease in the volume and level of activity for an asset or liability compared with normal market activity for the asset or liability. This FSP did not have a significant impact on our consolidated financial statements since the markets in which we purchase and sell commodities and derivative instruments are not distressed. See notes 3 and 4.

New Accounting Pronouncement Not Yet Adopted Disclosures about Plan Assets. The FASB issued FSP FAS 132(R)-1, Employer s Disclosures about Postretirement Benefit Plan Assets, which is effective for 2009. In addition to enhanced disclosures regarding investment policies and strategies, this FSP will require us to disclose in our 2009 Annual Report on Form 10-K information about fair value measurements of plan assets that would be similar to the disclosures about fair value measurements required by SFAS No. 157, Fair Value Measurements.

(2) Stock-based Compensation and Other Employee Matters

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in millions)			
Stock-based incentive plans compensation expense (pre-tax)(1)	$ 1	$ 4	$ 4	$ 8

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

During June 2009, the compensation committee of our board of directors granted 817,030 time-based restricted stock units and 817,030 time-based cash units to employees under our stock and incentive plans. The awards will vest in June 2012. No tax benefits related to stock-based compensation were realized during the three and six months ended June 30, 2009 and 2008 due to our net operating loss carryforwards.

Other Employee Matters. As of June 30, 2009, approximately 45% of our employees are subject to collective bargaining arrangements. Approximately 35% of our employees are subject to collective bargaining arrangements that will expire by June 30, 2010. We intend to negotiate the renewal of these agreements.

(3) Fair Value Measurements

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

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

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

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Level 3: This category includes our energy derivative instruments whose fair value is estimated based on internally developed models and methodologies utilizing significant inputs that are generally less readily observable from objective sources (such as implied volatilities and correlations). Our OTC, complex or structured derivative instruments that are transacted in less liquid markets with limited pricing information are included in Level 3. Examples are coal contracts, longer term natural gas contracts and options valued using implied or internally-developed inputs.

We value some of our OTC, complex or structured derivative instruments using valuation models, which utilize inputs that may not be corroborated by market data, such as market prices for power and fuel, price shapes, volatilities and correlations as well as other relevant factors. When such inputs are significant to the fair value measurement, the derivative assets or liabilities are classified as Level 3 when we do not have corroborating market evidence to support significant valuation model inputs and cannot verify the model to market transactions. We believe the transaction price is the best estimate of fair value at inception under the exit price methodology. Accordingly, when a pricing model is used to value such an instrument, the resulting value is adjusted so the model value at inception equals the transaction price. Valuation models are typically impacted by Level 1 or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Subsequent to initial recognition, we update Level 1 and Level 2 inputs to reflect observable market changes. Level 3 inputs are updated when corroborated by available market evidence. In the absence of such evidence, management s best estimate is used.

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

	June 30, 2009				
	Level 1	Level 2	Level 3 (in millions)	Reclassification	Total Fair Value
Total derivative assets	$ 172	$ 68	$ 1	$ (1)	$ 241
Total derivative liabilities	53	179	118	(1)	350
Other assets(2)	32				32

(1) Reclassifications are required to reconcile to our consolidated balance sheet presentation. Amounts are insignificant as of June 30, 2009.

(2) Includes $12 million in available-for-sale securities (shares in a public exchange) and $20 million in trading securities

(rabbi trust investments (which is comprised of mutual funds) associated with our non-qualified deferred compensation plans for key and highly compensated employees).

	December 31, 2008				
	Level 1	Level 2	Level 3 (in millions)	Reclassifications	Total Fair Value
Total derivative assets	$ 125	$ 111	$ 7	$ (3)[1]	$ 240
Total derivative liabilities	17	208	121	(3)[1]	343
Other assets[2]	29				29

(1) Reclassifications are required to reconcile to our consolidated balance sheet presentation.

(2) Includes $8 million in available-for-sale securities (shares in a public exchange) and $21 million in trading securities (rabbi trust investments (which is comprised of mutual funds) associated with our non-qualified deferred compensation plans for key and highly

compensated
employees).

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The fair values of cash and cash equivalents, accounts receivable and payable, margin deposits, available-for-sale securities, trading securities and derivative assets and liabilities approximate their carrying amounts. Values of our debt for continuing operations (see note 7) are:

	June 30, 2009		December 31, 2008	
	Carrying Value	Fair Value[1]	Carrying Value	Fair Value[1]
	(in millions)			
Fixed rate debt	$ 2,572	$ 2,421	$ 2,623	$ 2,168
Total debt	$ 2,572	$ 2,421	$ 2,623	$ 2,168

(1) We based the fair values of our fixed rate debt on market prices and quotes from an investment bank.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	Net Derivatives (Level 3)		Net Derivatives (Level 3)	
	(in millions)			
Balance, beginning of period	$ (153)	$ 85	$ (114)	$ 21
Total gains (losses) realized/unrealized:				
Included in earnings	(12)[1]	127[1]	(79)[1]	141[1]
Purchases, issuances and settlements (net)	48	(36)	76	14
Transfers in and/or out of Level 3 (net)	[2]	[3]	[4]	[5]
Balance, end of period	$ (117)	$ 176	$ (117)	$ 176
Changes in unrealized gains (losses) relating to derivative assets and liabilities still held at June 30, 2009 and 2008:				
Revenues	$	$ (2)	$ (2)	$ (1)
Cost of sales	(5)	124	(54)	102
Total	$ (5)	$ 122	$ (56)	$ 101

(1) Recorded in revenues and cost of sales.

(2) Represents fair value as of March 31, 2009.

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

(4) Represents fair value as of December 31, 2008.

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

See note 2(e) to our consolidated financial statements in our Form 10-K for additional information about fair value measurements.

(4) Derivative Instruments and Hedging Activities

We account for our derivative instruments and hedging activities in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS No. 133). Effective January 1, 2009, we adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161).

Changes in commodity prices prior to the energy delivery period are inherent in our business. However, we believe the benefits of generally hedging our generation assets do not justify the costs, including collateral postings. Accordingly, we may enter selective hedges, including originated transactions, based on our assessment of (a) operational and market limitations requiring us to enter into power, fuel, capacity and emissions transactions to manage our generation assets, (b) the near term economic environment and volatile commodity markets and the benefits of hedging some of the downside risk to our earnings and cash flows and (c) market fundamentals and the opportunity to increase the return from our generation assets. For our risk management activities, we use derivative and non-derivative contracts that provide for settlement in cash or by delivery of a commodity. We use derivative instruments such as futures, forwards, swaps and options to execute our wholesale hedge strategy. We may also enter into derivatives to manage our exposure to changes in prices of emission and exchange allowances.

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We account for our derivatives under one of three accounting methods (mark-to-market, accrual (under the normal purchase/normal sale exception to fair value accounting) or cash flow hedge accounting) based on facts and circumstances. The fair values of our derivative activities are determined by (a) prices actively quoted, (b) prices provided by other external sources or (c) prices based on models and other valuation methods. See note 5 for discussion on fair value measurements.

A derivative is recognized at fair value in the balance sheet whether or not it is designated as a hedge, except for derivative contracts designated as normal purchase/normal sale exceptions, which are not in our consolidated balance sheet or results of operations prior to settlement resulting in accrual accounting treatment.

Realized gains and losses on derivative contracts used for risk management purposes and not held for trading purposes are reported either on a net or gross basis based on the relevant facts and circumstances. Hedging transactions that do not physically flow are included in the same caption as the items being hedged.

A summary of our derivative activities and classification in our results of operations is:

ument	**Primary Risk Exposure**	**Purpose for Holding or Issuing Instrument[1]**	**Transactions that Physically Flow/Settle**	**Transactions Financially Se**
r futures, forward, swap and option contracts	Price risk	Power sales to customers	Revenues	Revenues
		Power purchases related to operations	Cost of sales	Revenues
		Power purchases/sales related to legacy trading and non-core asset management positions[3]	Revenues	Revenues
al gas and fuel futures, forward, swap and option contracts	Price risk	Natural gas and fuel sales related to operations	Revenues/Cost of sales	Cost of sales
		Natural gas sales related to power generation[4]	N/A[5]	Revenues
		Natural gas and fuel purchases related to operations	Cost of sales	Cost of sales
		Natural gas and fuel purchases/sales related to legacy trading and non-core asset management positions[3]	Cost of sales	Cost of sales
sion and exchange allowances futures[6]	Price risk	Purchases/sales of emission and exchange allowances	N/A[5]	Revenues/Cost sales

(1) The purpose for holding or issuing does not impact the accounting method elected

for each instrument.

