

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002

OR

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

For the transition period from _____ to _____

Commission file number 1-3187

RELIANT ENERGY, INCORPORATED
(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of incorporation or organization)

74-0694415
(I.R.S. Employer Identification No.)

1111 Louisiana
Houston, Texas
(Address of principal executive offices)

77002
(Zip Code)

(713) 207-3000
(Registrant's telephone number, including area code)

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

As of May 9, 2002, Reliant Energy, Incorporated had 303,558,973 shares of common
stock outstanding, including 5,949,332 ESOP shares not deemed outstanding for
financial statement purposes and excluding shares held as treasury stock.

RELIANT ENERGY, INCORPORATED
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2002

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PART I. FINANCIAL INFORMATION
 RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES
 STATEMENTS OF CONSOLIDATED INCOME
 (THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS)
 (UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(AS RESTATED)	
REVENUES	\$ 12,078,216	\$ 8,655,733
EXPENSES:		
Fuel and cost of gas sold	7,682,104	3,552,950
Purchased power	2,876,263	3,586,087
Operation and maintenance	722,320	654,032
Taxes other than income taxes	140,304	125,705
Depreciation	102,113	199,319
Amortization	94,546	20,371
Other	2,305	745
Total	11,619,955	8,139,209
OPERATING INCOME	458,261	516,524
OTHER INCOME (EXPENSE):		
Unrealized gain (loss) on AOL Time Warner investment	137,082	(217,597)
Unrealized (loss) gain on indexed debt securities	(135,047)	203,233
Income from equity investment of unconsolidated subsidiaries	12,606	3,784
Interest expense	(178,062)	(154,056)
Distribution on trust preferred securities	(13,900)	(13,899)
Minority interest	291	(16,433)
Other, net	27,415	17,617
Total	(149,615)	(177,351)
INCOME BEFORE INCOME TAXES, CUMULATIVE EFFECT OF ACCOUNTING CHANGE AND PREFERRED DIVIDENDS	308,646	339,173
Income Tax Expense	107,718	113,821
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE AND PREFERRED DIVIDENDS Cumulative Effect of Accounting Change, net of tax of \$33,205	200,928	225,352
INCOME BEFORE PREFERRED DIVIDENDS	61,666	--
Preferred Dividends	262,594	225,352
NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	97	--
	\$ 262,497	\$ 225,352
	=====	=====
BASIC EARNINGS PER SHARE:		
Income before Cumulative Effect of Accounting Change	\$ 0.69	\$ 0.76
Cumulative Effect of Accounting Change, net of tax	0.22	--
Net Income Attributable to Common Stockholders	\$ 0.91	\$ 0.76
	=====	=====
DILUTED EARNINGS PER SHARE:		
Income before Cumulative Effect of Accounting Change	\$ 0.69	\$ 0.76
Cumulative Effect of Accounting Change, net of tax	0.21	--
Net Income Attributable to Common Stockholders	\$ 0.90	\$ 0.76
	=====	=====

See Notes to the Company's Interim Financial Statements

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

ASSETS

	DECEMBER 31, 2001	MARCH 31, 2002
	-----	-----
CURRENT ASSETS:		
Cash and cash equivalents	\$ 153,952	\$ 295,995
Restricted cash	167,421	346,885
Investment in AOL Time Warner common stock	826,609	609,013
Accounts receivable, net	1,911,923	2,245,432
Accrued unbilled revenues	240,698	476,723
Fuel stock and petroleum products	307,036	231,575
Materials and supplies	272,637	302,727
Trading and marketing assets	1,611,393	1,418,582
Non-trading derivative assets	399,896	550,962
Margin deposits on energy trading activities	213,727	65,727
Other	167,648	250,696
	-----	-----
Total current assets	6,272,940	6,794,317
	-----	-----
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment	24,139,145	28,305,935
Less accumulated depreciation and amortization	(8,344,269)	(8,391,320)
	-----	-----
Property, plant and equipment, net	15,794,876	19,914,615
	-----	-----
OTHER ASSETS:		
Goodwill, net	2,588,421	3,897,152
Other intangibles, net	377,732	387,508
Regulatory assets	3,276,800	3,233,036
Trading and marketing assets	446,610	642,588
Non-trading derivative assets	256,402	414,920
Equity investments in unconsolidated subsidiaries	386,841	383,152
Stranded costs indemnification receivable	203,693	199,540
Restricted cash	6,775	111,309
Other	1,098,762	1,013,303
	-----	-----
Total other assets	8,642,036	10,282,508
	-----	-----
TOTAL ASSETS	\$ 30,709,852	\$ 36,991,440
	=====	=====

See Notes to the Company's Interim Financial Statements

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS - (CONTINUED)
(THOUSANDS OF DOLLARS)
(UNAUDITED)

LIABILITIES AND STOCKHOLDERS' EQUITY

	DECEMBER 31, 2001	MARCH 31, 2002
	-----	-----
CURRENT LIABILITIES:		
Short-term borrowings	\$ 3,435,347	\$ 8,932,755
Current portion of long-term debt	660,757	841,556
Indexed debt securities derivative	730,225	526,992
Accounts payable	1,447,289	1,692,725
Taxes accrued	315,353	293,707
Interest accrued	114,721	147,610
Dividends declared	9	366
Trading and marketing liabilities	1,478,335	1,295,424
Non-trading derivative liabilities	396,021	302,411
Margin deposits from customers on energy trading activities	144,700	214,150
Regulatory liabilities	234,706	235,987
Accumulated deferred income taxes, net	385,820	476,129
Other	568,861	426,465
	-----	-----
Total current liabilities	9,912,144	15,386,277
	-----	-----
OTHER LIABILITIES:		
Accumulated deferred income taxes, net	2,345,202	2,570,129
Unamortized investment tax credits	247,407	242,792
Trading and marketing liabilities	361,786	566,643
Non-trading derivative liabilities	540,036	581,893
Benefit obligations	547,369	633,858
Regulatory liabilities	1,125,176	905,336
Non-derivative stranded costs liability	203,693	199,540
Other	1,069,312	971,912
	-----	-----
Total other liabilities	6,439,981	6,672,103
	-----	-----
LONG-TERM DEBT	5,746,444	5,986,240
	-----	-----
COMMITMENTS AND CONTINGENCIES (NOTES 1 AND 13)		
MINORITY INTEREST IN CONSOLIDATED SUBSIDIARIES	1,047,366	1,074,946
	-----	-----
COMPANY OBLIGATED MANDATORILY REDEEMABLE PREFERRED SECURITIES OF SUBSIDIARY TRUSTS HOLDING SOLELY JUNIOR SUBORDINATED DEBENTURES OF THE COMPANY	705,744	705,854
	-----	-----
STOCKHOLDERS' EQUITY:		
Common stock	3,897,301	3,911,960
Unearned ESOP stock	(131,888)	(113,028)
Retained earnings	3,176,533	3,290,869
Accumulated other comprehensive (loss) income	(83,773)	76,219
	-----	-----
Total stockholders' equity	6,858,173	7,166,020
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 30,709,852	\$ 36,991,440
	=====	=====

See Notes to the Company's Interim Financial Statements

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED CASH FLOWS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income attributable to common stockholders	\$ 262,497	\$ 225,352
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	196,659	219,690
Deferred income taxes	53,809	72,207
Investment tax credits	(4,583)	(4,614)
Cumulative effect of accounting change	(61,666)	--
Unrealized (gain) loss on AOL Time Warner investment	(137,082)	217,597
Unrealized loss (gain) on indexed debt securities	135,047	(203,233)
Undistributed earnings of unconsolidated subsidiaries	2,269	(2,285)
Minority interest	(291)	16,433
Changes in other assets and liabilities, net of effects of acquisitions:		
Restricted cash	50,000	56,716
Accounts receivable and accrued unbilled revenues, net	149,183	(559,786)
Inventory	61,264	107,244
Accounts payable	(753,305)	138,432
Fuel cost (under) over recovery	(164,602)	98,381
Net trading and marketing assets and liabilities	(44,855)	24,023
Margin deposits on energy trading activities, net	206,157	217,450
Net non-trading derivative assets and liabilities	4,421	(93,623)
Prepaid lease obligation	(111,367)	(40,292)
Interest and taxes accrued	200,812	(21,380)
Net regulatory assets and liabilities	(37,814)	(129,094)
Collateral for generating equipment, net	23,244	130,421
Other current assets	38,246	8,197
Other current liabilities	(93,751)	(196,677)
Other assets	73,529	20,458
Other liabilities	36,414	(105,671)
Other, net	35,927	39,996
Net cash provided by operating activities	120,162	235,942
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(491,558)	(392,674)
Business acquisitions, net of cash acquired	--	(2,948,821)
Investments in unconsolidated subsidiaries	(724)	--
Other, net	(4,974)	17,484
Net cash used in investing activities	(497,256)	(3,324,011)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt, net	544,632	22,575
(Decrease) increase in short-term borrowing, net	(168,902)	3,358,229
Payments of long-term debt	(26,556)	(38,051)
Payment of common stock dividends	(107,597)	(110,936)
Proceeds from issuance of stock	36,895	4,076
Decrease in restricted cash related to securitization financing	--	2,958
Other, net	(958)	(8,073)
Net cash provided by financing activities	277,514	3,230,778
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(8,240)	(666)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(107,820)	142,043
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	191,825	153,952
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 84,005	\$ 295,995
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Payments:		
Interest (net of amounts capitalized)	\$ 181,091	\$ 118,134
Income taxes	2,757	867

See Notes to the Company's Interim Financial Statements

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) BACKGROUND AND BASIS OF PRESENTATION

Included in this Quarterly Report on Form 10-Q (Form 10-Q) for Reliant Energy, Incorporated (Reliant Energy), together with its subsidiaries (collectively, the Company), are Reliant Energy's consolidated interim financial statements and notes (Interim Financial Statements) including these companies' wholly owned and majority owned subsidiaries. The Interim Financial Statements are unaudited, omit certain financial statement disclosures and should be read with the Annual Report on Form 10-K of Reliant Energy (Reliant Energy Form 10-K) for the year ended December 31, 2001.

RESTATEMENT

On May 9, 2002, Reliant Resources determined that it had engaged in same-day commodity trading transactions involving purchases and sales with the same counterparty for the same volume at substantially the same price, which the personnel who effected these transactions apparently did so with the objective of increasing volumes. Reliant Resources commenced a review to quantify the amount and assess the impact of these trades (round trip trades). The Audit Committee of the Company's Board of Directors has also directed an internal investigation by outside legal counsel of the facts and circumstances relating to the round trip trades and related matters.

The Company currently reports all trading, marketing and risk management services transactions on a gross basis with such transactions being reported in revenues and expenses except primarily for financial gas transactions such as swaps. Therefore, the round trip trades were reflected in both the Company's revenues and its expenses. The round trip trades should not have been recognized in revenues or expenses (i.e., they should have been reflected on a net basis). However, since the round trip trades were done at the same volume and substantially the same price, they had no impact on the Company's reported cash flows, operating income or net income.

Based on the Company's review, the Company has determined that the Company engaged in such round trip trades in 1999, 2000 and 2001 and the Company's review did not identify any round trip trades conducted during 2002. The results of the Audit Committee's investigation are consistent with the results of the Company's review. During the first quarter of 2001, the trades of this nature were 20 million megawatt hours (MWh) of power. In the first quarter of 2001, these transactions had the effect of increasing revenues and purchased power expense by approximately \$1.2 billion, or approximately 10% and 43%, respectively.

The consolidated financial statements for the three months ended March 31, 2001 have been restated from amounts previously reported to reflect these transactions on a net basis. The restatement had no impact on previously reported consolidated cash flows, operating income or net income. A summary of the principal effects of the restatement are as follows: (Note - Those line items for which no change in amounts are shown were not affected by the restatement.)

	THREE MONTHS ENDED MARCH 31, 2001	
	AS RESTATED	AS PREVIOUSLY REPORTED
	-----	-----
	(IN MILLIONS)	
Revenues	\$ 12,078	\$ 13,310
Expenses:		
Fuel and cost of gas sold	7,682	7,682
Purchased power	2,876	4,108
Other expenses	1,062	1,062
	-----	-----
Total	11,620	12,852
	-----	-----
Operating Income	458	458
Other Expense, net	(149)	(149)
Income Tax Expense	(108)	(108)
	-----	-----
Income Before Cumulative Effect of Accounting Change	201	201
Cumulative Effect of Accounting Change, net of tax .	61	61
	-----	-----
Net Income Attributable to Common Stockholders	\$ 262	\$ 262
	=====	=====

The restatement did not impact earnings per share, the Consolidated Balance Sheet as of December 31, 2001 or the Statement of Consolidated Cash Flows for the three months ended March 31, 2001.

In addition to the round trip trades described above, the Company's review and the Audit Committee's investigation also considered other transactions executed at the same volume, price and delivery terms and with the same counterparty. These transactions were executed in the normal course of the Company's trading and marketing activities, reported on a gross basis, and were not significant.

For the future, the Company is considering presenting certain of its mark-to-market transactions on a net, rather than gross, basis. Management believes that net reporting may be a better representation of performance of the business. The Company is currently consulting with its outside auditors, Deloitte & Touche LLP, and intends to consult with the Securities and Exchange Commission (SEC) staff, about this possible change in accounting method and other related issues.

As previously reported, during the May 2001 through September 2001 time frame, the Company entered into four structured transactions involving a series of forward or swap contracts to buy and sell an energy commodity in 2001 and to buy and sell an energy commodity in 2002 or 2003 (the four structured transactions). Each series of contracts in a structure were executed contemporaneously with the same counterparty and were for the same commodities, quantities and locations. The contracts in each structure were offsetting in terms of physical attributes. These transactions were previously recorded on a gross basis with such transactions being reported in revenues and expenses which resulted in \$1.9 billion of revenues, \$746 million in fuel and cost of gas sold and \$1.2 billion of purchased power expense being recognized during the period from May 2001 through December 31, 2001. Having further reviewed the transactions, the Company now believes these transactions should have been accounted for on a net basis. The information included in the Company's first quarter 2002 earnings release, included as an exhibit to the Company's Current Report on Form 8-K dated April 29, 2002, included \$71 million of revenues and purchased power expense related to these transactions which have been eliminated from the Interim Financial Statements for the three months ended March 31, 2002.

While the Company is still completing its review of these round trip trades, as soon as practical, the Company will reissue its consolidated financial statements for the years ended December 31, 1999, 2000 and 2001 to restate the revenues, fuel and cost of gas sold and purchased power expense from the amounts previously reported for the round trip trades effected during such years and for the four structured transactions in 2001. In addition, if the Company changes its accounting policy to account for certain trading, marketing and risk management services activities on a net, rather than gross basis, such reissued consolidated financial statements for such years may also reflect this change in accounting policy.

BASIS OF PRESENTATION

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Interim Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to present fairly the financial position and results of operations for the respective periods. Amounts reported in the Company's Statements of Consolidated Income are not necessarily indicative of amounts expected for a full year period due to the effects of, among other things, (a) seasonal fluctuations in demand for energy and energy services, (b) changes in energy commodity prices, (c) timing of maintenance and other expenditures and (d) acquisitions and dispositions of businesses, assets and other interests. In addition, certain amounts from the prior year have been reclassified to conform to the Company's presentation of financial statements in the current year. These reclassifications do not affect the earnings of the Company.

The following notes to the consolidated financial statements in the Reliant Energy Form 10-K relate to certain contingencies. These notes, as updated herein, are incorporated herein by reference:

Notes to Consolidated Financial Statements of Reliant Energy (Reliant Energy 10-K Notes): Note 2(e) (Long-Lived Assets and Intangibles), Note 2(f) (Regulatory Assets and Liabilities), Note 3 (Business Acquisitions), Note 4 (Regulatory Matters), Note 5 (Derivative Financial Instruments), Note 8 (Indexed Debt Securities (ACES and ZENS) and AOL Time Warner Securities), Note 14 (Commitments and Contingencies), Note 21 (Bankruptcy of Enron Corp. and its Affiliates) and Note 22 (Subsequent Events).

For information regarding certain legal, tax and regulatory proceedings and environmental matters, see Note 13.