(2) Includes classification for mark-to-market derivatives and amounts reclassified from accumulated other comprehensive income (loss) related to cash flow hedges.

(3) See discussion below regarding trading activities.

(4) Natural gas financial swaps and options transacted to economically hedge generation in the PJM region.

(5) N/A is not applicable.

(6) Includes emission and exchange allowances futures for sulfur dioxide (SO_2), nitrogen oxide (NO_X) and carbon dioxide (CO_2).

In addition to market risk, we are exposed to credit and operational risk. We have a risk control framework to manage these risks, which include: (a) measuring and monitoring these risks, (b) review and approval of new transactions relative to these risks, (c) transaction validation and (d) portfolio valuation and reporting. We use mark-to-market valuation, value-at-risk and other metrics in monitoring and measuring risk. Our risk control framework includes a variety of separate but complementary processes, which involve commercial and senior management and our Board of Directors. See note 5 for further discussion of our credit policy.

Earnings Volatility from Derivative Instruments. We procure natural gas, coal, oil, natural gas transportation and storage capacity and other energy-related commodities to support our business. Some types of transactions may cause us to experience volatility in our earnings due to natural gas inventory related to transportation and storage generally receiving accrual treatment while the related derivative instruments are marked to market through earnings.

Unrealized gains and losses on energy derivatives consist of both gains and losses on energy derivatives during the current reporting period for derivative assets or liabilities that have not settled as of the balance sheet date and the reversal of unrealized gains and losses from prior periods for derivative assets or liabilities that settled prior to the balance sheet date but during the current reporting period.

Cash Flow Hedges. If certain conditions are met, a derivative instrument may be designated as a cash flow hedge. Derivatives designated as cash flow hedges must have a high correlation between price movements in the derivative and the hedged item. The changes in fair value of cash flow hedges are deferred in accumulated other comprehensive income (loss), net of tax, to the extent the contracts are, or have been, effective as hedges, until the forecasted transactions affect earnings. At the time the forecasted transactions affect earnings, we reclassify the amounts in accumulated other comprehensive income (loss) into earnings. We record the ineffective portion of changes in fair value of cash flow hedges immediately into earnings. For all other derivatives, changes in fair value are recorded as unrealized gains or losses in our results of operations.

If and when an acceptable level of correlation no longer exists, hedge accounting ceases and changes in fair value are recognized in our results of operations. If it becomes probable that a forecasted transaction will not occur, we immediately recognize the related deferred gains or losses in our results of operations. The associated hedging instrument is then marked to market through our results of operations for the remainder of the contract term unless a new hedging relationship is redesignated.

Over the past several years, we have substantially decreased derivatives accounted for as cash flow hedges, in favor of utilizing the mark-to-market method of accounting or the normal purchase/normal sale exception for these derivatives. During the first quarter of 2007, we de-designated our remaining cash flow hedges; therefore, as of June 30, 2009 and December 31, 2008, we do not have any designated cash flow hedges.

Presentation of Derivative Assets and Liabilities. We present our derivative assets and liabilities on a gross basis (regardless of master netting arrangements with the same counterparty). Cash collateral amounts are also presented on a gross basis.

As of June 30, 2009, our commodity derivative assets and liabilities include amounts for non-trading and trading activities as follows:

	Derivative Assets		Derivative Liabilities		Net Derivative Assets
	Current	Long-Term	Current	Long-Term	(Liabilities)
			(in millions)		
Non-trading	$ 95	$ 64	$ (194)	$ (102)	$ (137)
Trading	62	20	(41)	(13)	28
Total derivatives	$ 157	$ 84	$ (235)	$ (115)	$ (109)

We have the following derivative commodity contracts outstanding as of June 30, 2009:

		Notional Volumes	
Commodity	Unit	Current	Long-term
		(in millions)	
Power	MWh[(1)]	(3)[(2)]	(5)[(2)]
Natural gas	MMBTU[(3)]	7	25
Natural gas basis	MMBTU[(3)]		1
Coal	MMBTU[(3)]	109	235

(1) MWh is megawatt hours.

(2) Negative amounts indicate net forward sales.

(3) MMBTU is million British thermal units.

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The income (loss) associated with our energy derivatives is:

Derivatives Not Designated as Hedging Instruments Under SFAS No. 133[(1)]	**Three Months Ended June 30, 2009**	
	Revenues	**Cost of Sales**
	(in millions)	
Non-Trading Commodity Contracts:		
Unrealized[(2)]	$ (22)	$ 31
Realized[(3)(4)(5)]	81	(66)
Total non-trading	$ 59	$ (35)
Trading Commodity Contracts:		
Unrealized	$	$ (2)
Realized[(3)]		1
Total trading	$	$ (1)

Derivatives Not Designated as Hedging Instruments Under SFAS No. 133[(1)]	**Six Months Ended June 30, 2009**	
	Revenues	**Cost of Sales**
	(in millions)	
Non-Trading Commodity Contracts:		
Unrealized[(2)]	$ (26)	$ (9)
Realized[(3)(4)(5)]	187	(74)
Total non-trading	$ 161	$ (83)
Trading Commodity Contracts:		
Unrealized	$	$ (2)
Realized[(3)]		20
Total trading	$	$ 18

(1) Interest rate swap instruments were liquidated in 2002 and the related deferred losses in accumulated other

comprehensive loss are being amortized into interest expense through 2012. An immaterial amount was amortized during the three and six months ended June 30, 2009 and 2008, which was included in interest expense under other operations.

(2) During 2007, we de-designated our remaining cash flow hedges. During the three and six months ended June 30, 2009, previously measured ineffectiveness gains (losses) reversing due to settlement of the derivative contracts was insignificant.

(3) Does not include realized gains or losses associated with cash month transactions, non-derivative transactions or derivative transactions that qualify for the normal purchase/normal sale exception.

(4) Excludes settlement value of fuel contracts

classified as inventory upon settlement.

(5) Includes gains or losses from de-designated cash flow hedges reclassified from accumulated other comprehensive loss due to settlement of the derivative contracts. See note 6.

As of June 30, 2009 and December 31, 2008, we do not have any designated cash flow hedges. Amounts included in accumulated other comprehensive loss are:

	June 30, 2009	
	At the End of the Period	Expected to be Reclassified into Results of Operations in Next 12 Months
	(in millions)	
De-designated cash flow hedges[(1)(2)(3)]	$ 41	$ 15

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

(2) During the three and six months ended June 30, 2008, previously measured ineffectiveness gains (losses) in revenues of $1 million and

$0, respectively, reversed due to settlement of the derivative contracts.

(3) During the three and six months ended June 30, 2009 and 2008, $0 was recognized in our results of operations as a result of the discontinuance of cash flow hedges because it was probable that the forecasted transaction would not occur.

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Trading Activities. Prior to March 2003, we engaged in proprietary trading activities. Trading positions entered into prior to our decision to exit this business are being closed on economical terms or are being retained and settled over the contract terms. In addition, we have current transactions relating to non-core asset management, such as gas storage and transportation contracts not tied to generation assets, which are classified as trading activities. The income (loss) associated with these transactions is:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in millions)			
Revenues	$	$	$	$
Cost of sales	5	(13)	16	(17)
Total[(1)]	$ 5	$ (13)	$ 16	$ (17)

(1) Includes realized and unrealized gains and losses on both derivative instruments and non-derivative instruments.

(5) Credit Risk

We have a credit policy that governs the management of credit risk, including the establishment of counterparty credit limits and specific transaction approvals. Credit risk is monitored daily and the financial condition of our counterparties is reviewed periodically. We try to mitigate credit risk by entering into contracts that permit netting and allow us to terminate upon the occurrence of certain events of default. We measure credit risk as the replacement cost for our derivative positions plus amounts owed for settled transactions.

Our credit exposure is based on our derivative assets and accounts receivable from our wholesale energy counterparties, after taking into consideration netting within each contract and any master netting contracts with counterparties. We believe this represents the maximum potential loss we would incur if our counterparties failed to perform according to their contract terms. In determining the fair value of our derivative assets, we include assumptions for counterparty non-performance risk. See note 3 above and note 2(e) to our consolidated financial statements in our Form 10-K for additional information about fair value measurements. Additionally, we provide an allowance for doubtful accounts for outstanding receivable balances.

As of June 30, 2009, our derivative assets and accounts receivable from our wholesale energy counterparties, after taking into consideration netting within each contract and any master netting contracts with counterparties, are:

Credit Rating Equivalent	Exposure Before Collateral[(1)(2)]	Credit Collateral Held[(3)]	Exposure Net of Collateral	Number of Counterparties >10%	Net Exposure of Counterparties >10%
			(dollars in millions)		

Investment grade	$	224	$	45	$	179		2(4)	$	145
Non-investment grade		2				2				
No external ratings:										
Internally rated Investment grade		66				66		1(5)		65
Internally rated Non-investment grade		7		6		1				
Total	$	299	$	51	$	248		3	$	210

(1) The table includes amounts related to certain contracts classified as discontinued operations in our consolidated balance sheets. These contracts settle through the expiration date in 2010.

(2) The table excludes amounts related to contracts classified as normal purchase/normal sale and non-derivative contractual commitments that are not recorded in our consolidated balance sheets, except for any related accounts receivable. Such contractual commitments contain credit and economic risk if a counterparty

does not perform. Nonperformance could have a material adverse impact on our future results of operations, financial condition and cash flows.

(3) Collateral consists of cash, standby letters of credit and other forms approved by management.

(4) These counterparties are a power grid operator and an energy merchant.

(5) This counterparty is a financial institution.

As of December 31, 2008, three investment grade counterparties (a financial institution and two power grid operators) represented 63% ($156 million) of our credit exposure.

Based on our current credit ratings, any additional collateral postings that would be required from us due to a credit downgrade would be immaterial. As of June 30, 2009 and December 31, 2008, we have posted cash margin deposits of $122 million and $70 million, respectively, as collateral for our derivative liabilities receiving mark-to-market accounting treatment and our accounts payable (classified either as continuing or discontinued operations). Additionally, as of June 30, 2009 and December 31, 2008, we have $95 million and $103 million, respectively, in letters of credit issued as collateral for our derivative liabilities receiving mark-to-market accounting treatment and our accounts payable (classified either as continuing or discontinued operations). See note 7.

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(6) Comprehensive Income

The components of total comprehensive income are:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in millions)			
Net income	$ 803	$ 359	$ 652	$ 736
Other comprehensive income, net of tax:				
Reclassification of net deferred loss from cash flow hedges realized into net income/loss (net of tax)	3	6	8	16
Unrealized gain on available-for-sale securities (net of tax)[1]	2		3	
Reclassification of benefits actuarial net loss into net income/loss (net of tax)	1		1	
Comprehensive income	$ 809	$ 365	$ 664	$ 752

(1) As of June 30, 2009 and December 31, 2008, $12 million and $8 million, respectively, of unrealized net gains (excluding taxes) are included in accumulated other comprehensive loss for available-for-sale securities.

(7) Debt

	June 30, 2009			December 31, 2008		
	Weighted Average Stated Interest Rate[1]	Long-term	Current	Weighted Average Stated Interest Rate[1]	Long-term	Current
	(in millions, except interest rates)					

Facilities, Bonds and Notes:						
RRI Energy:						
Senior secured revolver due 2012	2.35%	$	$	3.18%	$	$
Senior secured notes due 2014[2][3]	6.75	453		6.75	498	
Senior unsecured notes due 2014	7.625	575		7.625	575	
Senior unsecured notes due 2017	7.875	725		7.875	725	
Subsidiary Obligations:						
Orion Power Holdings, Inc. senior notes due 2010 (unsecured)	12.00		400	12.00	400	
PEDFA[4] fixed-rate bonds due 2036[5]	6.75	408		6.75	408	
Total facilities, bonds and notes		2,161	400		2,606	
Other:						
Adjustment to fair value of debt[6]			11		4	13
Total other debt			11		4	13
Total debt[7]		$ 2,161	$ 411		$ 2,610	$ 13

(1) The weighted average stated interest rates are as of June 30, 2009 or December 31, 2008.

(2) We repurchased $45 million during the three months ended June 30, 2009. See note 15.

(3) Excludes $22 million and $169 million classified as discontinued operations as of

June 30, 2009 and December 31, 2008, respectively. See note 15.

(4) PEDFA is the Pennsylvania Economic Development Financing Authority. These bonds were issued for our Seward plant.

(5) Excludes $14 million and $92 million classified as discontinued operations as of June 30, 2009 and December 31, 2008, respectively. See note 15.

(6) Debt acquired in the Orion Power acquisition was adjusted to fair value as of the acquisition date. Included in interest expense is amortization of $3 million and $3 million for valuation adjustments for debt during the three months ended June 30, 2009 and 2008, respectively, and $6 million and $6 million

during the six months ended June 30, 2009 and 2008, respectively.

(7) Excludes $36 million and $261 million classified as discontinued operations as of June 30, 2009 and December 31, 2008, respectively. See note 15.

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Amounts borrowed and available for borrowing under our revolving credit agreements as of June 30, 2009 are:

	Total Committed Credit	Drawn Amount	Letters of Credit	Unused Amount
		(in millions)		
RRI Energy senior secured revolver due 2012	$ 500	$	$ 39	$ 461
RRI Energy letter of credit facility due 2014	250		250	
Total	$ 750	$	$ 289	$ 461

(8) Earnings (Loss) Per Share

The amounts used in the basic and diluted earnings (loss) per common share computations are the same.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
		(in millions)		
Income (loss) from continuing operations (basic and diluted)	$ (103)	$ 82	$ (209)	$ 95

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
		(shares in thousands)		
Diluted Weighted Average Shares Calculation:				
Weighted average shares outstanding (basic)	350,665	346,616	350,577	346,017
Plus: Incremental shares from assumed conversions:				
Stock options	(1)	4,317	(1)	4,285
Restricted stock	(1)	575	(1)	559
Employee stock purchase plan	(1)	47	(1)	23
5.00% convertible senior subordinated notes	N/A(2)	18	N/A(2)	115
Warrants	N/A(3)	2,481	N/A(3)	3,079
Weighted average shares outstanding assuming conversion (diluted)	350,665	354,054	350,577	354,078

(1) As we incurred a loss from continuing operations for this period,

diluted loss per share is calculated the same as basic loss per share.

(2) In December 2006, we converted 99.2% of our convertible senior subordinated notes to common stock. During 2008, the remaining outstanding notes were converted to common stock.

(3) All unexercised warrants expired in August 2008.

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

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2009	**2008**	**2009**	**2008**
	(shares in thousands, dollars in millions)			
Shares excluded from the calculation of diluted earnings (loss) per share	438(1)	N/A(2)	442(1)	N/A(2)
Shares excluded from the calculation of diluted earnings (loss) per share because the exercise price exceeded the average market price	6,217(3)	1,833(3)	7,086(3)	1,849(3)

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

(2) Not applicable as we included the item in the

calculation of diluted earnings/loss per share.

(3) Includes stock options.

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(9) Income Taxes

(a) Tax Rate Reconciliation.

A reconciliation of the federal statutory income tax rate to the effective income tax rate for our continuing operations is:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Federal statutory rate	(35)%	35%	(35)%	35%
Additions (reductions) resulting from:				
Federal valuation allowance	(8)			
State income taxes, net of federal income taxes	(1)[1]	5[2]	(1)[3]	6[4]
Other		3		2
Effective rate	(44)%	43%	(36)%	43%

(1) Of this percentage, $9 million relates to additional valuation allowance.