Reliant Energy is in the process of separating its regulated and unregulated businesses into two publicly traded companies. In December 2000, Reliant Energy transferred a significant portion of its unregulated businesses to Reliant Resources, Inc. (Reliant Resources) which, at the time, was a wholly owned subsidiary. In May 2001, Reliant Resources conducted an initial public offering (Offering) of approximately 20% of its common stock (59.8 million shares of its common stock) at a price of \$30 per share, and received net proceeds from the Offering of \$1.7 billion. After the Offering, Reliant Energy owned approximately 80% of Reliant Resources. As of March 31, 2002, Reliant Energy owns approximately 83% of Reliant Resources due to treasury stock repurchases of \$189 million during 2001 by Reliant Resources. Pursuant to a master separation agreement between Reliant Energy and Reliant Resources, Reliant Resources used \$147 million of the net proceeds of the Offering to repay certain indebtedness owed to Reliant Energy. In connection with the Offering, Reliant Energy converted \$1.7 billion of intercompany indebtedness owed by Reliant Resources and its subsidiaries prior to the closing of the Offering to equity as a capital contribution to Reliant Resources. In December 2001, Reliant Energy's shareholders approved an agreement and plan of merger by which the following will occur (which is referred to as the Restructuring):

- CenterPoint Energy, Inc. (CenterPoint Energy), currently a wholly owned subsidiary of Reliant Energy, will become the holding company for Reliant Energy and its subsidiaries;
- Reliant Energy and its subsidiaries will become subsidiaries of CenterPoint Energy; and
- each share of Reliant Energy common stock will be converted into one share of CenterPoint Energy common stock.

After the Restructuring, Reliant Energy plans, subject to further corporate approvals, market and other conditions, to complete the separation of its regulated and unregulated businesses by distributing the shares of common stock of Reliant Resources that the Company owns to its shareholders (Distribution). The Company's goal is to complete the Restructuring and subsequent Distribution as quickly as possible after all the necessary conditions are fulfilled, including receipt of an order from the Securities and Exchange Commission (SEC) granting the required approvals under the Public Utility Holding Company Act of 1935 (1935 Act) and an extension from the Internal Revenue Service of its private letter ruling that the Company has obtained regarding the tax-free treatment of the Distribution. The Company believes it will receive the necessary approvals. Reliant Energy currently expects to complete the Restructuring and Distribution in the summer of 2002. However, until the requisite approvals are received, no assurance can be provided that the Distribution will occur as described above or that it will occur within this time period. Upon receipt of approval under the 1935 Act, CenterPoint Energy expects to register and become subject, with its subsidiaries, to regulation as a registered holding company system under the 1935 Act.

Thereafter, in order to enable CenterPoint Energy ultimately to comply with the requirements for exemption from registration in Section 3(a)(1) of the 1935 Act, Reliant Energy plans to divide the gas distribution businesses conducted by Reliant Energy Resources Corp.'s (RERC Corp.) three unincorporated divisions, Reliant Energy Entex, Reliant Energy Arkla and Reliant Energy Minnegasco among three separate entities. The entity that will hold the Reliant Energy Entex assets will also hold RERC Corp.'s natural gas pipelines and gathering business. In addition to regulatory approvals the Company has obtained, this restructuring will require approval of the public service commissions of Louisiana, Mississippi, Oklahoma and Arkansas.

Although the Company believes that this business restructuring will be completed, it can provide no assurance that this will, in fact, occur, or that CenterPoint Energy will ultimately be exempt from regulation as a registered holding company under the 1935 Act. For further information on the RERC Corp. restructuring, see "Our Business -- RERC Corp. Restructuring" in Item 1 of the Reliant Energy Form 10-K.

During 2001, the Electric Operations business segment reflected the regulated electric utility business, including generation, transmission and distribution, and retail electric sales. As of January 1, 2002, with the opening of the Texas market to full retail electric competition, generation and retail sales were deregulated. Retail electric sales involve the sale of electricity and related services to end users of electricity and were included as part of the bundled regulated service prior to 2002. Retail electric sales are now reported as the Retail Energy business segment of Reliant Resources. Although the Company's retail sales are now conducted by Reliant Resources, retail customers remained regulated customers of Reliant Energy HL&P through the date of their first meter reading in 2002. Sales of

electricity to retail customers in 2002 prior to this meter reading are reflected in the Electric Transmission and Distribution business segment.

Beginning in 2002, Reliant Energy is reporting two new business segments for what was the former Electric Operations business segment:

- Electric Generation; and
- Electric Transmission and Distribution.

The previously regulated generation operations in Texas are being reported in the new Electric Generation business segment. The transmission and distribution function is now reported separately in the Electric Transmission and Distribution business segment, which also includes all revenues and effects from generation-related regulatory assets recoverable by the regulated utility, including the Excess Cost Over Market (ECOM) true-up component of stranded costs. For additional information regarding regulatory matters affecting the Company's electric segments, see Note 4 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference and Note 3 below.

(2) NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations" (SFAS No. 141). SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against these new criteria and may result in certain intangibles being transferred to goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. The Company adopted the provisions of the statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 on January 1, 2002. The adoption of SFAS No. 141 did not have a material impact on the Company's historical results of operations or financial position.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 provides new guidance on the recognition of impairment losses on long-lived assets to be held and used or to be disposed of and also broadens the definition of what constitutes a discontinued operation and how the results of a discontinued operation are to be measured and presented. SFAS No. 144 supersedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," while retaining many of the requirements of these two statements. Under SFAS No. 144, assets held for sale that are a component of an entity will be included in discontinued operations if the operations and cash flows will be or have been eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations prospectively. SFAS No. 144 did not materially change the methods used by the Company to measure impairment losses on long-lived assets, but may result in additional future dispositions being reported as discontinued operations than was previously permitted. The Company adopted SFAS No. 144 on January 1, 2002. As a result of the adoption of SFAS No. 144, the Company's remaining Latin America operations have been presented on a gross basis in the consolidated financial statements.

See Note 4 for a discussion of the Company's adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133) on January 1, 2001 and adoption of subsequent cleared guidance. See Note 6 for a discussion of the Company's adoption of SFAS No. 142 "Goodwill and Other Intangible Assets" (SFAS No. 142) on January 1, 2002.

(3) REGULATORY MATTERS

(a) Excess Cost Over Market (ECOM) True-Up.

Reliant Energy's Electric Generation business segment conducted auctions of installed electric generation capacity in September, October and December 2001 and March 2002. Excluding reserves for planned and forced outages, as a result of these auctions, the Company's Texas generation business has sold entitlements to all of its capacity through August 2002, an average of 72% per month of its capacity through December 2002 and 10% of its capacity for each month in 2003. In the contractually mandated auctions held so far, Reliant Resources has purchased, on average, 72% per month of the 2002 capacity sold by Reliant Energy and 58% per month of Reliant Energy's 2003 capacity sold in the auctions. These purchases have been made either through the exercise by Reliant Resources of its contractual rights or through the submission of bids.

The capacity auctions were consummated at market-based prices that are substantially below the historical regulated return on the facilities in the Company's Texas generation business. The Texas electric restructuring law provides for the recovery in a "true-up" proceeding in 2004 (2004 True-Up Proceeding) of any difference between

market power prices received in the capacity auctions and the earlier estimates of those market prices by the Public Utility Commission of Texas (Texas Utility Commission). For the three months ended March 31, 2002, Reliant Energy recorded approximately \$141 million in revenue related to the recovery of the difference between the market power prices and the Texas Utility Commission's earlier estimates. For additional information regarding the capacity auctions and the related true-up proceeding, please read Note 4 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

(b) Generation Asset Impairment Contingency.

The Company evaluates the recoverability of its long-lived assets in accordance with SFAS No. 144. As of March 31, 2002, no impairment had been indicated in its Texas generation assets. The Company anticipates that future events, such as the expected public offering after the Restructuring by the subsidiary that will conduct the Company's Texas generation operations, or a change in the estimated holding period of the Texas generation assets, will require the Company to re-evaluate these assets for impairment between now and 2004. If an impairment is indicated, it could be material and may not be fully recoverable through the 2004 True-Up Proceeding.

The Texas electric restructuring law provides the Company recovery of the regulatory book value of its Texas generating assets for the amount the regulatory book value exceeds the estimated market value. If the Texas generating assets are sold in the future, a loss on sale of these assets, or an impairment of the recorded recoverable electric generation plant mitigation regulatory asset, will occur to the extent the recorded book value of the Texas generating assets exceeds the regulatory book value. As of March 31, 2002, the recorded book value was \$656 million in excess of the regulatory book value. This amount declines each year as the recorded book value is depreciated and increases by the amount of non-environmental capital expenditures. For further discussion of the difference between the regulatory book value and the recorded book value, see Note 4 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

(c) Regulatory Assets Contingency.

As of March 31, 2002, in contemplation of the 2004 True-up Proceeding, the Company's Electric Transmission and Distribution business segment has recorded a regulatory asset of \$2.0 billion representing the estimated future recovery of previously incurred stranded costs, which includes a regulatory liability of \$1.1 billion plus the reversal of previously recorded redirected depreciation. This estimated recovery is based upon current projections of the market value of the Company's Texas generation assets to be covered by the 2004 True-up Proceeding calculations. The regulatory liability reflects a current refund obligation arising from prior mitigation of stranded costs deemed excessive by the Texas Utility Commission. Because accounting principles generally accepted in the United States of America require the Company to estimate fair market values in advance of the final reconciliation, the financial impacts of the Texas electric restructuring law with respect to the final determination of stranded costs in the 2004 True-Up Proceeding are subject to material changes. Factors affecting such changes may include estimation risk, uncertainty of future energy and commodity prices and the economic lives of the plants. If events were to occur that made the recovery of some of the remaining generation related regulatory assets no longer probable, the Company would write off the remaining balance of such assets as a charge against earnings.

(4) DERIVATIVE FINANCIAL INSTRUMENTS

Adoption of SFAS No. 133 on January 1, 2001 resulted in an after-tax increase in net income of \$61 million and a cumulative after-tax increase in accumulated other comprehensive loss of \$252 million during the three months ended March 31, 2001. For additional information regarding the adoption of SFAS No. 133 and the Company's accounting policies for derivative financial instruments, see Note 5 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

The application of SFAS No. 133 is still evolving as the FASB clears issues submitted to the Derivatives Implementation Group for consideration. During the second quarter of 2001, an issue that applies exclusively to the electric industry and allows the normal purchases and normal sales exception for option-type contracts if certain criteria are met was approved by the FASB with an effective date of July 1, 2001. The adoption of this cleared guidance had no impact on the Company's results of operations. Certain criteria of this previously approved guidance were revised in October and December 2001 and became effective on April 1, 2002. The adoption of the revised guidance did not have a material impact on the Company's consolidated financial statements.

During the third quarter of 2001, the FASB cleared an issue related to application of the normal purchases and normal sales exception to contracts that combine forward and purchased option contracts. The effective date of this guidance was April 1, 2002, and the adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Cash Flow Hedges. During the three months ended March 31, 2002, the amount of hedge ineffectiveness recognized in earnings from derivatives that are designated and qualify as cash flow hedges was immaterial. No component of the derivative instruments' gain or loss was excluded from this assessment of effectiveness. During the three months ended March 31, 2002, a \$0.9 million deferred loss was recognized in earnings as a result of the discontinuance of cash flow hedges because it was no longer probable that the forecasted transaction would occur due to credit problems of a customer. As of March 31, 2002, the Company expects \$98 million in accumulated other comprehensive income to be reclassified into net income during the next twelve months.

Interest Rate Swaps. As of March 31, 2002, the Company holds interest rate swaps with an aggregate notional amount of \$2.7 billion to fix the interest rate applicable to floating rate short-term debt and floating rate long-term debt. Of these swaps, \$1.5 billion relating to short-term debt do not qualify as cash flow hedges under SFAS No. 133, and are marked to market in the Company's Consolidated Balance Sheets with changes reflected in interest expense in the Statements of Consolidated Income. The remaining \$1.2 billion in swaps relating to both short-term and long-term debt qualify for hedge accounting under SFAS No. 133 and the periodic settlements are recognized as an adjustment to interest expense in the Statements of Consolidated Income over the term of the swap agreements. The Company has also entered into forward-starting interest rate swaps having an aggregate notional amount of \$2.5 billion to hedge the interest rate on future offerings of long-term fixed-rate notes. These swaps qualify as cash flow hedges under SFAS No. 133. Should the expected issuance of the debt no longer be probable, any deferred amount will be recognized immediately into income. The maximum length of time the Company is hedging its exposure to the payment of variable interest rates is ten years.

Hedge of Net Investment in Foreign Subsidiaries. The Company has substantially hedged its net investment in its European subsidiaries through a combination of Euro-denominated borrowings, foreign currency swaps and foreign currency forward contracts to reduce the Company's exposure to changes in foreign currency rates. During the three months ended March 31, 2002, the derivative and non-derivative instruments designated as hedging the net investment in the Company's European subsidiaries resulted in an after-tax gain of \$35 million, which is included in the balance of the cumulative translation adjustment in accumulated other comprehensive income.

Other Derivatives. In December 2000, the Dutch parliament adopted legislation allocating to the Dutch generation sector, including Reliant Energy Power Generation Benelux N.V. (REPG), financial responsibility for various out-of-market contracts and other liabilities. The legislation became effective in all material respects on January 1, 2001. In particular, the legislation allocated to the Dutch generation sectors, including REPG, financial responsibility to purchase imported electricity and gas under long-term contracts. These contracts are derivatives pursuant to SFAS No. 133. As of December 31, 2001 and March 31, 2002, the Company had recognized \$369 million and \$330 million, respectively, in total short-term and long-term non-trading derivative liabilities for REPG's portion of these out-of-market import contracts. During the three months ended March 31, 2002, the Company recognized a \$19 million gain related to changes in the valuation of certain out-of-market contracts in the first quarter of 2002 recorded in fuel expense. For additional information regarding REPG's obligations under out-of-market contracts and the related indemnification by former shareholders of these stranded costs during 2001, see Note 14(h) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

During the May 2001 through September 2001 time frame, the Company entered into two structured transactions which were recorded on the Consolidated Balance Sheets in non-trading derivative assets and liabilities involving a series of forward contracts to buy and sell an energy commodity in 2001 and to buy and sell an energy commodity in 2002 or 2003. The change in fair value of these derivative assets and liabilities must be recorded in the Statements of Consolidated Income for each reporting period. As of December 31, 2001, the Company has recognized \$221 million of non-trading derivative assets and \$103 million of non-trading derivative liabilities related to these transactions. During the three months ended March 31, 2002, \$24 million of net non-trading derivative assets were settled related to these transactions, and a \$1 million pre-tax unrealized gain was recognized. As of March 31, 2002, the Company has recognized \$201 million of non-trading derivative assets and \$106 million of non-trading derivative liabilities related to these transactions.

(5) ACQUISITION OF ORION POWER HOLDINGS, INC.

In February 2002, Reliant Resources acquired all of the outstanding shares of common stock of Orion Power Holdings, Inc. (Orion Power) for \$26.80 per share in cash for an aggregate purchase price of \$2.9 billion. Reliant Resources funded the Orion Power acquisition with a \$2.9 billion term loan and \$41 million of cash on hand. The term loan must be repaid by February 19, 2003. As a result of the acquisition, Reliant Resources' consolidated net debt obligations also increased by the amount of Orion Power's net debt obligations. As of February 19, 2002, Orion Power's debt obligations were \$2.4 billion (\$2.1 billion net of restricted cash pursuant to debt covenants). Orion Power is an electric power generating company formed in March 1998 to acquire, develop, own and operate power-generating facilities in certain deregulated wholesale markets throughout North America. As of March 31, 2002, Orion Power had 81 power plants with a total generating capacity of 5,644 Megawatts (MW) and two development projects with an additional 804 MW of capacity under construction.

The Company accounted for the acquisition as a purchase with assets and liabilities of Orion Power reflected at their estimated fair values. The Company's fair value adjustments included adjustments in property, plant and equipment, unrecognized pension and post retirement benefits liabilities and related deferred taxes. The Company expects to finalize these fair value adjustments no later than February 2003, based on valuations of property, plant and equipment, intangible assets and other assets and obligations.