(2) Of this percentage, $3 million relates to additional valuation allowance.

(3) Of this percentage, $15 million relates to additional valuation allowance.

(4) Of this percentage, $4 million relates to additional valuation

allowance.

(b) Tax Attributes Carryovers.

Our tax attributes carryovers were substantially not affected by the Texas retail sale to the subsidiary of NRG Energy, Inc. See note 15.

(c) Valuation Allowances.

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

Our valuation allowances for continuing deferred tax assets are:

	Federal	State	Capital, Foreign and Other, Net
		(in millions)	
As of December 31, 2008	$ 49	$ 103	$ 14
Changes in valuation allowance	16	6	
As of March 31, 2009	65	109	14
Changes in valuation allowance	(16)	9	1
As of June 30, 2009	$ 49	$ 118	$ 15

(d) FIN 48 and Income Tax Uncertainties.

We may only recognize the tax benefit for financial reporting purposes from an uncertain tax position when it is more-likely-than-not that, based on the technical merits, the position will be sustained by taxing authorities or the courts. The recognized tax benefits are measured as the largest benefit having a greater than fifty percent likelihood of being realized upon settlement with a taxing authority. We classify accrued interest and penalties related to uncertain income tax positions in income tax expense/benefit.

Our unrecognized federal and state tax benefits did not change significantly during the three and six months ended June 30, 2009 and 2008.

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

- $177 million payment to CenterPoint during 2004 related to our residential customers;
- $351 million charge during 2005 to settle certain civil litigation and claims relating to the Western states energy crisis; and
- the timing of tax deductions as a result of negotiations with respect to California-related revenue, depreciation, emission allowances and certain employee benefits.

We are in ongoing discussions with the Internal Revenue Service (IRS) regarding the timing of revenue recognition and tax deductions with respect to certain California-related items in our 2002 short taxable period return (subsequent to our separation from CenterPoint Energy, Inc.). The IRS has informed us it expects to issue a notice of denial of our administrative claim for refund involving these California-related items and we expect to institute refund litigation with respect to this claim in the U.S. District Court or U.S. Court of Federal Claims. In order to set a jurisdictional prerequisite to institute such a refund suit, we expect to make a payment of approximately $60 million to $65 million (which includes an asserted tax liability of $38 million plus interest) some time during 2009. If the IRS were to ultimately prevail in this matter, there would be no impact on the effective tax rate except for interest. The payment is refundable with interest if we are successful in the litigation.

(10) Guarantees and Indemnifications

We have guaranteed some non-qualified benefits of CenterPoint s existing retirees at September 20, 2002. The estimated maximum potential amount of future payments under the guarantee is approximately $53 million as of June 30, 2009 and no liability is recorded in our consolidated balance sheet for this item.

We also guarantee the $500 million PEDFA bonds, which are included in our consolidated balance sheet as either outstanding debt or liabilities of discontinued operations ($422 million and $500 million are in our consolidated balance sheet as of June 30, 2009 and December 31, 2008, respectively). Our guarantees are secured by the same collateral as our 6.75% senior secured notes. The guarantees require us to comply with covenants similar to those in the 6.75% senior secured notes indenture. The PEDFA bonds will become secured by certain assets of our Seward power plant if the collateral supporting both the 6.75% senior secured notes and our guarantees are released. Our maximum potential obligation under the guarantees is for payment of the principal of $500 million and related interest charges at a fixed rate of 6.75%. During June and July 2009, we purchased $78 million and $14 million, respectively, of the PEDFA bonds and are the holder of these repurchased bonds. Therefore, the net amount payable by us would not exceed the amount of PEDFA bonds outstanding, excluding the PEDFA bonds we hold.

We have guaranteed payments to a third party relating to energy sales from El Dorado Energy, LLC, a former investment. The estimated maximum potential amount of future payments under this guarantee is approximately $21 million as of June 30, 2009 and no liability is recorded in our consolidated balance sheet for this item.

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

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

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

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(11) Contingencies

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

(a) Pending Natural Gas Litigation.

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

We are party to 13 lawsuits, several of which are class action lawsuits, in state and federal courts in California, Kansas, Missouri, Nevada, Tennessee and Wisconsin. These lawsuits relate to alleged conduct to increase natural gas prices in violation of antitrust and similar laws. The lawsuits seek treble or punitive damages, restitution and/or expenses. The lawsuits also name a number of unaffiliated energy companies as parties.

Recent developments in these cases include:

In January 2009, we reached an agreement to settle the five California-related cases pending in federal court in Nevada. The settlement is subject to approval of the court. The charges anticipated to be incurred in connection with the settlement were expensed in the third quarter of 2008. This settlement will resolve all of the remaining California gas cases.

In January 2009, the Circuit Court of Jackson County, Missouri dismissed the case filed by the Missouri Public Service Commission for lack of standing to bring the action. An appeal was filed in February 2009.

(b) Merrill Lynch Action.

In December 2008, we terminated our $300 million retail working capital facility agreement with Merrill Lynch in order to address any issue that might be asserted regarding the minimum adjusted retail EBITDA covenant in that facility. On December 24, 2008, Merrill Lynch filed an action in the Supreme Court of the State of New York seeking a judgment declaring that under our credit sleeve and reimbursement agreement (the agreement), we did not have the right to terminate the working capital facility without their consent and that such termination is an event of default under the agreement. On May 1, 2009, we and Merrill Lynch filed to dismiss this lawsuit and the agreement was transferred in connection with the closing of the sale of our Texas retail business. The Court granted an order dismissing the action with prejudice on May 4, 2009. See note 15.

(c) Environmental Matters.

New Source Review Matters. The United States Environmental Protection Agency (EPA) and various states are investigating compliance of coal-fueled electric generating stations with the pre-construction permitting requirements of the Clean Air Act known as New Source Review. In 2000 and 2001, we responded to the EPA s information requests related to five of our stations, and in December 2007, we received supplemental requests for two of those stations. In September 2008, we received an EPA request for information related to two additional stations. The EPA agreed to share information relating to its investigations with state environmental agencies. In January 2009, we received a Notice of Violation (NOV) from the EPA alleging that past work at our Shawville, Portland and Keystone generation facilities violated the agency s regulations regarding New Source Review. We believe that the projects listed by the EPA were conducted in compliance with applicable regulations.

In December 2007, the New Jersey Department of Environmental Protection (NJDEP) filed suit against us in the United States District Court in Pennsylvania, alleging that New Source Review violations occurred at one of our power plants located in Pennsylvania. The suit seeks installation of best available control technologies for each pollutant, to enjoin us from operating the plant if it is not in compliance with the Clean Air Act and civil penalties. The suit also names three past owners of the plant as defendants. In March 2009, the Connecticut Department of Environmental Protection became an intervening party to the suit.

We are unable to predict the ultimate outcome of the EPA s NOV or the NJDEP s suit, but a final finding that we violated the New Source Review requirements could result in significant capital expenditures associated with the implementation of emissions reductions on an accelerated basis and possible penalties. Most of these work projects were undertaken before our ownership of those facilities. We believe we are indemnified by or have the right to seek indemnification from the prior owners for certain losses and expenses that we may incur from activities occurring prior to our ownership.

Ash Disposal Landfill Closures. We are responsible for environmental costs related to the future closures of seven ash disposal landfills. We recorded the estimated discounted costs ($12 million as of June 30, 2009 and December 31, 2008) associated with these environmental liabilities as part of our asset retirement obligations. See note 2(q) to our consolidated financial statements in our Form 10-K.

Remediation Obligations. We are responsible for environmental costs related to site contamination investigations and remediation requirements at four power plants in New Jersey. We recorded the estimated long-term liability for the remediation costs of $8 million as of June 30, 2009 and December 31, 2008.

Conemaugh Action. In April 2007, PennEnvironment and the Sierra Club filed a citizens suit against us in the United States District Court, Western District of Pennsylvania to enforce provisions of the water discharge permit for the Conemaugh plant, of which we are the operator and have a 16.45% interest. PennEnvironment and the Sierra Club seek civil penalties, remediation and an injunction against further violations. We are confident that the Conemaugh plant has operated and will continue to operate in material compliance with its water discharge permit, its consent order agreement with the Pennsylvania Department of Environmental Protection, and related state and federal laws. However, if PennEnvironment and the Sierra Club are successful, we could incur additional capital expenditures associated with the implementation of discharge reductions and penalties, which we do not believe would be material.