The Company's results of operations include the results of Orion Power only for the period beginning February 19, 2002. The following table presents selected financial information and unaudited pro forma information for the three months ended March 31, 2001 and 2002, as if the acquisition had occurred on January 1, 2001 and 2002, as applicable.

	THREE MONTHS ENDED MARCH 31,			
	2001		2002	
	ACTUAL	PRO FORMA	ACTUAL	PRO FORMA
	(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)			
Revenues	\$ 12,078	\$ 12,352	\$ 8,656	\$ 8,790
Income before cumulative effect of accounting change	201	203	225	177
Net income	262	265	225	177
Basic earnings per share before cumulative effect of accounting change	\$ 0.69	\$ 0.71	\$ 0.76	\$ 0.60
Diluted earnings per share before cumulative effect of accounting change	0.69	0.70	0.76	0.60
Basic earnings per share	0.91	0.92	0.76	0.60
Diluted earnings per share	0.90	0.91	0.76	0.60

These unaudited pro forma results, based on assumptions deemed appropriate by the Company's management, have been prepared for informational purposes only and are not necessarily indicative of the amounts that would have resulted if the acquisition of Orion Power had occurred on January 1, 2001 and 2002, as applicable. Purchase-related adjustments to the results of operations include the effects on depreciation and amortization, interest expense, interest income and income taxes. The unaudited pro forma condensed consolidated financial statements reflect the acquisition of Orion Power in accordance with SFAS No. 141 and SFAS No. 142. For additional information regarding the Company's adoption of SFAS No. 142, please read Note 6.

In connection with Reliant Resources' acquisition of Orion Power, Reliant Resources assumed various credit facilities, senior notes and convertible senior notes, which are discussed below.

New York Credit Agreement. As of March 31, 2002, Orion Power New York, LP (Orion NY), a wholly owned subsidiary of Orion Power, had a secured credit agreement (New York Credit Agreement), which includes a \$502 million acquisition facility and a \$30 million revolving working capital facility. As of March 31, 2002, Orion NY had \$502 million of acquisition loans outstanding. As of March 31, 2002, there were no revolving loans outstanding. A total of \$10 million in letters of credit were outstanding under the New York Credit Agreement. The loans bear interest at the borrower's option at (a) a base rate or (b) the London inter-bank offered rate (LIBOR) plus

a margin. The rate as of March 31, 2002, was 3.75%. The credit agreement is secured by substantially all of the assets of Orion NY. The credit agreement expires in December 2002.

MidWest Credit Agreement. As of March 31, 2002, Orion Power MidWest LP (Orion MidWest), a wholly owned subsidiary of Orion Power, had a secured credit agreement (Midwest Credit Agreement), which includes a \$988 million acquisition facility and a \$75 million revolving working capital facility. As of March 31, 2002, Orion MidWest had \$988 million and \$28 million of acquisition loans and revolving loans outstanding, respectively. The borrowings under each facility bear interest at a floating rate. A total of \$15 million in letters of credit were outstanding under the Midwest Credit Agreement. The loans bear interest at the borrower's option at (a) a base rate or (b) LIBOR plus a margin. The rate as of March 31, 2002, was 3.34%. Borrowings under the Midwest Credit Agreement are secured by substantially all the assets of Orion MidWest. The credit agreement expires in October 2002.

The New York Credit Agreement and the Midwest Credit Agreement (collectively, the Orion Credit Agreements) contain restrictive covenants that restrict the ability to, among other things, make dividend distributions unless Orion NY or Orion MidWest satisfy various conditions. As of March 31, 2002 restricted cash under the Orion Credit Agreements totaled \$267 million.

In connection with the Orion Power acquisition, the existing interest rate swaps for the New York Credit Agreement and Midwest Credit Agreement were bifurcated into a debt component and a derivative component. The fair value of the debt component, approximately \$31 million for the New York Credit Agreement and \$59 million for the Midwest Credit Agreement, was based on Reliant Resources' incremental borrowing rates at the acquisition date for similar types of borrowing arrangements. The value of the debt component will be amortized to interest expense over the life of the interest rate swaps. For the period from February 20, 2002 through March 31, 2002, \$1 million and \$2 million was amortized to interest expense for the New York Credit Agreement and Midwest Credit Agreement, respectively. See Note 4 for information regarding the Company's derivative financial instruments.

The Orion Credit Agreements contain various business and financial covenants requiring Orion NY or Orion MidWest to, among other things, maintain a debt service coverage ratio of at least 1.5 to 1.0. For the three months ended March 31, 2002, Orion MidWest did not meet its debt service coverage ratio, and alternatively made a \$25 million prepayment on March 22, 2002, as permitted by the Midwest Credit Agreement in order to maintain compliance. Orion MidWest may not be able to meet this debt service coverage ratio for the quarter ending June 30, 2002. It is Reliant Resources' current intention to arrange for the repayment, refinancing or amendment of these facilities prior to June 30, 2002. If the Midwest Credit Agreement facility is not repaid, refinanced or amended prior to that date, and if a waiver is required under this credit facility, Reliant Resources believes that it will be able to obtain such a waiver. However, Reliant Resources currently has no assurance that it will be able to obtain such a waiver or amendment from the lender groups if required under the Midwest Credit Agreement.

Liberty Credit Agreement. Liberty Electric Power, LLC (Liberty), a wholly owned subsidiary of Orion Power, has entered into a facility that provides for (a) a construction/term loan in an amount of up to \$105 million; (b) an institutional term loan in an amount of up to \$165 million; (c) an equity bridge loan in an amount of up to \$41 million; (d) a revolving working capital facility for an amount of up to \$5 million; and (e) a debt service reserve letter of credit facility of \$17.5 million (Liberty Credit Agreements).

Amounts outstanding under this facility bear interest at a floating rate for a portion of the facility, which may be either (a) a base rate or (b) LIBOR plus a margin, except for the institutional term loan which bears interest at a fixed rate. At March 31, 2002, the interest rate was 3.04% on the floating rate component and 9.02% on the fixed rate portion. As of March 31, 2002, Liberty had \$135 million and \$165 million of the floating rate and fixed rate portions of the facility outstanding, respectively.

The lenders under the Liberty Credit Agreements have a security interest in substantially all of the assets of Liberty and have negative pledges on other fixed assets of Liberty. The Liberty Credit Agreement contains restrictive covenants that restrict Liberty's ability to, among other things, make dividend distributions unless Liberty satisfies various conditions. As of March 31, 2002, restricted cash under the Liberty Credit Agreement totaled \$25 million.

The Liberty equity bridge loan matures on the earlier of October 1, 2002, or a date on which the conditions precedent to conversion to a term loan are met. The debt service reserve letter of credit facility becomes available for use when the conditions precedent to conversion to a term loan are met and matures five years thereafter. The working capital facility becomes available for use six months prior to the scheduled conversion date and matures five years thereafter. The construction/term loan matures on the earlier of October 1, 2002, or a date on which the conditions precedent to conversion to a term loan are met and matures ten years thereafter. The institutional term loan has a final maturity date of April 15, 2026.

Senior Notes. Orion Power has outstanding \$400 million of 12% senior notes due 2010 (Senior Notes). The Senior Notes are senior unsecured obligations of Orion Power. Orion Power is not required to make any mandatory redemption or sinking fund payments with respect to the Senior Notes. The Senior Notes are not guaranteed by any of Orion Power's subsidiaries. In connection with the Orion Power acquisition, Reliant Resources recorded the Senior Notes at estimated fair value, \$479 million. The \$79 million premium will be amortized against interest expense over the life of the Senior Notes. The fair value of the Senior Notes is based on Reliant Resources' incremental borrowing rates for similar types of borrowing arrangements. The Senior Notes indenture contains covenants that include among others, restrictions on the payment of dividends by Orion Power.

Pursuant to certain change of control provisions, Orion Power commenced an offer to repurchase the Senior Notes on March 21, 2002. The offer to repurchase expired on April 18, 2002. There were no acceptances of the offer to repurchase and the entire \$400 million remains outstanding.

Before May 1, 2003, Orion Power may redeem up to 35% of the Senior Notes issued under the indenture at a redemption price of 112% of the principal amount of the notes redeemed, plus accrued and unpaid interest and special interest, with the net cash proceeds of an equity offering provided that certain provisions under the indenture are met.

Revolving Senior Credit Facility. Orion Power has an unsecured \$75 million revolving senior credit facility that matures in December 2002. Amounts outstanding under the facility bear interest at a floating rate. As of March 31, 2002, there were no outstanding borrowings under this facility, but a total of \$70 million in letters of credit were outstanding. This credit facility contains various covenants that include among others, restrictions on the payment of dividends by Orion Power. As of March 31, 2002, restricted cash under this revolving senior credit facility totaled \$9 million.

The senior credit facility of Orion Power contains various business and financial covenants that require Orion Power to, among other things, maintain a debt service coverage ratio of at least 1.4 to 1.0. Orion Power did not meet the debt service coverage ratio for the quarter ended March 31, 2002. In the event that Orion Power is unable to meet this financial covenant for a second consecutive fiscal quarter, it would constitute a default under its credit facility. It is Reliant Resources' current intention to arrange for the repayment, refinancing or amendment of this facility prior to June 30, 2002. If this facility is not repaid, refinanced or amended prior to that date, and if a waiver is required under this credit facility, Reliant Resources believes that it will be able to obtain such a waiver. However, Reliant Resources currently has no assurance that it will be able to obtain such a waiver or amendment from the lender groups if required under this credit facility.

Convertible Senior Notes. Orion Power had outstanding \$200 million of 4.5% convertible senior notes, due on June 1, 2008 (Convertible Senior Notes). Pursuant to certain change of control provisions, Orion Power commenced an offer to repurchase the Convertible Senior Notes on March 1, 2002, which expired on April 10, 2002. During the second quarter of 2002, Reliant Resources repurchased \$189 million in principal amount under the offer to repurchase and \$11 million aggregate principal amount of the Convertible Senior Notes remains outstanding.

(6) GOODWILL AND INTANGIBLES

In July 2001, the FASB issued SFAS No. 142, which provides for a nonamortization approach, whereby goodwill and certain intangibles with indefinite lives will not be amortized into results of operations, but instead will be reviewed periodically for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles with indefinite lives is more than its fair value. The Company adopted the provisions of the statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 on January 1, 2002.

With the adoption of SFAS No. 142, the Company ceased amortization of goodwill as of January 1, 2002. A reconciliation of previously reported net income and earnings per share to the amounts adjusted for the exclusion of goodwill amortization follows:

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS, EXCEPT PER SHARE)	
Reported net income	\$ 262	\$ 225
Add: Goodwill amortization, net of tax	21	--
Adjusted net income	\$ 283	\$ 225
Basic Earnings Per Share:		
Reported net income	\$ 0.91	\$ 0.76
Add: Goodwill amortization, net of tax	0.07	--
Adjusted basic earnings	\$ 0.98	\$ 0.76
Diluted Earnings Per Share:		
Reported net income	\$ 0.90	\$ 0.76
Add: Goodwill amortization, net of tax	0.07	--
Adjusted diluted earnings	\$ 0.97	\$ 0.76

The components of the Company's other intangible assets consist of the following:

	DECEMBER 31, 2001		MARCH 31, 2002	
	CARRYING AMOUNT	ACCUMULATED AMORTIZATION	CARRYING AMOUNT	ACCUMULATED AMORTIZATION
	(IN MILLIONS)			
Air Emission Regulatory Allowances	\$ 255	\$ (78)	\$ 267	\$ (79)
Other Power Generation Site Permits	77	(3)	77	(4)
Water Rights	68	(4)	68	(5)
Land Use Rights	59	(11)	59	(11)
Other	16	(1)	19	(3)
Total	\$ 475	\$ (97)	\$ 490	\$ (102)

The Company recognizes specifically identifiable intangibles, including air emissions regulatory allowances and water and land use rights and permits, when specific rights and contracts are acquired. The Company amortizes air emissions regulatory allowances primarily on a units-of-production basis as utilized. The Company amortizes other acquired intangibles on a straight-line basis over the lesser of their contractual or estimated useful lives. The Company has no intangible assets with indefinite lives recorded as of March 31, 2002.

Amortization expense for other intangibles for the three months ended March 31, 2001 and 2002 was \$24 million and \$5 million, respectively. Estimated amortization expense for the remainder of 2002 and the five succeeding fiscal years is as follows (in millions):

2002.....	\$ 15
2003.....	15
2004.....	15
2005.....	16
2006.....	15
2007.....	15
Total.....	\$ 91

Changes in the carrying amount of goodwill for the three months ended March 31, 2002, by reportable business segment, are as follows:

	AS OF JANUARY 1, 2002	GOODWILL ACQUIRED DURING THE PERIOD	FOREIGN CURRENCY EXCHANGE IMPACT	OTHER	AS OF MARCH 31, 2002
	(IN MILLIONS)				
Natural Gas Distribution	\$ 1,085	\$ --	\$ --	\$ --	\$ 1,085
Pipelines and Gathering	601	--	--	--	601
Wholesale Energy	184	1,321	--	1	1,506
European Energy	632	--	(13)	--	619
Retail Energy	32	--	--	--	32
Other Operations	54	--	--	--	54
Total	\$ 2,588	\$ 1,321	\$ (13)	\$ 1	\$ 3,897

The Company is in the process of determining further effects of adoption of SFAS No. 142 on its consolidated financial statements, including the review of goodwill for impairment. The Company has not completed its review pursuant to SFAS No. 142. However, based on the Company's preliminary review, the Company believes an impairment of its European Energy business segment goodwill is reasonably possible. The Company has retained outside valuation firms to assist in completion of its review and will finalize its review of goodwill for its reporting units during the second quarter of 2002. Any impairment loss resulting from the transitional impairment test will be recorded retroactively as a cumulative effect of a change in accounting principle for the quarter ended March 31, 2002. As of March 31, 2002, the Company has completed its assessment of intangible assets and no indefinite lived intangible assets were identified. No impairment losses were recorded in the first quarter of 2002 and no changes were made to the expected useful lives of the Company's intangible assets as a result of this assessment.

(7) COMPREHENSIVE INCOME

The following table summarizes the components of total comprehensive income:

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS)	
Net income attributable to common stockholders	\$ 262	\$ 225
Other comprehensive (loss) income, net of tax:		
Foreign currency translation adjustments	(1)	(12)
Additional minimum non-qualified pension liability adjustment	(2)	--
Cumulative effect of adoption of SFAS No. 133	(252)	--
Net deferred gains from cash flow hedges	176	200
Reclassification of deferred loss (gain) from cash flow hedges realized in net income	7	(27)
Unrealized gain (loss) on available-for-sale securities	7	(1)
Other comprehensive (loss) income	(65)	160
Comprehensive income	\$ 197	\$ 385

(8) SHORT-TERM BORROWINGS

As of March 31, 2002, the Company had credit facilities, which included the facilities of various financing subsidiaries, Reliant Resources, REPG and Reliant Energy Resources Corp. (RERC Corp.) and their subsidiaries, with financial institutions that provide for an aggregate of \$13.4 billion in committed credit. The facilities expire as follows: \$7.6 billion in 2002, \$4.3 billion in 2003 and \$1.5 billion in 2004 and beyond. As of March 31, 2002, borrowings and letters of credit of \$10.0 billion were outstanding or supported under these credit facilities of which \$0.6 billion was classified as long-term debt, based on availability of committed credit with expiration dates exceeding one year and management's intention to borrow these amounts for periods in excess of one year. Various credit facilities aggregating \$2.5 billion may be used for letters of credit of which \$0.6 billion was outstanding as of March 31, 2002. Interest rates on borrowings are based on LIBOR plus a margin, Euro interbank deposits plus a margin, a base rate or a rate determined through a bidding process. Credit facilities aggregating \$6.1 billion are

unsecured. The credit facilities contain covenants and requirements which must be met to borrow funds and obtain letters of credit, as applicable. Facilities having covenants that may materially restrict the borrowers from borrowing funds or obtaining letters of credit, as applicable, under such facilities are expected to be replaced with less restrictive facilities by July 2002. As of March 31, 2002, the borrowers were in compliance with the covenants under all of these credit agreements, but under certain debt instruments of Orion Power and its subsidiaries as discussed in Note 5, Orion Power will cease to be in compliance unless certain coverage ratios improve.