Mandalay Notice of Violation. In November 2008, the California State Water Resources Control Board Los Angeles Region proposed a settlement payment in the amount of $192,000 relating to alleged violations of our wastewater discharge permit for our Mandalay plant. We are reviewing the Board s proposal and we believe that there are reasonable grounds for reduction of the amount of the settlement proposed by the Board.

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

(d) Other.

Excess Mitigation Credits. From January 2002 to April 2005, CenterPoint applied excess mitigation credits (EMCs) to its monthly charges to retail energy providers. The PUCT imposed these credits to facilitate the transition to competition in Texas, which had the effect of lowering the retail energy providers monthly charges payable to CenterPoint. CenterPoint represents that the portion of those EMCs credited to our Texas retail business totaled $385 million. In its stranded cost case, CenterPoint sought recovery of all EMCs credited to all retail electric providers, including our Texas retail business, and the PUCT ordered that relief. On appeal, the Texas Third Court of Appeals ruled that CenterPoint s stranded cost recovery should exclude EMCs credited to our Texas retail business for price-to-beat customers. The case is now before the Texas Supreme Court. In November 2008, CenterPoint asked us to agree to suspend any limitations periods that might exist for possible claims against us or our Texas retail business if it is ultimately not allowed to include in its stranded cost calculation EMCs credited to our Texas retail business. We agreed to suspend only unexpired deadlines, if any, that may apply to a CenterPoint claim relating to EMCs credited to our Texas retail business. Regardless of the outcome of the Texas Supreme Court proceeding, we believe that any claim by CenterPoint that we are liable to it for any EMCs credited to our Texas retail business lacks legal merit and is unsupported by our Master Separation Agreement with CenterPoint. In addition, CenterPoint has publicly stated that it has no legal recourse against us or our Texas retail business for any reduction in the amount of its recoverable stranded costs should EMCs credited to our Texas retail business be excluded.

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

Texas Franchise Audit. The state of Texas has issued assessment orders indicating an estimated tax liability of approximately $58 million (including interest and penalties of $20 million) relating primarily to the sourcing of receipts for 2000 through 2005. We are contesting the audit assessments related to this issue.

Sales Tax Contingencies. Some of our sales tax computations are subject to challenge under audit. As of June 30, 2009 and December 31, 2008, we have $13 million accrued in current and long-term liabilities relating to these contingencies.

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Refund Contingency Related to Transportation Rates. In September 2008, Kern River Gas Transmission Company (Kern), a natural gas pipeline company, and certain of its shippers entered into a settlement agreement to which we were a party. The agreement set Kern s transportation rates as of November 2004 at 12.5% return on equity, which resulted in a refund to us of $30 million during the fourth quarter of 2008 (recorded as a current liability). In January 2009, FERC rejected the settlement and directed Kern to recalculate the refunds based on a rate of 11.55% return on equity. Accordingly, we expect to receive an additional approximately $4 million in 2009. If the settlement is appealed, that amount may be subject to adjustment on resolution of the appeal.

(12) Supplemental Guarantor Information

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

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Condensed Consolidating Statements of Operations.

	Three Months Ended June 30, 2009				
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments (1)	Consolidated
Revenues	$	$ 385	$ 186	$ (181)	$ 390
Cost of sales		318	142	(179)	281
Operation and maintenance		47	112	(2)	157
General and administrative		1	27		28
Gains on sales of assets and emission and exchange allowances, net		(2)			(2)
Depreciation and amortization		32	35		67
Total		396	316	(181)	531
Operating loss		(11)	(130)		(141)
Loss of equity investment, net		(1)			(1)
Loss of equity investments of consolidated subsidiaries	(70)	(37)		107	
Debt extinguishments gain	1				1
Interest expense	(36)	(7)	(2)		(45)
Interest income	1				1
Interest income (expense) affiliated companies, net	18	(3)	(15)		
Total other expense	(86)	(48)	(17)	107	(44)
Loss from continuing operations before income taxes	(86)	(59)	(147)	107	(185)
Income tax benefit	(18)	(11)	(54)	1	(82)
Loss from continuing operations	(68)	(48)	(93)	106	(103)
Income (loss) from discontinued operations	871	(2)	37		906
Net income (loss)	$ 803	$ (50)	$ (56)	$ 106	$ 803

	Three Months Ended June 30, 2008				
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments (1)	Consolidated

Revenues	$	$ 990	$ 415	$ (391)	$ 1,014
Cost of sales		825	132	(388)	569
Operation and maintenance		51	116	(2)	165
General and administrative		6	28	(1)	33
Gains on sales of assets and emission and exchange allowances, net		(20)	(2)		(22)
Depreciation and amortization		33	50		83
Total		895	324	(391)	828
Operating income		95	91		186
Income of equity investment, net		1			1
Income of equity investments of consolidated subsidiaries	353	35		(388)	
Interest expense	(38)	(7)	(6)		(51)
Interest income	4	4			8
Interest income (expense) affiliated companies, net	44	(28)	(16)		
Total other income (expense)	363	5	(22)	(388)	(42)
Income from continuing operations before income taxes	363	100	69	(388)	144
Income tax expense	4	27	28	3	62
Income from continuing operations	359	73	41	(391)	82
Income (loss) from discontinued operations		(15)	291	1	277
Net income	$ 359	$ 58	$ 332	$ (390)	$ 359

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	Six Months Ended June 30, 2009				
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments (1)	Consolidated
Revenues	$	$ 836	$ 443	$ (423)	$ 856
Cost of sales		660	365	(420)	605
Operation and maintenance		109	208	(3)	314
General and administrative		4	53		57
Gains on sales of assets and emission and exchange allowances, net		(17)	(3)		(20)
Depreciation and amortization		64	71		135
Total		820	694	(423)	1,091
Operating income (loss)		16	(251)		(235)
Loss of equity investments of consolidated subsidiaries	(177)	(59)		236	
Debt extinguishments gain	1				1
Interest expense	(74)	(14)	(4)		(92)
Interest income	1				1
Interest income (expense) affiliated companies, net	35	(6)	(29)		
Total other expense	(214)	(79)	(33)	236	(90)
Loss from continuing operations before income taxes	(214)	(63)	(284)	236	(325)
Income tax benefit	(11)	(2)	(106)	3	(116)
Loss from continuing operations	(203)	(61)	(178)	233	(209)
Income (loss) from discontinued operations	855	7	(1)		861
Net income (loss)	$ 652	$ (54)	$ (179)	$ 233	$ 652

	Six Months Ended June 30, 2008				
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments (1)	Consolidated
Revenues	$	$ 1,851	$ 832	$ (789)	$ 1,894

Cost of sales		1,597	266	(785)	1,078
Operation and maintenance		112	211	(2)	321
General and administrative		13	51	(2)	62
Western states litigation and similar settlements	34				34
Gains on sales of assets and emission and exchange allowances, net		(21)	(2)		(23)
Depreciation and amortization		69	97		166
Total	34	1,770	623	(789)	1,638
Operating income (loss)	(34)	81	209		256
Income of equity investment, net		1			1
Income of equity investments of consolidated subsidiaries	739	79		(818)	
Debt extinguishment loss	(1)				(1)
Interest expense	(76)	(14)	(12)		(102)
Interest income	10	4			14
Interest income (expense) affiliated companies, net	98	(65)	(33)		
Total other income (expense)	770	5	(45)	(818)	(88)
Income from continuing operations before income taxes	736	86	164	(818)	168
Income tax expense (benefit)	(1)	8	66		73
Income from continuing operations	737	78	98	(818)	95
Income (loss) from discontinued operations	(1)	(16)	661	(3)	641
Net income	$ 736	$ 62	$ 759	$ (821)	$ 736

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

subsidiary levels
compared to the
consolidated level.