The Company sells commercial paper to provide financing for general corporate purposes. As of March 31, 2002, \$2.1 billion of commercial paper was outstanding. The commercial paper borrowings are supported by various credit facilities discussed above, including \$4.7 billion in credit facilities expiring in 2002 and a \$350 million revolving credit facility expiring in 2003.

RERC Corp. has a receivables facility under which it sells its customer accounts receivable. Advances under this facility are reflected in the Consolidated Balance Sheets as short-term debt. In the first quarter of 2002, RERC Corp. reduced its trade receivables facility from \$350 million to \$150 million. Borrowings under the receivables facility aggregating \$196 million were repaid in January 2002 with proceeds from the issuance of commercial paper under RERC Corp.'s \$350 million revolving credit facility and from the liquidation of short-term investments. At March 31, 2002, RERC Corp. had letters of credit outstanding under this facility of \$2.5 million.

(9) RECEIVABLES FACTORING AGREEMENT

In December 2001, Reliant Energy HL&P terminated an agreement under which it had historically sold its customer accounts receivable. Proceeds from the sale of customer accounts receivable pursuant to this agreement were historically treated as a sale and not reflected as debt in the Consolidated Balance Sheets. In connection with this termination, in January 2002, Reliant Energy HL&P repurchased \$369 million of previously sold customer accounts receivable. Funds used to repurchase these receivables were obtained from a combination of bank loans and the sale of commercial paper.

(10) EARNINGS PER SHARE

The following table presents Reliant Energy's basic and diluted earnings per share (EPS) calculation:

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS, EXCEPT SHARE AND PER SHARE AMOUNTS)	
Basic EPS Calculation:		
Income before cumulative effect of accounting change	\$ 201	\$ 225
Cumulative effect of accounting change, net of tax	61	--
Net income attributable to common stockholders	<u>\$ 262</u>	<u>\$ 225</u>
Weighted average shares outstanding	<u>287,336,000</u>	<u>296,222,000</u>
Basic EPS:		
Income before cumulative effect of accounting change	\$ 0.69	\$ 0.76
Cumulative effect of accounting change, net of tax	0.22	--
Net income attributable to common stockholders	<u>\$ 0.91</u>	<u>\$ 0.76</u>
Diluted EPS Calculation:		
Net income attributable to common stockholders	\$ 262	\$ 225
Plus: Income impact of assumed conversions:		
Interest on 6-1/4% convertible trust preferred securities	--	--
Total earnings effect assuming dilution	<u>\$ 262</u>	<u>\$ 225</u>
Weighted average shares outstanding	<u>287,336,000</u>	<u>296,222,000</u>
Plus: Incremental shares from assumed conversions(1):		
Stock options	2,337,000	403,000
Restricted stock	486,000	528,000
6-1/4% convertible trust preferred securities	14,000	13,000
Weighted average shares assuming dilution	<u>290,173,000</u>	<u>297,166,000</u>
Diluted EPS:		
Income before cumulative effect of accounting change	\$ 0.69	\$ 0.76
Cumulative effect of accounting change, net of tax	0.21	--
Net income attributable to common stockholders	<u>\$ 0.90</u>	<u>\$ 0.76</u>

(1) For the three months ended March 31, 2001 and 2002, the computation of diluted EPS excludes 191,266 and 5,595,200 purchase options, respectively, for shares of common stock that have exercise prices (ranging from \$41.69 to \$47.22 per share and \$24.38 to \$50.00 per share for the first quarter 2001 and 2002, respectively) greater than the per share average market price for the period and would thus be anti-dilutive if exercised.

(11) CAPITAL STOCK

Common Stock. Reliant Energy has 700,000,000 authorized shares of common stock. At December 31, 2001, 302,943,709 shares of Reliant Energy common stock were issued and 295,873,820 shares of Reliant Energy common stock were outstanding. At March 31, 2002, 303,496,203 shares of Reliant Energy common stock were issued and 297,437,214 shares of Reliant Energy common stock were outstanding. Outstanding common shares exclude shares pledged to secure a loan to Reliant Energy's Employee Stock Ownership Plan (7,069,889 and 6,058,989 at December 31, 2001 and March 31, 2002, respectively). Reliant Energy declared dividends of \$0.375 per share in the first quarter of 2001 and 2002.

(12) TRUST PREFERRED SECURITIES

(a) Reliant Energy.

Statutory business trusts created by Reliant Energy have issued trust preferred securities, the terms of which, and the related series of junior subordinated debentures, are described below (in millions):

TRUST	AGGREGATE LIQUIDATION AMOUNT		DISTRIBUTION RATE/ INTEREST RATE	MANDATORY REDEMPTION DATE/ MATURITY DATE	JUNIOR SUBORDINATED DEBENTURES
	DECEMBER 31, 2001	MARCH 31, 2002			
REI Trust I	\$ 375	\$ 375	7.20%	March 2048	7.20% Junior Subordinated Debentures due 2048
HL&P Capital Trust I	\$ 250	\$ 250	8.125%	March 2046	8.125% Junior Subordinated Deferrable Interest Debentures Series A
HL&P Capital Trust II	\$ 100	\$ 100	8.257%	February 2037	8.257% Junior Subordinated Deferrable Interest Debentures Series B

For additional information regarding the \$625 million of preferred securities and the \$100 million of capital securities, see Note 11 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference. The sole asset of each trust consists of junior subordinated debentures of Reliant Energy having interest rates and maturity dates that correspond to the distribution rates and the mandatory redemption dates for each series of preferred securities or capital securities, and the principal amounts corresponding to the common and preferred securities or capital securities issued by that trust.

(b) RERC Corp.

A statutory business trust created by RERC Corp. (RERC Trust) has issued convertible trust preferred securities, the terms of which, and the related series of convertible junior subordinated debentures, are described below (in millions):

TRUST	AGGREGATE LIQUIDATION AMOUNT		DISTRIBUTION RATE/ INTEREST RATE	MANDATORY REDEMPTION DATE/ MATURITY DATE	JUNIOR SUBORDINATED DEBENTURES
	DECEMBER 31, 2001	MARCH 31, 2002			
RERC Trust	\$ 1	\$ 1	6.25%	June 2026	6.25% Convertible Junior Subordinated Debentures due 2026

For additional information regarding the convertible preferred securities, see Note 11 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference. The sole asset of the trust consists of convertible junior subordinated debentures of RERC Corp. having an interest rate and maturity date that correspond to the distribution rate and mandatory redemption date of the convertible preferred securities, and the principal amount corresponding to the common and convertible preferred securities issued by the trust.

(13) COMMITMENTS AND CONTINGENCIES

(a) Legal Matters.

Reliant Energy HL&P Municipal Franchise Fee Lawsuits. In February 1996, the cities of Wharton, Galveston and Pasadena filed suit, for themselves and a proposed class of all similarly situated cities in Reliant Energy HL&P's service area, against Reliant Energy and Houston Industries Finance, Inc. (formerly a wholly owned subsidiary of

Reliant Energy) alleging underpayment of municipal franchise fees. Plaintiffs claim that they are entitled to 4% of all receipts of any kind for business conducted within these cities over the previous four decades. Because the franchise ordinances at issue affecting Reliant Energy HL&P expressly impose fees only on its own receipts and only from sales of electricity for consumption within a city, the Company regards all of plaintiffs' allegations as spurious and is vigorously contesting the case. The plaintiffs' pleadings asserted that their damages exceeded \$250 million. The 269th Judicial District Court for Harris County granted partial summary judgment in favor of Reliant Energy dismissing all claims for franchise fees based on sales tax collections. Other motions for partial summary judgment were denied. A six-week jury trial of the original claimant cities (but not the class of cities) ended on April 4, 2000 (Three Cities case). Although the jury found for Reliant Energy on many issues, they found in favor of the original claimant cities on three issues, and assessed a total of \$4 million in actual and \$30 million in punitive damages. However, the jury also found in favor of Reliant Energy on the affirmative defense of laches, a defense similar to a statute of limitations defense, due to the original claimant cities having unreasonably delayed bringing their claims during the 43 years since the alleged wrongs began.

The trial court in the Three Cities case granted most of Reliant Energy's motions to disregard the jury's findings. The trial court's rulings reduced the judgment to \$1.7 million, including interest, plus an award of \$13.7 million in legal fees. In addition, the trial court granted Reliant Energy's motion to decertify the class and vacated its prior orders certifying a class. Following this ruling, 45 cities filed individual suits against Reliant Energy in the District Court of Harris County.

The Three Cities case has been appealed. The Company believes that the \$1.7 million damage award resulted from serious errors of law and that it will be set aside by the Texas appellate courts. In addition, the Company believes that because of an agreement between the parties limiting fees to a percentage of the damages, reversal of the award of \$13.7 million in attorneys' fees in the Three Cities case is probable.

The extent to which issues in the Three Cities case may affect the claims of the other cities served by Reliant Energy HL&P cannot be assessed until judgments are final and no longer subject to appeal. However, the trial court's rulings disregarding most of the jury's findings are consistent with Texas Supreme Court opinions over the past decade. The Company estimates the range of possible outcomes for the plaintiffs in the Three Cities case to be between zero and \$18 million inclusive of interest and attorneys' fees.

California Wholesale Market. Reliant Energy, Reliant Energy Services, Inc. (Reliant Energy Services), REPG and several other subsidiaries of Reliant Resources, as well as two former officers and one present officer of some of these companies, have been named as defendants in class action lawsuits and other lawsuits filed against a number of companies that own generation plants in California and other sellers of electricity in California markets. Pursuant to the terms of the master separation agreement between Reliant Energy and Reliant Resources, Reliant Resources has agreed to indemnify Reliant Energy for any damages arising under these lawsuits and may elect to defend these lawsuits at its own expense. Three of these lawsuits were filed in the Superior Court of the State of California, San Diego County; two were filed in the Superior Court in San Francisco County; and one was filed in the Superior Court of Los Angeles County. While the plaintiffs allege various violations by the defendants of state antitrust laws and state laws against unfair and unlawful business practices, each of the lawsuits is grounded on the central allegation that defendants conspired to drive up the wholesale price of electricity. In addition to injunctive relief, the plaintiffs in these lawsuits seek treble the amount of damages alleged, restitution of alleged overpayments, disgorgement of alleged unlawful profits for sales of electricity, costs of suit and attorneys' fees. The cases were initially removed to federal court and were then assigned to Judge Robert H. Whaley, United States District Judge, pursuant to the federal procedures for multi-district litigation. On July 30, 2000, Judge Whaley remanded the cases to state court. Upon remand to state court, the cases were assigned to Superior Court Judge Janis L. Sammartino pursuant to the California state coordination procedures. On March 4, 2002, Judge Sammartino adopted a schedule proposed by the parties that would result in a trial beginning on March 1, 2004. On March 8, 2002, the plaintiffs filed a single, consolidated complaint naming numerous defendants, including Reliant Energy Services and other Reliant Resources' subsidiaries, that restated the allegations described above and alleged that damages against all defendants could be as much as \$1 billion. On April 17, 2002, a demurrer was filed in the coordinated proceedings seeking dismissal of the complaints on the basis of the filed rate doctrine and federal preemption. On April 22 and 23, 2002, the Company and Duke Energy filed cross complaints in the coordinated proceedings seeking, in an alternative pleading, relief against other market participants in California, including Powerex Corp., the Los Angeles Department of Water and Power and the Bonneville Power Administration. Plaintiffs have voluntarily dismissed Reliant Energy from two of the three class actions in which it was named as a defendant.

On April 23, 2002 and on May 14, 2002, two class action lawsuits were filed against a number of companies that own generation facilities in California and other sellers of electricity in California, including Reliant Energy and the Company's subsidiaries that own generation facilities in California. One of the lawsuits was filed in the San Mateo County Superior Court and the other lawsuit was filed in the San Francisco County Superior Court. These lawsuits assert causes of action similar to those alleged in the Clayton Act lawsuit filed by the California Attorney General described below and claim that defendants acquired California generating plants with "the purpose and effect of substantially lessening competition," and that these acquisitions allowed defendants "to exercise market power to withhold capacity and raise prices above competitive levels." Additionally, these lawsuits allege that the named defendants manipulated the market and used market power to "game" the system through both the physical and economic withholding of power. The Company has not yet answered or otherwise responded to these lawsuits.

On March 11, 2002, the California Attorney General filed a civil lawsuit in San Francisco Superior Court naming Reliant Energy, Reliant Resources, Reliant Energy Services, REPG, and several other subsidiaries of Reliant Resources as defendants. Pursuant to the terms of the master separation agreement between Reliant Energy and Reliant Resources, Reliant Resources has agreed to indemnify Reliant Energy for any damages arising under these lawsuits and may elect to defend these lawsuits at its own expense. The Attorney General alleges various violations by the defendants of state laws against unfair and unlawful business practices arising out of transactions in the markets for ancillary services run by the California Independent System Operator (Cal ISO). In addition to injunctive relief, the Attorney General seeks restitution and disgorgement of alleged unlawful profits for sales of electricity, and civil penalties. The Company has removed this lawsuit to federal court, where it has been assigned to Judge Samuel Conti in the Northern District of California.

On March 19, 2002, the California Attorney General filed a complaint with the Federal Energy Regulatory Commission (FERC) naming Reliant Energy Services and "all other public utility sellers" in California as defendants. The complaint alleges that sellers with market-based rates have violated their tariffs by not filing with the FERC transaction-specific information about all of their sales and purchases at market-based rates. The California Attorney General argues that, as a result, all past sales should be subject to refund if found to be above just and reasonable levels.

On April 15, 2002, the California Attorney General filed a lawsuit in San Francisco County Superior Court against Reliant Energy, Reliant Resources and a number of its subsidiaries. The complaint is substantially similar to the complaint described above filed by the California Attorney General with the FERC on March 19, 2002. The complaint also alleges that the Company consistently charged unjust and unreasonable prices for electricity, and that each instance of overcharge violates California law. The lawsuit seeks fines of up to \$2,500 for each alleged violation, and "other equitable relief as appropriate." The Company has removed this case to federal court, where it has been assigned to Judge Vaughn Walker in the Northern District of California.

On April 15, 2002, the California Attorney General and the California Department of Water Resources (CDWR) filed a complaint in the United States District Court for the Northern District of California against Reliant Energy, Reliant Resources and a number of its subsidiaries. In this lawsuit, the Attorney General alleges that the Company's acquisition of electric generating facilities from Southern California Edison (SCE) in 1998 violated Section 7 of the Clayton Act, which prohibits mergers or acquisitions that substantially lessen competition. The lawsuit claims that the acquisitions gave the Company market power which it then exercised to overcharge California consumers for electricity. The lawsuit seeks injunctive relief against alleged unfair competition, divestiture of the Company's California facilities, disgorgement of alleged illegal profits, damages, and civil penalties for each alleged exercise of market power. This lawsuit also has been assigned to Judge Vaughn Walker. The Company has not yet answered or otherwise responded to this lawsuit.

The above-described lawsuits and proceedings regarding California electricity sales are currently the subject of intense, highly-charged media and political attention. Their ultimate outcome cannot be predicted at this time.

Natural Gas Measurement Lawsuits. In 1997, a suit was filed under the Federal False Claim Act against RERC Corp. and certain of its subsidiaries alleging mismeasurement of natural gas produced from federal and Indian lands. The suit seeks undisclosed damages, along with statutory penalties, interest, costs, and fees. The complaint is part of a larger series of complaints filed against 77 natural gas pipelines and their subsidiaries and affiliates. An earlier single action making substantially similar allegations against the pipelines was dismissed by the U.S. District Court for the District of Columbia on grounds of improper joinder and lack of jurisdiction. As a result, the various

individual complaints were filed in numerous courts throughout the country. This case was consolidated, together with the other similar False Claim Act cases filed and transferred to the District of Wyoming. Motions to dismiss were denied. The defendants intend to vigorously contest this case.

In addition, RERC Corp., Reliant Energy Gas Transmission Company (REGT), Reliant Energy Field Services, Inc. (REFS) and Mississippi River Transmission Corporation (MRT) have been named as defendants in a class action filed in May 1999 against approximately 245 pipeline companies and their affiliates. The plaintiffs in the case purport to represent a class of natural gas producers and fee royalty owners who allege that they have been subject to systematic gas mismeasurement by the defendants, including certain Reliant Energy entities, for more than 25 years. The plaintiffs seek compensatory damages, along with statutory penalties, treble damages, interest, costs and fees. The action is currently pending in state court in Stevens County, Kansas. Plaintiffs initially sued Reliant Energy Services, but that company was dismissed without prejudice on June 8, 2001. Other Reliant Energy entities that were misnamed or duplicative have also been dismissed. MRT and REFS have filed motions to dismiss for lack of personal jurisdiction and are currently responding to discovery on personal jurisdiction. All four Reliant Energy defendants have joined in a motion to dismiss.

The defendants plan to raise significant affirmative defenses based on the terms of the applicable contracts, as well as on the broad waivers and releases in take or pay settlements that were granted by the producer-sellers of natural gas who are putative class members.

(b) Environmental Matters.

Clean Air Standards. The Company has participated in a lawsuit against the Texas Natural Resource Conservation Commission (TNRCC) regarding the limitation of the emission of oxides of nitrogen (NOx) in the Houston area. A settlement of the lawsuit was reached with the TNRCC in the second quarter of 2001 and revised emissions limitations were adopted by the TNRCC in the third quarter of 2001. The revised limitations provide for an increase in allowable NOx emissions, compared to the original TNRCC requirements, through 2004. Further emission reductions may or may not be required by 2007, depending upon the outcome of continuing investigations of regional air quality issues. To achieve the 2004 TNRCC NOx reduction requirements, the Company anticipates investing up to \$721 million in capital for emission control equipment, including costs incurred through December 31, 2001, and potentially up to an additional \$88 million by 2007.

The Texas electric restructuring law provides for stranded cost recovery for expenditures incurred before May 1, 2003 to achieve the NOx reduction requirements. Incurred costs include costs for which contractual obligations have been made. The Texas Utility Commission had determined that the Company's emission control plan is the most effective control option and that up to \$699 million is eligible for cost recovery. In addition, the Company is required to provide \$16.2 million in funding for certain NOx reduction projects associated with East Texas pipeline companies. These funds are also eligible for cost recovery.

Hydrocarbon Contamination. On August 24, 2001, 37 plaintiffs filed suit against REGT, Reliant Energy Pipeline Services, Inc., RERC Corp., Reliant Energy Services, other Reliant Energy entities and third parties (Docket No. 460, 916-Div. "B"), in the 1st Judicial District Court, Caddo Parish, Louisiana. The petition has now been supplemented five times. As of May 13, 2002, there were 534 plaintiffs, a majority of whom are Louisiana residents who live near the Wilcox Aquifer. In addition to the Reliant Energy entities, the plaintiffs have sued the State of Louisiana through its Department of Environmental Quality, several individuals, some of whom are present employees of the State of Louisiana, the Bayou South Gas Gathering Company, L.L.C., Martin Timber Company, Inc., and several trusts.

The suit alleges that, at some unspecified date prior to 1985, the defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer which lies beneath property owned or leased by the defendants and which is the sole or primary drinking water aquifer in the area. The primary source of the contamination is alleged by the plaintiffs to be a gas processing facility in Houghton, Bossier Parish, Louisiana known as the "Sligo Facility." This facility was purportedly used for gathering natural gas from surrounding wells, separating gasoline and hydrocarbons from the natural gas for marketing, and transmission of natural gas for distribution. This site was originally leased and operated by predecessors of REGT in the late 1940s and was operated until Arkansas Louisiana Gas Company ceased operations of the plant in the late 1970s.

Beginning about 1985, the predecessors of certain Reliant Energy defendants engaged in a voluntary remediation of any subsurface contamination of the groundwater below the property they own or lease. This work has been done in conjunction with and under the direction of the Louisiana Department of Environmental Quality. The plaintiffs seek monetary damages for alleged damage to the aquifer underlying their property, unspecified alleged personal injuries, alleged fear of cancer, alleged property damage or diminution of value of their property, and in addition seek damages for trespass, punitive, and exemplary damages. The quantity of monetary damages sought is unspecified. As of March 31, 2002, the Company is unable to estimate the monetary damages, if any, that the plaintiffs may be awarded in this matter.

Manufactured Gas Plant Sites. RERC Corp. and its predecessors operated a manufactured gas plant (MGP) until 1960 adjacent to the Mississippi River in Minnesota, formerly known as Minneapolis Gas Works (MGW). RERC Corp. has substantially completed remediation of the main site other than ongoing water monitoring and treatment. The manufactured gas was stored in separate holders. RERC Corp. is negotiating clean-up of one such holder. There are six other former MGP sites in the Minnesota service territory. Remediation has been completed on one site. Of the remaining five sites, RERC Corp. believes that two were neither owned nor operated by RERC Corp. RERC Corp. believes it has no liability with respect to the sites it neither owned nor operated.

At March 31, 2002, RERC Corp. had accrued \$23 million for remediation of the Minnesota sites. At March 31, 2002, the estimated range of possible remediation costs was \$11 million to \$49 million. The cost estimates of the MGW site are based on studies of that site. The remediation costs for the other sites are based on industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites remediated, the participation of other potentially responsible parties (PRP), if any, and the remediation methods used.

Issues relating to the identification and remediation of MGPs are common in the natural gas distribution industry. The Company has received notices from the United States Environmental Protection Agency and others regarding its status as a PRP for other sites. Based on current information, the Company has not been able to quantify a range of environmental expenditures for potential remediation expenditures with respect to other MGP sites.

Mercury Contamination. The Company's pipeline and distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area with elemental mercury. This type of contamination has been found by the Company at some sites in the past, and the Company has conducted remediation at these sites. It is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total amount of these costs cannot be known at this time, based on experience by the Company and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, the Company believes that the costs of any remediation of these sites will not be material to the Company's financial position, results of operations or cash flows.

REMA Ash Disposal Site Closures and Site Contaminations. Under the agreement to acquire Reliant Energy Mid-Atlantic Power Holdings, LLC (REMA) (see Note 3(a) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference), the Company became responsible for liabilities associated with ash disposal site closures and site contamination at the acquired facilities in Pennsylvania and New Jersey prior to a plant closing, except for the first \$6 million of remediation costs at the Seward Generating Station. A prior owner retained liabilities associated with the disposal of hazardous substances to off-site locations prior to November 24, 1999. As of March 31, 2002, REMA had liabilities associated with six ash disposal site closures and six site investigations and environmental remediations. The Company has recorded its estimate of these environmental liabilities in the amount of \$36 million as of March 31, 2002. The Company expects approximately \$16 million will be paid over the next five years.

REPGB Asbestos Abatement and Soil Remediation. Prior to the Company's acquisition of REPGB (see Note 3(b) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference), REPGB had a \$23 million obligation primarily related to asbestos abatement, as required by Dutch law, and soil remediation at six sites. During 2000, the Company initiated a review of potential environmental matters associated with REPGB's properties. REPGB began remediation in 2000 of the properties identified to have exposed asbestos and soil

contamination, as required by Dutch law and the terms of some leasehold agreements with municipalities in which the contaminated properties are located. All remediation efforts are to be fully completed by 2005. As of March 31, 2002, the estimated undiscounted liability for this asbestos abatement and soil remediation was \$18 million.

Orion Power Environmental Contingencies. In connection with Orion Power's acquisition of 70 hydro plants in northern and central New York and four gas- or oil-fired plants in New York City, Orion Power recorded a liability for the estimated cost of environmental remediation. The liability was based on valuation reports provided by independent environmental liability assessment experts. In conjunction with these valuations, Orion Power has developed remediation plans for each item specifically identified. For environmental items at the New York City sites, the New York State Department of Environmental Conservation has issued consent orders requiring active investigation and remediation of past releases of petroleum and other substances by the prior owners. The consent order also contains obligations related to continuing compliance with environmental regulations. The liability assumed and recorded by the Company was approximately \$7 million which is expected to be paid out through 2009.

In connection with the acquisition of Midwest assets by Orion Power, Orion Power recorded a liability for the estimated cost of environmental remediation, based on valuations performed by independent environmental liability assessment experts. In conjunction with these valuations, Orion Power has developed remediation plans for the known liabilities. The liability assumed and recorded by the Company was approximately \$5 million, which will be paid out through 2009.

Other. From time to time the Company has received notices from regulatory authorities or others regarding its status as a PRP in connection with sites found to require remediation due to the presence of environmental contaminants. In addition, the Company has been named as a defendant in litigation related to such sites and in recent years has been named, along with numerous others, as a defendant in several lawsuits filed by a large number of individuals who claim injury due to exposure to asbestos while working at sites along the Texas Gulf Coast. Most of these claimants have been workers who participated in construction of various industrial facilities, including power plants, and some of the claimants have worked at locations owned by the Company. The Company anticipates that additional claims like those received may be asserted in the future and intends to continue vigorously contesting claims which it does not consider to have merit. Although their ultimate outcome cannot be predicted at this time, the Company does not believe, based on its experience to date, that these matters, either individually or in the aggregate, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

(c) **Other Legal and Environmental Matters.**

The Company is involved in other legal, environmental, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business. Some of these proceedings involve substantial amounts. The Company's management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. The Company's management believes that the disposition of these matters will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

(d) **California Wholesale Market Uncertainty.**

Receivables. During portions of 2000 and 2001, prices for wholesale electricity in California increased dramatically as a result of a combination of factors, including higher natural gas prices and emission allowance costs, reduction in available hydroelectric generation resources, increased demand, decreased net electric imports and limitations on supply as a result of maintenance and other outages. The resulting supply and demand imbalance disproportionately impacted California utilities that relied too heavily on short-term power markets to meet their load requirements. Although wholesale prices increased, California's deregulation legislation kept retail rates frozen at 10% below 1996 levels for two of California's public utilities, Pacific Gas and Electric (PG&E) and SCE, until rates were raised by the California Public Utilities Commission (CPUC) early in 2001.

Due to the disparity between wholesale and retail rates, the credit ratings of PG&E and SCE fell below investment grade. Additionally, PG&E filed for protection under the bankruptcy laws on April 6, 2001. As a result, PG&E and SCE are no longer considered creditworthy and since January 17, 2001 have not directly purchased

power from third-party suppliers through the Cal ISO to serve their net short load. Pursuant to emergency legislation enacted by the California Legislature, the CDWR has negotiated and purchased power through short- and long-term contracts and through real-time markets operated by the Cal ISO to serve the net short load requirements of PG&E and SCE to meet their net short loads. In December 2001, the CDWR began making payments to the Cal ISO for real-time transactions. The CDWR has now made payment through the Cal ISO for its real-time energy deliveries subsequent to January 17, 2001, although the Cal ISO's application of CDWR's payment for the month of January 2001 and failure to pay interest on past due CDWR payments are the subjects of motions filed by the Company with the FERC. On May 15, 2002, the FERC issued an order stating that sellers, including the Company, should receive interest payments on these past due amounts. In addition, the Company is prosecuting a lawsuit in California to recover the market value of forward contracts seized by California Governor Gray Davis in violation of the Federal Power Act. Governor Davis' actions prevented the liquidation of the contracts by the California Power Exchange (Cal PX) to satisfy the outstanding obligations of SCE and PG&E to wholesale suppliers, including the Company. The timing and ultimate resolution of this claim is uncertain at this time.

On September 20, 2001, PG&E filed a Plan of Reorganization and an accompanying disclosure statement with the bankruptcy court. Under this plan, PG&E would pay all allowed creditor claims in full, through a combination of cash and long-term notes. Components of the plan will require the approval of the FERC, the SEC and the Nuclear Regulatory Commission (NRC), in addition to the bankruptcy court. PG&E has stated it seeks to have this plan confirmed by December 31, 2002. On April 24, 2002, the bankruptcy judge approved PG&E's disclosure statement. A number of parties are contesting PG&E's reorganization plan, including a number of California parties and agencies. The bankruptcy judge in the PG&E case has ordered that the CPUC may file a competing plan. The ability of PG&E to have its reorganization plan confirmed, including the provision providing for the payment in full of unsecured creditors, is uncertain at this time. The CPUC has filed a competing plan and disclosure statement. The CPUC's plan provides for payment of allowed creditor claims in full in cash. The CPUC disclosure statement was approved on May 15, 2002. The timing and probability of confirmation of either plan, including the provision for payment in full of all unsecured creditors, is uncertain at this time.

On October 5, 2001, a federal district court in California entered a stipulated judgment approving a settlement between SCE and the CPUC in an action brought by SCE regarding the recovery of its wholesale power costs under the filed rate doctrine. Under the stipulated judgment, a rate increase approved earlier in 2001 will remain in place until the earlier of SCE recovering \$3.3 billion or December 31, 2002. After that date, the CPUC will review the sufficiency of retail rates through December 31, 2005. A consumer organization has appealed the judgment to the Ninth Circuit Court of Appeals, and no hearing has been held to date. Under the stipulated judgment, any settlement with SCE's creditors that is entered into after March 1, 2002 must be approved by the CPUC. The Company has appealed this provision of the judgment. On March 1, 2002, SCE made a payment to the Cal PX that included amounts it owed the Company. The Company has made a filing with FERC seeking an order providing for the disbursement of the funds owed to the suppliers. The FERC and the bankruptcy court governing the Cal PX bankruptcy proceedings are considering how to dispense this money and it remains uncertain when those funds will be paid over to the Company.

As of December 31, 2001 and March 31, 2002, the Company was owed a total of \$302 million and \$267 million, respectively, by the Cal ISO, the Cal PX, the CDWR, and California Energy Resources Scheduling for energy sales in the California wholesale market during the fourth quarter of 2000 through March 31, 2002. From March 31, 2002 through May 10, 2002, the Company has collected \$3 million of these receivable balances. As of December 31, 2001, the Company had a pre-tax provision of \$68 million against receivable balances related to energy sales in the California market. In the first quarter of 2002, \$33 million of a previously accrued credit provision for energy sales in California was reversed. The reversal resulted from collections of outstanding receivables during the period coupled with a determination that credit risk had been reduced on the remaining outstanding receivables as a result of payments in 2002 to the Cal PX, as referred to above. In the first quarter of 2001, the Company recorded a \$38 million provision against receivable balances related to energy sales in the West region. As of March 31, 2002, the Company had a remaining pre-tax provision of \$35 million against these receivable balances. Management will continue to assess the collectability of these receivables based on further developments affecting the California electricity market and the market participants described herein.

FERC Market Mitigation. In response to the filing of a number of complaints challenging the level of wholesale prices, the FERC initiated a staff investigation and issued a number of orders implementing a series of wholesale market reforms. In these orders, the FERC also instituted a refund proceeding, described below, as a result of which

the Company may face an as yet undetermined amount of refund liability. See "- FERC Refunds" below. Prior to accepting a methodology for calculating refunds in the refund proceeding, the FERC has identified, for the period January 1, 2001 through June 19, 2001, approximately \$20 million of the \$149 million charged by the Company for sales in California to the Cal ISO and the Cal PX as being subject to possible refunds. During the second quarter of 2001, the Company accrued refunds of \$15 million, \$3 million of which had been previously expensed during the first quarter of 2001.