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Condensed Consolidating Balance Sheets.

	June 30, 2009				
	RRI Energy	Guarantors	Non-Guarantors	Adjustments (1)	Consolidated
			(in millions)		
ASSETS					
Current Assets:					
Cash and cash equivalents	$ 1,477	$ 1	$ 9	$	$ 1,487
Restricted cash			3		3
Accounts and notes receivable, principally customer	8	110	17	(8)	127
Accounts and notes receivable affiliated companies	983	310	148	(1,441)	
Inventory		141	163		304
Derivative assets		123	34		157
Investment in and receivables from Channelview, net	1	24			25
Other current assets	72	34	97	(81)	122
Current assets of discontinued operations	135	262	5	(130)	272
Total current assets	2,676	1,005	476	(1,660)	2,497
Property, Plant and Equipment, net		2,304	2,484		4,788
Other Assets:					
Other intangibles, net		114	260		374
Notes receivable affiliated companies	2,383	604	1	(2,988)	
Equity investments of consolidated subsidiaries	1,787	273		(2,060)	
Derivative assets		61	23		84
Other long-term assets	42	800	348	(687)	503
Long-term assets of discontinued operations		25	1		26
Total other assets	4,212	1,877	633	(5,735)	987
Total Assets	$ 6,888	$ 5,186	$ 3,593	$ (7,395)	$ 8,272
LIABILITIES AND EQUITY					
Current Liabilities:					
Current portion of long-term debt and short-term borrowings	$	$	$ 411	$	$ 411

Accounts payable, principally trade		22	117	(2)	137
Accounts and notes payable affiliated companies		1,117	324	(1,441)	
Derivative liabilities		62	173		235
Other current liabilities	79	244	35	(123)	235
Current liabilities of discontinued operations	48	258	11	(130)	187
Total current liabilities	127	1,703	1,071	(1,696)	1,205
Other Liabilities:					
Notes payable affiliated companies		2,227	761	(2,988)	
Derivative liabilities		19	96		115
Other long-term liabilities	549	147	257	(648)	305
Long-term liabilities of discontinued operations	3	23	4		30
Total other liabilities	552	2,416	1,118	(3,636)	450
Long-term Debt	1,753	408			2,161
Commitments and Contingencies					
Temporary Equity Stock-based Compensation	5				5
Total Stockholders Equity	4,451	659	1,404	(2,063)	4,451
Total Liabilities and Equity	$ 6,888	$ 5,186	$ 3,593	$ (7,395)	$ 8,272

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	December 31, 2008				
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments (1)	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	$ 970	$	$ 34	$	$ 1,004
Restricted cash		1	2		3
Accounts and notes receivable, principally customer	15	216	33	(14)	250
Accounts and notes receivable affiliated companies	1,100	268	183	(1,551)	
Inventory		153	162		315
Derivative assets		127	34		161
Investment in and receivables from Channelview, net	1	58			59
Other current assets	5	56	126	(30)	157
Current assets of discontinued operations	272	211	2,661	(638)	2,506
Total current assets	2,363	1,090	3,235	(2,233)	4,455
Property, Plant and Equipment, net		2,369	2,451		4,820
Other Assets:					
Other intangibles, net		150	264	(34)	380
Notes receivable affiliated companies	2,260	578	54	(2,892)	
Equity investments of consolidated subsidiaries	1,731	332		(2,063)	
Derivative assets		37	42		79
Other long-term assets	45	749	344	(645)	493
Long-term assets of discontinued operations	2	12	686	(205)	495
Total other assets	4,038	1,858	1,390	(5,839)	1,447
Total Assets	$ 6,401	$ 5,317	$ 7,076	$ (8,072)	$ 10,722
LIABILITIES AND EQUITY					
Current Liabilities:					
Current portion of long-term debt and short-term borrowings	$	$	$ 13	$	$ 13
		31	132	(6)	157

Accounts payable, principally trade										
Accounts and notes payable affiliated companies				1,307		244		(1,551)		
Derivative liabilities				29		173				202
Other current liabilities		10		306		47		(72)		291
Current liabilities of discontinued operations		61		147		2,805		(637)		2,376
Total current liabilities		71		1,820		3,414		(2,266)		3,039
Other Liabilities:										
Notes payable affiliated companies				2,132		760		(2,892)		
Derivative liabilities				4		137				141
Other long-term liabilities		547		119		251		(645)		272
Long-term liabilities of discontinued operations		198		103		778		(206)		873
Total other liabilities		745		2,358		1,926		(3,743)		1,286
Long-term Debt		1,798		408		404				2,610
Commitments and Contingencies										
Temporary Equity Stock-based Compensation		9								9
Total Stockholders Equity		3,778		731		1,332		(2,063)		3,778
Total Liabilities and Equity	$	6,401	$	5,317	$	7,076	$	(8,072)	$	10,722

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

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Condensed Consolidating Statements of Cash Flows.

	Six Months Ended June 30, 2009				
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments(1)	Consolidated
Cash Flows from Operating Activities:					
Net cash provided by (used in) continuing operations from operating activities	$ (75)	$ 88	$ (109)	$	$ (96)
Net cash provided by discontinued operations from operating activities	135	22	351		508
Net cash provided by operating activities	60	110	242		412
Cash Flows from Investing Activities:					
Capital expenditures		(11)	(104)		(115)
Investments in, advances to and from and distributions from subsidiaries, net(2)	(64)			64	
Proceeds from sales of assets, net		36			36
Proceeds from sales (purchases) of emission allowances		46	(32)		14
Other, net		1			1
Net cash provided by (used in) continuing operations from investing activities	(64)	72	(136)	64	(64)
Net cash provided by (used in) discontinued operations from investing activities	701	4	(418)	12	299
Net cash provided by (used in) investing activities	637	76	(554)	76	235
Cash Flows from Financing Activities:					
Payments of long-term debt	(45)				(45)
Changes in notes with affiliated companies, net(3)		(122)	186	(64)	
Proceeds from issuances of stock	2				2
Net cash provided by (used in) continuing operations from financing activities	(43)	(122)	186	(64)	(43)

Net cash used in discontinued operations from financing activities	(147)	(63)	(3)	(12)	(225)
Net cash provided by (used in) financing activities	(190)	(185)	183	(76)	(268)
Net Change in Cash and Cash Equivalents, Total Operations	507	1	(129)		379
Less: Net Change in Cash and Cash Equivalents, Discontinued Operations			(104)		(104)
Cash and Cash Equivalents at Beginning of Period, Continuing Operations	970		34		1,004
Cash and Cash Equivalents at End of Period, Continuing Operations	$ 1,477	$ 1	$ 9	$	$ 1,487

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	Six Months Ended June 30, 2008				
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments[1]	Consolidated
Cash Flows from Operating Activities:					
Net cash provided by (used in) continuing operations from operating activities	$ 43	$ (172)	$ 217	$	$ 88
Net cash provided by (used in) discontinued operations from operating activities	(4)	39	68		103
Net cash provided by (used in) operating activities	39	(133)	285		191
Cash Flows from Investing Activities:					
Capital expenditures		(13)	(90)		(103)
Investments in, advances to and from and distributions from subsidiaries, net[2]	(40)	8	(8)	40	
Proceeds from sales (purchases) of emission allowances		59	(48)		11
Restricted cash			(4)		(4)
Other, net		1			1
Net cash provided by (used in) continuing operations from investing activities	(40)	55	(150)	40	(95)
Net cash provided by (used in) discontinued operations from investing activities	70		(89)	5	(14)
Net cash provided by (used in) investing activities	30	55	(239)	45	(109)
Cash Flows from Financing Activities:					
Payments of long-term debt	(45)				(45)
Changes in notes with affiliated companies, net[3]		94	(54)	(40)	
Proceeds from issuances of stock	6				6
	(39)	94	(54)	(40)	(39)

Net cash provided by (used in) continuing operations from financing activities					
Net cash provided by (used in) discontinued operations from financing activities		(17)	22	(5)	
Net cash provided by (used in) financing activities	(39)	77	(32)	(45)	(39)
Net Change in Cash and Cash Equivalents, Total Operations	30	(1)	14		43
Less: Net Change in Cash and Cash Equivalents, Discontinued Operations					
Cash and Cash Equivalents at Beginning of Period, Continuing Operations	490	1	33		524
Cash and Cash Equivalents at End of Period, Continuing Operations	$ 520	$	$ 47	$	$ 567

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

(2) Net investments in, advances to and from and distributions from subsidiaries are classified as investing activities.