On April 26, 2001, the FERC issued an order replacing previous price review procedures and establishing a market monitoring and mitigation plan, effective May 29, 2001, for the California markets. The plan establishes a cap on prices during periods when power reserves fall below 7% in the Cal ISO (reserve deficiency periods). The Cal ISO is instructed to use data submitted confidentially by gas-fired generators in California and daily indices of natural gas to establish the proxy market-clearing price in real-time based on the marginal cost of the highest-cost generator called to run. The plan also requires generators in California to offer all their available capacity for sale in the real-time market, and conditions sellers' market-based rate authority such that prices charged by sellers engaging in certain bidding practices will be subject to increased scrutiny by the FERC, and such sellers could face potential refunds and even revocation of their market-based rate authority. On June 19, 2001, the FERC issued an order modifying the market monitoring and mitigation plan adopted in its April 26 order, to apply price controls to all hours, instead of just hours of low operating reserve, and to extend the mitigation measures to other Western states in addition to California, including Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming. The FERC set July 2, 2001 as the refund effective date for sales subject to the price mitigation plan throughout the West region. This means that transactions after that date may be subject to refund if found to be unjust or unreasonable. The proxy market clearing price calculated by the Cal ISO under the June 19, 2001 order will apply during periods of reserve deficiency to all sales in the Cal ISO and Western spot markets. In non-reserve deficiency hours in California, the maximum price in California and the other Western states will be capped at 85% of the highest Cal ISO hourly market clearing price established during the most recent reserve deficiency period. Sellers other than marketers will be allowed to bid higher than the maximum prices, but such bids are subject to justification and potential refund. Justification of higher prices is limited to demonstrating higher actual gas costs than the gas price index used in the proxy price calculation together with showing that conditions in natural gas markets changed significantly. The modified monitoring and mitigation plan went into effect June 20, 2001, and is scheduled to terminate on September 30, 2002, covering two summer peak seasons, or approximately 16 months.

On December 19, 2001, the FERC issued additional orders on price mitigation in California and the West region. These orders largely maintained existing mitigation mechanisms, but allowed prices to rise in connection with natural gas prices for the period from December 20, 2001 through April 30, 2002, at which point the previous mitigation formula was reinstated.

In addition, the December 19, 2001 orders also affirmed the June 19, 2001 order's requirement that generators must offer all available capacity for sale in the real-time market. As a result of this requirement, the Company's opportunity to sell ancillary services in the West region is reduced. During 2001, the Company recorded \$42 million in revenues related to ancillary services in the West region.

On May 15, 2002, the FERC issued several orders clarifying and modifying its mitigation measures. These orders removed the possibility that the Cal ISO would retroactively adjust mitigated market clearing prices for 2001 and provided the Cal ISO with further instructions for payment of minimum load costs owed to sellers complying with the must offer obligation for the period June 20, 2001 through the expiration of mitigation on September 30, 2002.

The Company believes that while the mitigation plan will reduce volatility in the market, the Company will nevertheless be able to profitably operate its facilities in the West. Any adverse impacts of the mitigation plan on the Company's operations would be mitigated, in part, by the Company's forward hedging activities. Additionally, as noted above, the mitigation plan allows sellers, such as the Company, to justify prices above the proxy price. However, previous efforts by the Company to justify prices above the proxy price have been rejected by the FERC and there is no certainty that the FERC will allow for the recovery of costs above the proxy price.

FERC Refunds. The FERC issued an order on July 25, 2001 adopting a refund methodology and initiating a hearing schedule to determine (a) revised mitigated prices for each hour from October 2, 2000 through June 20, 2001; (b) the amount owed in refunds by each supplier according to the methodology (these amounts may be in

addition to or in place of the refund amounts previously determined by the FERC); and (c) the amount currently owed to each supplier. The amounts of any refunds will be determined by the FERC after the conclusion of the hearing process. On December 19, 2001, the FERC issued an order modifying the methodology to be used to determine refund amounts. The schedule currently anticipates that the Administrative Law Judge will make his refund amount recommendations to the FERC in October 2002. However, the Company does not know when the FERC will issue its final decision. The Company has not reserved any amounts for potential future refund liability resulting from the FERC refund hearing, nor can it currently predict the amount of these potential refunds, if any, because the methodology used to calculate these refunds is not final and will depend on information that is still subject to review and challenge in the hearing process. Any refunds that are determined in the FERC proceeding will likely be offset against unpaid amounts owed, if any, to the Company for its prior sales.

On November 20, 2001, the FERC instituted an investigation under Section 206 of the Federal Power Act regarding the tariffs of all sellers with market-based rates authority, including the Company. In this proceeding, the FERC proposes to condition the market-based rate authority of all sellers on their not engaging in anti-competitive behavior. Such condition would depend upon a further order from FERC establishing a refund effective date. This condition would allow the FERC, if it determines that a seller has engaged in anti-competitive behavior subsequent to the start of the refund effective period, to order refunds back to the date of such behavior. The FERC invited comments regarding this proposal, and the Company has filed comments in opposition to the proposal. On March 11, 2002, the FERC's Staff held a conference with market participants to discuss the comments FERC has received, and possible modification of the proposed conditions to address concerns raised in the comments while protecting consumers against anticompetitive behavior. The timing of further action by FERC is uncertain, although the FERC has publicly indicated that it is considering modifications that would limit the scope and application of its original proposal. If the FERC does not modify or reject its proposed approach for dealing with anti-competitive behavior, the Company's future earnings may be affected by the refund obligation.

On February 13, 2002, the FERC issued an order initiating a staff investigation into potential manipulation of electric and natural gas prices in the West region for the period January 1, 2000 forward. While this order does not propose any action against the Company, if the investigation results in findings that markets were dysfunctional during this period, those findings may be used in support of existing or future claims by the FERC or others that prices for sales in the West region after January 1, 2000 should be altered. As part of the investigation and in response to the disclosure of documents describing certain electricity trading strategies used by Enron Power Marketing (Enron documents), the FERC on May 8, 2002 issued a request for admissions and associated data to all sellers of wholesale electricity and ancillary services in the Cal ISO and Cal PX markets during 2000 through 2001, including the Company. The FERC's data request seeks information concerning whether the Company and approximately 150 other sellers used the same or similar trading strategies and practices as described in the Enron documents. The FERC has not yet publicly stated whether it may assert that any of these strategies and practices were impermissible under market rules in effect during the period in question. The Company is in the process of reviewing records and conducting internal interviews in order to prepare its response, which is due May 22, 2002. A similar set of data requests dated May 7, 2002 and received by the Company on May 8, 2002 has been issued by the California Senate Select Committee to investigate price manipulation of the wholesale energy market and the Company is similarly reviewing and preparing responses to those requests. The response date for the Senate Select Committee's request is on May 22, 2002.

The above-described lawsuits and proceedings regarding California electricity sales are currently the subject of intense, highly-charged media and political attention. Their ultimate outcome cannot be predicted at this time.

Other Investigations. In addition to the FERC investigation discussed above, several state and other federal regulatory investigations and complaints have commenced in connection with the wholesale electricity prices in California and other neighboring Western states to determine the causes of the high prices and potentially to recommend remedial action. In California, the California State Senate and the California Office of the Attorney General have separate ongoing investigations into the high prices and their causes. Although these investigations have not been completed and no findings have been made in connection with either of them, the California Attorney General has filed a civil lawsuit in San Francisco Superior Court alleging that the Company has violated state laws against unfair and unlawful business practices and a complaint with the FERC alleging the Company violated the terms of its tariff with the FERC (see Note 13(a)). Adverse findings or rulings could result in punitive legislation, sanctions, fines or even criminal charges against the Company or its employees. The Company is cooperating with both investigations and has produced a substantial amount of information requested in subpoenas issued by each

body. The Washington and Oregon Attorneys General have also begun similar investigations.

Legislative Efforts. Since the inception of the California energy crisis, various pieces of legislation, including tax proposals, have been introduced in the U.S. Congress and the California Legislature addressing several issues related to the increase in wholesale power prices in 2000 and 2001. For example, a bill was introduced in the California legislature that would have created a "windfall profits" tax on wholesale electricity sales and would subject exempt wholesale generators, such as the Company's subsidiaries that own generation facilities in California, to regulation by the CPUC as "public utilities." To date, only a few energy-related bills have passed, such as the recently enacted plant inspection law, which would empower the CPUC to monitor activities of the Company's generating plants. The Company believes this bill is vulnerable to challenge based on the preemptive effect of the Federal Power Act. The Company does not believe that this or other legislation that has been enacted to date will have a material adverse effect on the Company. However, it is possible that legislation could be enacted on either the state or federal level that could have a material adverse effect on the Company's financial condition, results of operations and cash flows.

(e) Indemnification of Dutch Stranded Costs.

Background. In January 2001, the Dutch Electricity Production Sector Transitional Arrangements Act (Transition Act) became effective and, among other things, allocated to REPG and the three other large-scale Dutch generation companies, a share of the assets, liabilities and stranded cost commitments of BV Nederlands Elektriciteit Administratiekantoor (NEA), the coordinating body for the Dutch electricity generating sector. Prior to the enactment of the Transition Act, NEA acted as the national electricity pooling and coordinating body for the generation output of REPG and the three other large-scale national Dutch generation companies. REPG and the three other large-scale Dutch generation companies are shareholders of NEA.

The Transition Act and related agreements specify that REPG has a 22.5% share of NEA's assets, liabilities and stranded cost commitments. NEA's stranded cost commitments consisted primarily of various uneconomical or stranded cost investments and commitments, including a gas supply and three power contracts entered into prior to the liberalization of the Dutch wholesale electricity market. REPG's stranded cost obligations also include uneconomical district heating contracts which were previously administered by NEA prior to deregulation of the Dutch power market.

The gas supply contract expires in 2016 and provides for gas imports aggregating 2.283 billion cubic meters per year. Prior to December 31, 2001, one of the stranded cost power contracts was settled. The two remaining stranded cost power contracts have the following capacities and terms: (a) 300 MW through 2003, and (b) 600 MW through March 2002, increasing to 750 MW through March 2009. Under the Transition Act, REPG can either assume its 22.5% allocated interest in the contracts or, subject to the terms of the contracts, sell its interests to third parties. The district heating obligations relate to three water heating supply contracts entered into with various municipalities and expire from 2008 through 2015. Under the district heating contracts, the municipal districts are required to take annually a combined minimum of 5,549 terajoules (TJ) increasing annually to 7,955 TJ over the life of the contracts.

The Transition Act provided that, subject to the approval of the European Commission, the Dutch government will provide financial compensation to the Dutch generation companies, including REPG, for liabilities associated with (a) long-term district heating contracts and (b) an experimental coal facility. In July 2001, the European Commission ruled that under certain conditions the Dutch government can provide financial compensation to the generation companies for the district heating contracts. To the extent that this compensation is not ultimately provided to the generation companies by the Dutch government, REPG was to collect its compensation directly from the former shareholders as further discussed below.

Settlement of Stranded Cost Indemnification Agreement with REPG's Former Shareholders. Until December 2001, the former shareholders agreed pursuant to a share purchase agreement to indemnify REPG for up to NLG 1.9 billion of its share of NEA's stranded cost liabilities. In December 2001, REPG and its former shareholders entered into a settlement agreement immediately absolving the former shareholders of their stranded cost indemnity obligations related to the gas supply and power contracts under the original share purchase agreement. This agreement provides conditional terms for the possible settlement of the former shareholders' stranded cost indemnity obligation related to district heating obligations under certain conditions. The settlement agreement was approved in December 2001 by the Ministry of Economic Affairs of the Netherlands.

Under the settlement agreement, the former shareholders paid to REPGb NLG 500 million (\$202 million) in January and February 2002. The payment represents a settlement of the obligations of the former shareholders to indemnify REPGb for all stranded cost liabilities other than those relating to the district heating contracts. The full amount of this payment was placed into an escrow account in the name of REPGb to fund its stranded cost obligations related to the gas and electric import contracts. As of March 31, 2002, the remaining escrow funds were \$154 million, of which \$46 million and \$108 million were recorded in restricted cash and long-term assets, respectively. Any remaining escrow funds as of January 1, 2004 will be distributed to REPGb.

Under the settlement agreement, the former shareholders will continue to indemnify REPGb for certain stranded cost liabilities relating to district heating contracts. The terms of the indemnity are as follows:

- The settlement agreement acknowledges that the Netherlands is finalizing regulations for compensation of stranded costs associated with district heating projects. Within 21 days after the date these compensation rules take effect, REPGb can elect to receive one of two forms of indemnification under the settlement agreement.
- If the compensation to be paid by the Netherlands under these rules is at least as much as the compensation to be paid under the original indemnification agreement, REPGb can elect to receive a one-time payment of NLG 60 million (\$24 million). In addition, unless the decree implementing the new compensation rules provides for compensation for the lifetime of the district heating projects, REPGb can receive an additional cash payment of NLG 15 million (\$6 million).
- If the compensation rules do not provide for compensation at least equal to that provided under the original indemnification agreement, REPGb can claim indemnification for stranded cost losses up to a maximum of NLG 700 million (\$282 million) less the amount of compensation provided by the new compensation rules and certain proceeds received from arbitrations.
- If no new compensation rules have taken effect on or prior to December 31, 2003, REPGb is entitled, but not obligated, to elect to receive indemnification under the formula described above.

Prior to the settlement agreement, pursuant to the purchase agreement of REPGb, as amended, REPGb was entitled to a NLG 125 million (\$51 million) dividend from NEA with any remainder owing to the former shareholders. Under the settlement agreement, the former shareholders waived all rights to distributions of NEA.

As a result of this settlement, in 2001 the Company recognized a net gain of \$37 million for the difference between the sum of (a) the cash settlement payment of \$202 million and the additional rights to claim distributions of the Company's NEA investment recognized of \$248 million and (b) the amount recorded as stranded cost indemnity receivable related to the stranded cost gas and electric commitments of \$369 million and claims receivable related to stranded cost incurred in 2001 of \$44 million, both previously recorded in the Company's Consolidated Balance Sheets.

Liability for Stranded Costs. In January 2001, the Company recognized an out-of-market, net stranded cost liability for its gas and electric contracts and district heating commitments. At such time, the Company recorded a corresponding asset of equal amount for the indemnification of this obligation from REPGb's former shareholders and the Dutch government, as applicable. As of December 31, 2001 and March 31, 2002, the Company has recorded a liability of \$369 million and \$330 million, respectively, for its stranded cost gas and electric commitments in non-trading derivative liabilities and a liability of \$206 million and \$202 million, respectively, for its district heating commitments in current and non-current other liabilities. As of December 31, 2001 and March 31, 2002, the Company has recorded an indemnification receivable from the Dutch government for the district heating stranded cost liability of \$206 million and \$202 million, respectively.

Pursuant to SFAS No. 133, the gas and electric contracts are marked-to-market (see Note 3). The valuation of the gas and electric contracts are affected by, among other things, changes in the price of electric power, coal, low sulfur fuel oil and the value of the United States dollar relative to the Euro. Changes in the valuation of these stranded cost import contracts are recorded in the Company's Statement of Consolidated Income. During the three months ended March 31, 2002, the Company recognized a \$19 million gain related to changes in the valuation of

certain stranded cost contracts in the first quarter of 2002 recorded in fuel expense. The Company and the other shareholders of NEA are in formal discussions with the counterparties to two of the stranded cost purchase contracts. Pursuant to one of these contracts, NEA is required to purchase up to 750 MW per year through 2009. In addition, the Company may initiate discussions with the other counterparties to other stranded cost contracts to modify the terms of such out-of-market contracts. The structure of these settlements, if consummated, likely would entail an upfront cash payment to the counterparty in exchange for amendments to price and other terms intended to make the contracts more market conforming. REPG would seek to fund these payments, if made, to the extent possible through the proceeds from the settlement of its stranded cost indemnity agreement and, possibly, anticipated distributions from NEA. The Company cannot currently predict the outcome of these negotiations. However, to the extent that these discussions result in amendments to the contracts, the Company could realize a gain.

For additional information regarding the indemnification and settlement of stranded costs, see Note 14(h) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

(f) Construction Agency Agreements and Equipment Financing Structure.