(3)

Net changes in notes with affiliated companies are classified as financing activities for subsidiaries of RRI Energy and as investing activities for RRI Energy.

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(13) Reportable Segment

Financial data for our wholesale energy segment, other operations, discontinued operations and consolidated are as follows:

	Wholesale Energy	Other Operations	Discontinued Operations (in millions)	Eliminations	Consolidated
Three months ended June 30, 2009:					
Revenues from external customers	$ 389(1)	$ 1	$	$	$ 390
Contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives(2)	(48)(3) (4)				(48)(3)
Three months ended June 30, 2008:					
Revenues from external customers	$ 1,014(5)	$	$	$	$ 1,014
Intersegment revenues		1		(1)	
Contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives(2)	279(6) (7)	1		(1)	279(6)
Six months ended June 30, 2009 (except as denoted):					
Revenues from external customers	$ 854(8)	$ 2	$	$	$ 856
Intersegment revenues		1		(1)	
Contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives(2)	(63)(9) (10)	2		(1)	(62)(9)
Total assets as of June 30, 2009	7,152	862	298	(40)	8,272
Six months ended June 30, 2008 (except as denoted):					
Revenues from external customers	$ 1,893(11)	$ 1	$	$	$ 1,894
Intersegment revenues		2		(2)	
Contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives(2)	496(12) (13)	2		(2)	496(12)

Total assets as of December 31, 2008	7,458	397	3,001	(134)	10,722

(1) Includes $44 million in revenues from a single counterparty, which represented 11% of our consolidated and wholesale energy segment s revenues. As of June 30, 2009, $4 million was outstanding from this counterparty.

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

(3) Includes $7 million in wholesale energy and consolidated results relating to unrealized gains on energy derivatives, which is a non-cash item.

(4) Includes $(70) million relating to wholesale hedges.

(5) Includes $146 million from affiliates.

(6) Includes $68 million in wholesale energy and consolidated results relating to unrealized gains on energy derivatives, which is a non-cash item.

(7) Includes $44 million relating to wholesale hedges.

(8) Includes $99 million in revenues from a single counterparty, which represented 12% of our consolidated and wholesale energy segment s revenues.

(9) Includes $(37) million in wholesale energy and consolidated results relating to unrealized losses on energy derivatives, which is a non-cash item.

(10) Includes $(74) million relating to wholesale hedges.

(11) Includes $253 million from affiliates.

(12) Includes $98 million in wholesale energy and consolidated results relating to unrealized gains on energy derivatives, which is a non-cash item.

(13) Includes $79 million relating to wholesale hedges.

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(in millions)			
Contribution margin, including wholesale hedges and unrealized gains/losses on energy derivatives	$ (48)	$ 279	$ (62)	$ 496
Operation and maintenance		(1)	1	2
General and administrative	28	33	57	61
Western states litigation and similar settlements				34
Gains on sales of assets and emission allowances, net	(2)	(22)	(20)	(23)
Depreciation	60	63	119	125
Amortization	7	20	16	41
Operating income (loss)	(141)	186	(235)	256
Income (loss) of equity investment, net	(1)	1		1
Debt extinguishments gains (losses)	1		1	(1)
Interest expense	(45)	(51)	(92)	(102)
Interest income	1	8	1	14
Income (loss) from continuing operations before income taxes	(185)	144	(325)	168
Income tax expense (benefit)	(82)	62	(116)	73
Income (loss) from continuing operations	(103)	82	(209)	95
Income from discontinued operations	906	277	861	641
Net income	$ 803	$ 359	$ 652	$ 736

(14) Sale of Channelview s Plant and the Bankruptcy Filings

On August 20, 2007, Channelview filed voluntary petitions in the United States Bankruptcy Court for the District of Delaware for reorganization under Chapter 11 of the Bankruptcy Code. Channelview filed for bankruptcy protection to prevent the lenders from exercising their remedies, including foreclosing on the project. The bankruptcy cases have been jointly administered, with Channelview managing its business in the ordinary course as debtors-in-possession subject to the supervision of the bankruptcy court.

In July 2008, Channelview sold its plant and related contracts for $500 million and paid off its secured lenders. During 2008, we recognized a $6 million gain relating to our net investment in and receivables from Channelview and incurrence of sale-related costs (classified in gains (losses) on sales of assets and emission and exchange allowances, net). As of June 30, 2009 and December 31, 2008, our net investment in and receivables from Channelview was $25 million and $59 million, respectively, classified as a current asset.

Channelview expects to distribute funds to us relating primarily to net proceeds from the sale, pre-petition sales of fuel to Channelview, funds from operations and funds escrowed for potential indemnification claims of approximately $60 million to $70 million in the aggregate through 2009. Of this amount, $25 million was distributed to us during 2008 and $35 million was distributed to us during the second quarter of 2009.

As a result of the bankruptcies, we deconsolidated Channelview s financial results beginning August 20, 2007, and began reporting our investment in Channelview using the cost method. We will continue to account for Channelview as a cost method investment until it emerges from bankruptcy, which is expected later in 2009. The following table describes the assets we expect to consolidate upon the emergence from bankruptcy of Channelview:

	June 30, 2009 (in millions)
Cash	$ 7
Deferred tax assets relating to federal and state net operating loss carryforwards	18

(15) Discontinued Operations

(a) Retail Energy Segment.

General. On May 1, 2009, we sold our Texas retail 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. We currently estimate the net working capital to be $78 million. We estimate our net proceeds will be $312 million after certain expenses. In connection with the sale, we received net proceeds of $297 million during primarily the second quarter of 2009 and expect to receive an additional $15 million later in 2009. This sale also included the rights to the Reliant Energy name. Accordingly, we changed our name to RRI Energy, Inc. on May 2, 2009. In connection with the sale, the lawsuit against our former retail affiliates related to the termination of the retail working capital facility has been dismissed. See note 11(b).

In connection with the sale transaction, we entered into a two-year sublease on our corporate office building with the buyer, with sublease rental income totaling $17 million over that period. We also entered a one-year transition services agreement with the buyer, which includes terms and conditions for information technology services, accounting services and human resources.

Estimated Pre-Tax Gain on Sale. We currently estimate and recognized a pre-tax gain on this sale of $1.2 billion, which is primarily due to the net derivative liability balance of $1.1 billion included in the transaction. This amount is subject to change due to various factors, such as the estimated net working capital.

Federal Valuation Allowance. As a result of the sale, we released $50 million of our discontinued federal valuation allowance for deferred tax assets in discontinued operations during the three months ended June 30, 2009.

Use of Proceeds and Assumptions Related to Debt, Deferred Financing Costs and Interest Expense on Discontinued Operations. As required by our debt agreements, offers to purchase secured notes and PEDFA bonds at par were made with a portion of the net proceeds. We purchased $225 million of the outstanding debt ($147 million of the secured notes and $78 million of the PEDFA bonds) in June 2009 and an additional $36 million ($22 million of the secured notes and $14 million of PEDFA bonds) in July 2009. These amounts and activity have been classified in discontinued operations. See note 7. We have also classified as discontinued operations the related deferred financing costs and interest expense on this debt. We allocated $4 million of related interest expense during the three months ended June 30, 2009 and 2008 to discontinued operations. We allocated $8 million of related interest expense during the six months ended June 30, 2009 and 2008 to discontinued operations.

Other Retail Energy Segment Discontinued Operations. We sold our C&I contracts in the PJM (excluding Illinois) and New York areas (collectively, Northeast) in December 2008. As this was a part of our retail energy segment, we have included this activity in our discontinued operations. We have also included our Illinois C&I activity in discontinued operations as it was a part of our retail energy segment and is held-for-sale.