In 2001, Reliant Resources, through several of its subsidiaries, entered into operative documents with special purpose entities to facilitate the development, construction, financing and leasing of several power generation projects. The special purpose entities are not consolidated by the Company. The special purpose entities have an aggregate financing commitment from equity and debt participants (Investors) of \$2.5 billion of which the last \$1.1 billion is currently available only if cash collateralized. The availability of the commitment is subject to satisfaction of various conditions, including the obligation to provide cash collateral for the loans and letters of credit outstanding on November 29, 2004. Reliant Resources, through several of its subsidiaries, acts as construction agent for the special purpose entities and is responsible for completing construction of these projects by December 31, 2004, but Reliant Resources has generally limited its risk during construction to an amount not in excess of 89.9% of costs incurred to date, except in certain events. Upon completion of an individual project and exercise of the lease option, Reliant Resources' subsidiaries will be required to make lease payments in an amount sufficient to provide a return to the Investors. If Reliant Resources does not exercise its option to lease any project upon its completion, Reliant Resources must purchase the project or remarket the project on behalf of the special purpose entities. Reliant Resources' ability to exercise the lease option is subject to certain conditions. Reliant Resources must guarantee that the Investors will receive an amount at least equal to 89.9% of their investment in the equipment in the case of a remarketing sale at the end of construction. At the end of an individual project's initial operating lease term (approximately five years from construction completion), Reliant Resources' subsidiary lessees have the option to extend the lease with the approval of Investors, purchase the project at a fixed amount equal to the original construction cost, or act as a remarketing agent and sell the project to an independent third party. If the lessees elect the remarketing option, they may be required to make a payment of an amount not to exceed 85% of the project cost, if the proceeds from remarketing are not sufficient to repay the Investors. Reliant Resources has guaranteed the performance and payment of its subsidiaries' obligations during the construction periods and, if the lease option is exercised, each lessee's obligations during the lease period. At any time during the construction period or during the lease, Reliant Resources may purchase a facility by paying an amount approximately equal to the outstanding balance plus costs.

Reliant Resources, through its subsidiary, REPG, has entered into an agreement with a bank whereby the bank, as owner, entered or will enter into contracts for the purchase and construction of power generation equipment and REPG, or its subagent, acts as the bank's agent in connection with administering the contracts for such equipment. Under the agreement, the bank has agreed to provide up to a maximum aggregate amount of \$650 million. REPG and its subagents must cash collateralize their obligation to administer the contracts. This cash collateral is approximately equivalent to the total payments by the bank for the equipment, interest and other fees. As of March 31, 2002, the bank had assumed contracts for the purchase of three turbines, two heat recovery steam generators and one air cooled condenser with an aggregate cost of \$140 million. REPG, or its designee, has the option at any time to purchase, or, at equipment completion, subject to certain conditions, including the agreement of the bank to extend financing, to lease the equipment, or to assist in the remarketing of the equipment under terms specified in the agreement. All costs, including the purchase commitment on the turbines, are the responsibility of the bank. The cash collateral is deposited by REPG or an affiliate into a collateral account with the bank and earns interest at LIBOR less 0.15%. Under certain circumstances, the collateral deposit or a portion of it, will be returned to REPG or its designee. Otherwise, it will be retained by the bank. At December 31, 2001 and March 31, 2002, REPG and its subsidiary had deposited \$230 million and \$100 million, respectively, into the collateral account. In January 2002, the bank sold to the parties to the construction agency agreements discussed above, equipment contracts with a total

contractual obligation of \$258 million, under which payments and interest during construction totaled \$142 million. Accordingly, \$142 million of Reliant Resources' collateral deposits were returned to Reliant Resources. As of March 31, 2002, there were equipment contracts with a total contractual obligation of \$140 million under which payments during construction totaled \$99.5 million. Currently this equipment is not designated for current planned power generation construction projects. Therefore, Reliant Resources anticipates that it will either purchase the equipment, assist in the remarketing of the equipment or negotiate to cancel the related contracts.

(g) REMA Sale/Leaseback Transactions.

In August 2000, subsidiaries of Reliant Resources entered into separate sale/leaseback transactions with each of the three owner-lessors for the Company's respective 16.45%, 16.67% and 100% interests in the Conemaugh, Keystone and Shawville generating stations, respectively, which Reliant Resources acquired in the REMA acquisition. The lease documents contain some restrictive covenants that restrict REMA's ability to, among other things, make dividend distributions unless REMA satisfies various conditions. As of March 31, 2002, these various conditions were satisfied by REMA. As of December 31, 2001, REMA had \$167 million of restricted funds that were available for REMA's working capital needs and to make future lease payments. For additional discussion of these lease transactions, please read Notes 3(a) and 14(b) to the Reliant Energy 10-K Notes, which notes are incorporated herein by reference.

(h) Nuclear Insurance.

The Company has a 30.8% interest in the South Texas Project Electric Generating Station (South Texas Project), which consists of two 1,250 MW nuclear generating units and bears a corresponding 30.8% share of capital and operating costs associated with the project. The South Texas Project is owned as a tenancy in common among its four co-owners, with each owner retaining its undivided ownership interest in the two nuclear-fueled generating units and the electrical output from those units. The Company and the other owners of the South Texas Project maintain nuclear property and nuclear liability insurance coverage as required by law and periodically review available limits and coverage for additional protection. The owners of the South Texas Project currently maintain \$2.75 billion in property damage insurance coverage, which is above the legally required minimum, but is less than the total amount of insurance currently available for such losses.

Pursuant to the Price Anderson Act, the maximum liability to the public of owners of nuclear power plants was \$9.3 billion as of March 31, 2002. Owners are required under the Price Anderson Act to insure their liability for nuclear incidents and protective evacuations. The Company and the other owners of the South Texas Project currently maintain the required nuclear liability insurance and participate in the industry retrospective rating plan.

There can be no assurance that all potential losses or liabilities will be insurable, or that the amount of insurance will be sufficient to cover them. Any substantial losses not covered by insurance would have a material effect on the Company's financial condition, results of operations and cash flows.

(i) Nuclear Decommissioning.

The Company contributed \$14.8 million per year in 2000 and 2001 to a trust established to fund its share of the decommissioning costs for the South Texas Project. Pursuant to an October 3, 2001 Order from the Texas Utility Commission, beginning in 2002, the Company will contribute \$2.9 million per year to this trust. There are various investment restrictions imposed upon the Company by the Texas Utility Commission and the NRC relating to the Company's nuclear decommissioning trust. Additionally, the Company's board of directors has appointed the Nuclear Decommissioning Trust Investment Committee to establish the investment policy of the trust and oversee the investment of the trusts' assets. The securities held by the trust for decommissioning costs had an estimated fair value of \$168 million as of March 31, 2002, of which approximately 45% were fixed-rate debt securities and the remaining 55% were equity securities. For a discussion of the accounting treatment for the securities held in the Company's nuclear decommissioning trust, see Note 6 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference. In July 1999, an outside consultant estimated the Company's portion of decommissioning costs to be approximately \$363 million. While the current funding levels currently exceed minimum NRC requirements, no assurance can be given that the amounts held in trust will be adequate to cover the actual decommissioning costs of the South Texas Project. Such costs may vary because of changes in the assumed date of decommissioning and changes in regulatory requirements, technology and costs of labor, materials and equipment. Pursuant to the Texas

electric restructuring law, costs associated with nuclear decommissioning that have not been recovered as of January 1, 2002, will continue to be subject to cost-of-service rate regulation and will be included in a charge to transmission and distribution customers.

(14) REPORTABLE BUSINESS SEGMENTS

The Company's determination of reportable business segments considers the strategic operating units under which the Company manages sales, allocates resources and assesses performance of various products and services to wholesale or retail customers in differing regulatory environments. The Company has identified the following reportable business segments: Electric Generation, Electric Transmission and Distribution, Natural Gas Distribution, Pipelines and Gathering, Wholesale Energy, European Energy, Retail Energy and Other Operations. Effective with the deregulation of the Texas electric industry beginning January 1, 2002, the basis of business segment reporting has changed for the Company's electric operations. Although the Company's retail sales are now conducted by Reliant Resources, retail customers remained regulated customers of Reliant Energy HL&P through the date of their first meter reading in 2002. Sales of electricity in 2002 prior to such meter reading are reflected in the Electric Transmission and Distribution business segment. The Texas generation operations of Reliant Energy's former integrated utility, Reliant Energy HL&P, are now a separate reportable business segment, whereas they previously had been part of the Electric Operations business segment. The remaining transmission and distribution function is now reported separately in the Electric Transmission and Distribution business segment, which also includes all impacts from generation-related regulatory assets recoverable by the regulated utility, including the ECOM true-up component of stranded costs. In 2001, Latin America was a separate business segment, but is now reported in the Other Operations business segment beginning in 2002. Reportable business segments from 2001 have been restated to conform to the 2002 presentation. Note that estimates have been used to separate historical, pre-January 1, 2002, Electric Generation business segment data. For descriptions of these reportable business segments, see Note 1 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

Beginning in the first quarter of 2002, the Company began to evaluate business segment performance on an earnings (loss) before interest expense, minority interest and income taxes (EBIT) basis. Prior to 2002, the Company evaluated performance on operating income. EBIT, as defined, is shown because it is a widely accepted measure of financial performance used by analysts and investors to analyze and compare companies on the basis of operating performance. EBIT is not defined under accounting principles generally accepted in the United States (GAAP), and should not be considered in isolation or as a substitute for a measure of performance prepared in accordance with GAAP and is not indicative of operating income from operations as determined under GAAP.

Financial data for the reportable business segments are as follows:

	FOR THE THREE MONTHS ENDED MARCH 31, 2001			AS OF DECEMBER 31, 2001
	REVENUES FROM NON-AFFILIATES	NET INTERSEGMENT REVENUES	EBIT	TOTAL ASSETS
	(IN MILLIONS)			
Electric Generation(1)	\$ --	\$ 1,023	\$ 37	\$ 4,295
Electric Transmission and Distribution	1,390	--	162	7,717
Natural Gas Distribution	2,269	54	137	3,732
Pipelines and Gathering	75	55	39	2,361
Wholesale Energy	8,053	309	229	8,252
European Energy	248	--	21	3,380
Retail Energy (3)	14	13	(3)	391
Other Operations	29	1	(131)	2,228
Eliminations/Other	--	(1,455)	9	(1,646)
Consolidated	\$ 12,078	\$ --	\$ 500	\$ 30,710
	=====	=====	=====	=====

FOR THE THREE MONTHS ENDED MARCH 31, 2002 AS OF
MARCH 31, 2002

	REVENUES FROM NON-AFFILIATES	NET INTERSEGMENT REVENUES	EBIT	TOTAL ASSETS
--	---------------------------------	---------------------------------	------	--------------

(IN MILLIONS)

Electric Generation(1)	\$ 95	\$ 231	\$ (52)	\$ 4,517
Electric Transmission and Distribution(2)	404	221	259	7,569
Natural Gas Distribution	1,178	2	110	3,589
Pipelines and Gathering	51	41	38	2,362
Wholesale Energy	5,419	114	114	13,639
European Energy	535	--	18	3,296
Retail Energy (3)	972	7	48	1,683
Other Operations	2	--	(13)	1,569
Eliminations/Other	--	(616)	1	(1,233)
	-----	-----	-----	-----
Consolidated	\$ 8,656	\$ --	\$ 523	\$ 36,991
	=====	=====	=====	=====

- (1) For 2001, revenues were derived based on an allowed regulatory rate of return on invested capital with Reliant Energy HL&P being the sole customer of the Electric Generation business segment. Expenses, such as fuel and cost of gas sold, operations and maintenance and depreciation and amortization, and assets, such as property, plant and equipment and inventory, were specifically identified by function and reported accordingly. Various allocations were used to disaggregate other common expenses, assets and liabilities between the Electric Generation and the Electric Transmission and Distribution business segments. Interest expense was calculated based upon an allocation methodology that charged the Electric Generation business segment with financing and equity costs from Reliant Energy in proportion to its share of total net assets prior to the effects of deregulation. For 2002, the Electric Generation business segments' operations reflect the results of market prices for power.
- (2) Retail customers remained regulated customers of Reliant Energy HL&P through the date of their first meter reading in 2002. Sales of electricity to retail customers in 2002 prior to this meter reading are reflected in the Electric Transmission and Distribution business segment.
- (3) The Retail Energy business segment became a provider of retail electricity in Texas when that market began opening to retail competition in late 2001 and fully opened to retail competition in January 2002. As a retail electric provider, the Retail Energy business segment generally procures or buys electricity from wholesale generators at unregulated rates, sells electricity at generally unregulated rates to retail customers and pays the local transmission and distribution regulated utilities a regulated tariff rate for delivering electricity. In January 2002, the Retail Energy business segment began to provide retail electric services to all of the approximately 1.7 million customers of Reliant Energy HL&P's electric utility located in its service area who did not take action to select another retail electric provider.

Reconciliation of Operating Income to EBIT and EBIT to Net Income
 Attributable to Common Stockholders:

FOR THE THREE MONTHS ENDED MARCH 31,

	2001	2002
	(IN MILLIONS)	
Operating income	\$ 458	\$ 517
Unrealized gain (loss) on AOL Time Warner investment	137	(218)
Unrealized (loss) gain on indexed debt securities	(135)	203
Income from equity investment of unconsolidated subsidiaries	13	4
Other income, net	27	17
EBIT	500	523
Interest expense	(178)	(154)
Distribution on trust preferred securities	(14)	(14)
Minority interest	1	(16)
Income before income taxes and cumulative effect of accounting change	309	339
Income tax expense	(108)	(114)
Cumulative effect of accounting change	61	--
Net income attributable to common stockholders	\$ 262	\$ 225

(15) SUBSEQUENT EVENTS

(a) Price to Beat Fuel Factor Adjustment.

The Texas Utility Commission regulations allow the Company to adjust the fuel factor in its price to beat to its Houston residential and small commercial customers based on the percentage change in the price of natural gas. In addition, the Company may also request an adjustment as a result of changes in the price of purchased energy. On May 2, 2002, Reliant Resources filed a request with the Texas Utility Commission to increase the fuel factor in its price to beat. Reliant Resources' price to beat was initially set by the Texas Utility Commission in November 2001 at the then average forward 12 month gas price strip of approximately \$3.11/mmbtu. Since the initial setting, the market price of natural gas has increased 20% to \$3.73/mmbtu during April 2002. The earliest the new price to beat could go into effect would be June 17, 2002.

(b) Liquidation of Interest Rate Swaps.

On May 9, 2002, Reliant Resources liquidated \$500 million of forward starting interest rate swaps that were entered into in January 2002. The liquidation of these hedges resulted in a loss of \$3 million, which will be recorded in other comprehensive income and amortized into interest expense over the life of the notes when issued in the future.

(c) Class Action Lawsuits.

The Company is aware that in May 2002 at least four class action lawsuits were filed on behalf of purchasers of securities of Reliant Resources. Reliant Resources and several of its executive officers are named as defendants. Reliant Energy is also named as a defendant in one of the lawsuits. The first two lawsuits were filed on May 15, 2002 and the other two lawsuits were filed on May 16, 2002. All of the lawsuits were filed in the United States District Court, Southern District of Texas, Houston Division. The complaints allege that the defendants violated federal securities laws by issuing false and misleading statements to the public. The plaintiffs allege that the defendants overstated the revenues of Reliant Resources by including transactions involving the purchase and sale of commodities with the same counterparty at the same price and that Reliant Resources improperly accounted for certain other transactions. The complaints seek monetary damages and, in one of the lawsuits rescission, on behalf of persons who purchased or otherwise acquired Reliant Resources securities between May 1, 2001 and May 10, 2002. The lawsuit that includes Reliant Energy as a named defendant was filed on behalf of purchasers of securities of Reliant Resources and/or Reliant Energy between May 14, 1999 and May 9, 2002. The Company has not yet answered or otherwise responded to these lawsuits. Their ultimate outcome cannot be predicted at this time.

Additionally, the Company is aware that on May 16, 2002 a class action lawsuit was filed on behalf of purchasers of securities of Reliant Energy. Reliant Energy and several of its executive officers are named as defendants. The lawsuit was filed in the United States District Court, Southern District of Texas, Houston Division. The complaint alleges that the

defendants violated federal securities laws by issuing false and misleading statements to the public. The plaintiffs allege that the defendants' false and misleading statements were part of a scheme to artificially inflate trading volumes and revenues by including transactions involving the purchase and sale of commodities with the same counterparty at the same price, to spin-off Reliant Resources to avoid exposure to Reliant Resources' liabilities and to cause the price of Reliant Resources' stock to rise artificially, among other things. The complaint seeks monetary damages on behalf of persons who purchased Reliant Energy securities between January 2, 1999 and May 10, 2002. The Company has not yet answered or otherwise responded to the lawsuit. Its ultimate outcome cannot be predicted at this time.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS OF RELIANT ENERGY AND SUBSIDIARIES

The following discussion and analysis should be read in combination with our Interim Financial Statements contained in this Form 10-Q.