(b) Other Discontinued Operations.

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

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(c) All Discontinued Operations.
The following summarizes certain financial information of the businesses reported as discontinued operations:

	Retail Energy Segment	New York Plants	European Energy	Total
	(in millions)			
Three Months Ended June 30, 2009				
Revenues	$ 499(1)	$	$	$ 499
Income before income tax expense/benefit	1,314(2)(3)		9	1,323
Three Months Ended June 30, 2008				
Revenues	$ 2,410(4)	$	$	$ 2,410
Income (loss) before income tax expense/benefit	438(5)	(3)	1	436
Six Months Ended June 30, 2009				
Revenues	$ 2,014(6)	$ 2	$	$ 2,016
Income before income tax expense/benefit	1,257(3)(7)	3	9	1,269
Six Months Ended June 30, 2008				
Revenues	$ 4,346(8)	$	$	$ 4,346
Income (loss) before income tax expense/benefit	1,014(9)	(3)	7	1,018

(1) Includes $13 million related to our Illinois C&I activity.

(2) Includes $35 million of unrealized gains on energy derivatives.

(3) Includes $1.2 billion gain on sale (of which $1.1 billion relates to derivatives).

(4)

Includes $14 million related to our Illinois C&I activity.

(5) Includes $502 million of unrealized gains on energy derivatives.

(6) Includes $38 million related to our Illinois C&I activity.

(7) Includes $189 million of unrealized losses on energy derivatives.

(8) Includes $20 million related to our Illinois C&I activity.

(9) Includes $1.0 billion of unrealized gains on energy derivatives.

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The following summarizes the assets and liabilities related to our discontinued operations:

	June 30, 2009	December 31, 2008
	(in millions)	
Current Assets:		
Cash and cash equivalents	$ 2	$ 105
Accounts receivable, principally customer, net	31	870
Derivative assets	86	1,010
Margin deposits	152	295
Accumulated deferred income taxes		217
Other current assets	1	9
Total current assets	272	2,506
Property, Plant and Equipment, net		57
Other Assets:		
Goodwill and other intangibles, net		59
Derivative assets	14	324
Accumulated deferred income taxes	11	48
Other	1	7
Total long-term assets	26	495
Total Assets	$ 298	$ 3,001
Current Liabilities:		
Current portion of long-term debt	$ 36	$
Accounts payable, principally trade	1	480
Derivative liabilities	94	1,637
Margin deposits	42	
Other current liabilities	14	259
Total current liabilities	187	2,376
Other Liabilities:		
Derivative liabilities	21	612
Other liabilities	9	
Total other liabilities	30	612
Long-term Debt		261
Total long-term liabilities	30	873
Total Liabilities	$ 217	$ 3,249

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our Form 10-K. This includes non-GAAP financial measures, which are not standardized; therefore it may not be possible to compare these financial measures with other companies non-GAAP financial measures having the same or similar names. These non-GAAP financial measures, which are discussed further in Consolidated Results of Operations, reflect an additional way of viewing aspects of our operations that, when viewed with our GAAP results, may provide a more complete understanding of factors and trends affecting our business. Investors should review our consolidated financial statements and publicly filed reports in their entirety and not rely on any single financial measure.

Business Overview

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

We believe the power generation industry is deeply cyclical and capital intensive. Given the nature of the industry, we believe scale and diversity are important long term. Given these beliefs, our strategy is to:

- Maintain a capital structure that positions us to manage through the cycles
- Intensely focus on operational excellence
- Employ a flexible operating model through the cycle
- Utilize a disciplined capital investment approach
- Create value from industry consolidation

The current market environment is challenging given the ongoing turmoil in the financial markets, uncertainty in the direction of the overall economy and declining power demand. Additionally, current commodity prices and spreads are near trough levels. While we believe these conditions will improve, the timing is uncertain.

We have taken a number of actions to navigate the current market challenges and position us for the longer term market recovery, with a focus on maximizing cash flow and building ample liquidity. Some of these actions include:

- Selling the Texas retail business
- Implementing a modest hedging program to achieve a high probability of achieving free cash flow breakeven or better even if market conditions deteriorate further
- Intensely focusing on operating efficiency and effectiveness
- Implementing flexible plant-specific operating models
- Realigning corporate support costs

We are regularly assessing the impact on our business of a wide variety of economic and commodity price scenarios, and believe we have the ability to operate through a significant downturn.

Key Earnings Drivers. Our earnings are significantly impacted by supply and demand fundamentals in the regions in which we operate as well as the spread between gas and coal prices. Our margins are driven by a number of factors, including the prices of power, capacity, natural gas, coal and fuel oil, the cost of emissions and transmission, as well as weather and global macro-economic factors, many of which are volatile. Our ability to control these factors is limited, and in most instances, the factors are beyond our control. We have the most control over the percentage of time that our generating assets are available to run when it is economical for them to do so (commercial capacity factor). Our key earnings drivers and various factors that affect these earnings drivers include:

Economic generation (amount of time our plants are economical to operate)

- Supply and demand fundamentals
- Generation asset fuel type and efficiency
- Absolute and relative cost of fuels used in power generation

Commercial capacity factor (generation as a percentage of economic generation)

- Operations excellence effectiveness
- Maintenance practices
- Planned and unplanned outages

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

Other margin
- Capacity prices and payments
- Power purchase agreements sold to others
- Ancillary services
- Equipment performance

Costs
- Operating efficiency
- Maintenance practices
- Generation asset fuel type
- Planned and unplanned outages

Hedges
- Hedging strategy
- Volumes
- Commodity prices
- Effectiveness

Flexible Plant-Specific Operating Model. We have different operating approaches for our power generation facilities. These operating approaches are determined by each facility's condition, environmental controls, profitability, market rules, upside availability and value drivers. We have separated our facilities into four general groups for the purposes of developing an operating model.

Long-term value This part of our fleet is well positioned to generate revenue for the forseeable future, and we would expect that little environmental investments will be needed in future years. We plan to invest and manage these plants, representing approximately 2,500 MW, for current and long-term profitability for both capacity and energy revenues.

Long-term capacity resource These plants, representing approximately 4,400 MW, are also well positioned to generate revenue for the forseeable future, and we expect little future environmental investment. We plan to invest in this part of our fleet for long-term profitability from capacity and/or power purchase and sale agreements.

Near-term profit/controls These plants, representing approximately 5,400 MW, are well positioned to generate revenue in the current environment but do not have $S0_2$, NO_x or mercury emission controls. We expect to maintain near-term profitability and preserve the option for supply/demand recovery and/or improved gas-coal spreads in this group of plants. We may install emission controls in the future depending on environmental regulations and market conditions. See "—Recent Events."

Restore profit This part of our fleet, representing approximately 1,600 MW, faces lower levels of profitability in the current environment. We will minimize spending, improve profitability and preserve our options for supply/demand recovery and/or improved gas-coal spreads in these plants.

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Recent Events

In this section, we present recent and potential events that have impacted or could in the future impact our results of operations, financial condition or liquidity. In addition to the events described below, a number of other factors could affect our future results of operations, financial condition or liquidity, including changes in natural gas prices, plant availability, weather and other factors (see Risk Factors in Item 1A of our Form 10-K).

Review of Strategic Alternatives Lead to Exit of Retail Business. In October 2008, our Board of Directors initiated a process to review strategic alternatives and formed a special committee to oversee this process. In late 2008, we sold our Northeast retail C&I contracts. On May 1, 2009, we sold our Texas retail business. The sale of the retail business achieved a number of important strategic objectives for us:

- eliminated the need for approximately $2.0 billion of credit support and removed capital requirements associated with contingent collateral requirements, which lowered our overall risk profile; and
- enhanced our consolidated balance sheet and improved our liquidity position.

In connection with the sale, the lawsuit related to the termination of the retail working capital facility has been dismissed. Our Board of Directors has concluded its review of strategic alternatives. See Liquidity and Capital Resources and notes 11(b) and 15 to our interim financial statements.

Environmental Matters- Near-term profit/controls group. In April 2009, the New Jersey Department of Environmental Protection finalized a regulation requiring a two-phase reduction