EFFECTS OF RESTATEMENT ON THE INTERIM FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2001

On May 9, 2002, Reliant Resources determined that they had engaged in same-day commodity trading transactions involving purchases and sales with the same counterparty for the same volume at substantially the same price, which the personnel who effected these transactions apparently did so with the objective of increasing volumes. Reliant Resources commenced a review to quantify the amount and assess the impact of these trades (round trip trades). The Audit Committee of the Board of Directors has also directed an internal investigation by outside legal counsel of the facts and circumstances relating to the round trip trades and related matters.

We currently report all trading, marketing and risk management services transactions on a gross basis with such transactions being reported in revenues and expenses except primarily for financial gas transactions such as swaps. Therefore, the round trip trades were reflected in both our revenues and expenses. The round trip trades should not have been recognized in revenues or expenses (i.e., they should have been reflected on a net basis). However, since the round trip trades were done at the same volume and substantially the same price they had no impact on our reported cash flows, operating income or net income.

Based on our review, we have determined that we engaged in such round trip trades in 1999, 2000 and 2001, and our review did not identify any round trip trades conducted during 2002. The results of the Audit Committee's investigation are consistent with the results of our review. During the first quarter of 2001, the trades of this nature were 20 million megawatt hours (MWh) of power. In the first quarter of 2001, these transactions had the effect of increasing revenues and purchased power expense by approximately \$1.2 billion, or approximately 10% and 43%, respectively.

The consolidated financial statements for the three months ended March 31, 2001 have been restated from amounts previously reported to reflect these transactions on a net basis. The reinstatement had no impact on previously reported consolidated cash flows, operating income or net income. The principal effects of the restatement on the accompanying financial statements are set forth in Note 1 of the Interim Financial Statements.

OVERVIEW

We are a diversified international energy services and energy delivery company that provides energy and energy services primarily in North America and Western Europe. We operate one of the United States' largest electric transmission and distribution utilities, and our three natural gas distribution divisions together form one of the United States' largest natural gas distribution operations in terms of customers served. We invest in the acquisition, development and operation of domestic non-rate regulated power generation facilities. We own two interstate natural gas pipelines that provide gas transportation, supply, gathering and storage services, and we also engage in wholesale energy marketing and trading.

In this section we discuss our results of operations on a consolidated basis and individually for each of our business segments. We also discuss our liquidity, capital resources and critical accounting policies. Our financial reporting business segments include Electric Generation, Electric Transmission and Distribution, Natural Gas Distribution, Pipelines and Gathering, Wholesale Energy, European Energy, Retail Energy and Other Operations. Effective with the full deregulation of sales of electric energy to retail customers in Texas beginning January 1, 2002, the basis of business segment reporting has changed for our electric operations. Although our retail sales are now conducted by Reliant Resources, retail customers remained regulated customers of Reliant Energy HL&P through the date of their first meter reading in 2002. Sales of electricity to retail customers in 2002 prior to this meter reading are reflected in the Electric Transmission and Distribution business segment. The Texas generation operations of Reliant Energy's former integrated utility, Reliant Energy HL&P, are now a separate reportable business segment, whereas they previously had been part of the Electric Operations business segment. The remaining transmission and distribution function is now reported separately in the Electric Transmission and Distribution business segment. In 2001, Latin America was a separate business segment, but is now reported in the Other Operations business segment beginning in 2002. Reportable business segments from 2001 have been restated to conform to the 2002 presentation. For business segment reporting information, please read Notes 1 and 14 to our Interim Financial Statements.

We are in the process of separating our regulated and unregulated businesses into two publicly traded companies. In December 2000, we transferred a significant portion of our unregulated businesses to Reliant Resources, which, at the time, was a wholly owned subsidiary. Reliant Resources conducted an

initial public offering (Offering) of approximately 20% of its common stock in May 2001. In December 2001, our shareholders approved an agreement and plan of merger by which, subject to regulatory approvals, the following will occur

(which we refer to herein as the Restructuring):

- CenterPoint Energy, Inc. (CenterPoint Energy) will become the holding company for the Reliant Energy group of companies;
- Reliant Energy and its subsidiaries will become subsidiaries of CenterPoint Energy; and
- each share of Reliant Energy common stock will be converted into one share of CenterPoint Energy common stock.

After the Restructuring, we plan, subject to further corporate approvals, market and other conditions, to complete the separation of our regulated and unregulated businesses by distributing the shares of common stock of Reliant Resources that we own to our shareholders (which we refer to herein as the Distribution). Our goal is to complete the Restructuring and subsequent Distribution as quickly as possible after all the necessary conditions are fulfilled, including receipt of an order from the Securities and Exchange Commission (SEC) granting the required approvals under the Public Utility Holding Company Act of 1935 (1935 Act) and an extension from the Internal Revenue Service for a private letter ruling we have obtained regarding the tax-free treatment of the Distribution. We believe we will receive the necessary approvals. We currently expect to complete the Restructuring and Distribution in the summer of 2002. However, until the requisite approvals are received, no assurance can be provided that the Distribution will occur as described above or that it will occur within this time period. Upon receipt of approval under the 1935 Act, CenterPoint Energy expects to register and become subject, with its subsidiaries, to regulation as a registered holding company system under the 1935 Act.

Thereafter, in order to enable CenterPoint Energy ultimately to comply with the requirements for exemption from registration in Section 3(a)(1) of the 1935 Act, we plan to divide the gas distribution businesses conducted by Reliant Energy Resources Corp.'s (RERC Corp.) three unincorporated divisions, Reliant Energy Entex, Reliant Energy Arkla and Reliant Energy Minnegasco among three separate entities. The entity that will hold the Reliant Energy Entex assets will also hold RERC Corp.'s natural gas pipelines and gathering business. In addition to regulatory approvals we have obtained, this restructuring will require approval of the public service commissions of Louisiana, Mississippi, Oklahoma and Arkansas.

Although we believe that this business restructuring will be completed, we can provide no assurance that this will, in fact, occur, or that CenterPoint Energy will ultimately be exempt from registration under the 1935 Act. For further information on the RERC Corp. restructuring, see "Our Business -- RERC Corp. Restructuring" in Item 1 of the Reliant Energy Form 10-K.

CONSOLIDATED RESULTS OF OPERATIONS

	THREE MONTHS ENDED MARCH 31,	
	----- 2001 -----	----- 2002 -----
	(IN MILLIONS, EXCEPT PER SHARE DATA)	
Revenues	\$ 12,078	\$ 8,656
Operating Expenses	(11,620)	(8,139)
Operating Income	458	517
Unrealized Gain (Loss) on AOL Time Warner Investment	137	(218)
Unrealized (Loss) Gain on Indexed Debt Securities	(135)	203
Income from Equity Investments in Unconsolidated Subsidiaries	13	4
Other Income, net	27	17
Earnings Before Interest and Taxes	500	523
Interest Expense	(178)	(154)
Distribution on Trust Preferred Securities	(14)	(14)
Minority Interest	1	(16)
Income Before Income Taxes and Cumulative Effect of Accounting Change	309	339
Income Tax Expense	(108)	(114)
Cumulative Effect of Accounting Change, net of tax	61	--
Net Income Attributable to Common Stockholders	\$ 262	\$ 225
Basic Earnings Per Share	\$ 0.91	\$ 0.76
Diluted Earnings Per Share	\$ 0.90	\$ 0.76

Three months ended March 31, 2001 compared to three months ended March 31, 2002

Net Income. We reported consolidated net income of \$225 million (\$0.76 per diluted share) for the three months ended March 31, 2002 compared to \$262 million (\$0.90 per diluted share) for the three months ended March 31, 2001. The 2001 results reflect a \$61 million after-tax non-cash gain from the adoption of Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, and a \$65 million after-tax non-cash charge relating to the redesign of some of our benefit plans in anticipation of our separation from Reliant Resources. For additional discussion of the adoption of SFAS No. 133, please read Note 5 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference. Effective January 1, 2002, we discontinued amortizing goodwill in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets (SFAS No. 142)." During the first quarter of 2001, we recognized \$21 million of goodwill amortization expense. A discussion of earnings before interest and taxes (EBIT) by segment is presented following the consolidated results of operations discussion below. The decrease in net income attributable to common stockholders for the first quarter of 2002 was primarily due to the following:

- a \$115 million decrease in EBIT from our Wholesale Energy business segment primarily due to less favorable market conditions;
- a \$27 million decrease in EBIT from our Natural Gas Distribution business segment primarily due to milder weather;
- a \$16 million negative impact related to our investment in AOL Time Warner securities and related indexed debt securities;
- a \$17 million increase in minority interest expense primarily related to minority interest in Reliant Resources as a result of the initial public offering of Reliant Resources' common stock in May 2001; and
- a \$61 million after-tax non-cash gain in the first quarter of 2001 from the adoption of SFAS No. 133.

The above items were partially offset by:

- a \$101 million pre-tax (\$65 million after-tax), non-cash charge incurred in the first quarter of 2001 relating to the redesign of some of our benefit plans in anticipation of our separation from Reliant Resources;
- a \$51 million increase in EBIT from our Retail Energy business segment;
- a \$21 million decrease in goodwill amortization in the first quarter of 2002 due to the adoption of SFAS No. 142; and
- a \$24 million decrease in interest expense.

Interest Expense. We incurred interest expense of \$154 million during the three months ended March 31, 2002 compared to \$178 million in the same period of 2001. The decrease in interest expense of \$24 million in 2002 as compared to 2001 resulted primarily from lower interest rates partially offset by increased borrowing levels due to the acquisition of Orion Power Holdings, Inc. (Orion Power) on February 19, 2002 as discussed in Note 5 to our Interim Financial Statements.

Income Tax Expense. During the three months ended March 31, 2001 and 2002, our effective tax rate was 34.9% and 33.6%, respectively. The decrease in the effective tax rate for the first quarter of 2002 compared to the first quarter of 2001 was primarily due to lower state tax expense, the discontinuance of goodwill amortization in accordance with SFAS No. 142, and other favorable adjustments, offset by the nondeductible minority interest provision, and higher taxes on Reliant Energy Power Generation Benelux N.V.'s (REPGB) earnings. In 2001, the earnings of REPGB were subject to a zero percent Dutch corporate income tax rate as a result of a tax holiday for the Dutch electricity industry. In 2002, REPGB's earnings in the Netherlands are subject to the standard Dutch corporate income tax rate, which is currently 34.5%.

EARNINGS BEFORE INTEREST AND INCOME TAXES BY BUSINESS SEGMENT

The following table presents EBIT for each of our business segments for the three months ended March 31, 2001 and 2002. EBIT represents earnings (loss) before interest expense, minority interest and income taxes. EBIT, as defined, is shown because it is a widely accepted measure of financial performance used by analysts and investors to analyze and compare companies on the basis of operating performance. It is not defined under generally accepted accounting principles, and should not be considered in isolation or as a substitute for a measure of performance prepared in accordance with generally accepted accounting principles (GAAP) in the United States and is not indicative of operating income from operations as determined under GAAP. Additionally, our computation of EBIT may not be comparable to other similarly titled measures computed by other companies, because all companies do not calculate it in the same fashion. For a reconciliation of our business segments' operating income (loss) to EBIT and EBIT to net income, please read Note 14 to our Interim Financial Statements.

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS)	
Electric Generation	\$ 37	\$ (52)
Electric Transmission and Distribution	162	259
Natural Gas Distribution	137	110
Pipelines and Gathering	39	38
Wholesale Energy	229	114
European Energy	21	18
Retail Energy	(3)	48
Other Operations	(131)	(13)
Eliminations/Other	9	1
	-----	-----
Total Consolidated EBIT	\$ 500	\$ 523
	=====	=====

ELECTRIC BUSINESS SEGMENTS

For information regarding factors that may affect the future results of operations of our Electric business segments, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations --

Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Electric Operations" in the Reliant Energy Form 10-K, which is incorporated herein by reference.

The following tables provide summary data, including EBIT, of our Electric business segments for the three months ended March 31, 2001 and 2002:

	THREE MONTHS ENDED MARCH 31, 2001	
	----- (IN MILLIONS)	
Operating Revenues:		
Electric Revenues	\$	1,390

Total Operating Revenues		1,390
Operating Expenses:		
Fuel and Purchased Power		786
Operation and Maintenance		248
Depreciation and Amortization		79
Other Operating Expenses		91

Total Operating Expenses		1,204
Operating Income		186
Other Income, net		13

Earnings Before Interest and Income Taxes .	\$	199
	=====	
Electric Sales Including Unbilled (Gwh(1)):		
Residential		3,951
Commercial		3,969
Industrial		7,438
Other		296

Total Sales Including Unbilled		15,654
	=====	

(1) Gigawatt hours

	THREE MONTHS ENDED MARCH 31, 2002			
	ELECTRIC GENERATION	ELECTRIC TRANSMISSION & DISTRIBUTION	ELIMINATIONS	TOTAL
	----- (IN MILLIONS)			
Operating Revenues:				
Electric Revenues.....	\$ 326	\$ 484	\$ (101)	\$ 709
ECOM True-Up.....	--	141	--	141
	-----	-----	-----	-----
Total Operating Revenues.....	326	625	(101)	850
Operating Expenses:				
Fuel and Purchased Power.....	229	76	(60)	245
Operation and Maintenance.....	96	181	(41)	236
Depreciation and Amortization.....	40	64	--	104
Other Operating Expenses.....	13	50	--	63
	-----	-----	-----	-----
Total Operating Expenses.....	378	371	(101)	648
Operating Income.....	(52)	254	--	202
Other Income, net.....	--	5	--	5
	-----	-----	-----	-----
Earnings Before Interest and Income Taxes.....	\$ (52)	\$ 259	\$ --	\$ 207
	=====	=====	=====	=====
Throughput Data Including Unbilled (Gwh):				
Residential.....				4,473
Commercial.....				3,975
Industrial.....				6,338
Other.....				42

Total Throughput Including Unbilled.....				14,828
				=====

During 2001, our Electric Operations business segment reflected the regulated electric utility business, including generation, transmission and distribution, and retail electric sales. As of January 1, 2002, with the opening of the Texas market to full retail electric competition, generation and retail sales were deregulated. Retail electric sales involve the sale of electricity and related services to end users of electricity and were included as part of the bundled regulated service prior to 2002. Retail electric sales are now reported as the Retail Energy business segment of Reliant Resources.

Beginning in 2002, we are reporting two new business segments for what was the former Electric Operations business segment:

- Electric Generation, and
- Electric Transmission and Distribution.

The previously regulated generation operations in Texas are being reported in the new Electric Generation business segment. The Electric Transmission and Distribution business segment will report results from two sources. This business segment includes the regulated electric transmission and distribution operations as well as impacts of generation-related stranded costs recoverable by the regulated utility.

As a result of the implementation of deregulation and the corresponding new business segments, the regulated transmission and distribution utility recovers the cost of its service through an energy delivery charge, and not as a component of the prior bundled rate. Accordingly, there are no meaningful comparisons for these business segments against prior periods. The design of the new energy delivery rate, which is based on an 11.25% return on equity, differs from the prior bundled energy rate. The winter/summer rate differential for residential customers has been eliminated and large commercial and industrial rates no longer have an energy-based component, but are demand driven. This new rate design will tend to lessen some of the pronounced seasonal variation of revenues which has been experienced in prior periods. For estimates of historical Electric Generation revenues, please read Note 14 to our Interim Financial Statements.

Although our retail sales are now conducted by Reliant Resources, retail customers remained regulated customers of Reliant Energy HL&P through the date of their first meter reading in 2002. Sales during this transition period produced EBIT of \$14 million in the first quarter of 2002, reflected in the Electric Transmission and Distribution business segment. We expect to incur additional transition expenses during the remainder of the year and a substantial portion of these earnings are expected to be offset.

The new Electric Generation business segment is comprised of over 14,000 Megawatts of electric generation located entirely in the state of Texas, and will be called Texas Genco after the Restructuring. This business segment reported a \$52 million loss before interest and taxes for the first quarter of 2002 primarily due to low natural gas prices and ample generating capacity in Texas, which created a weak price environment for the capacity auctions described below.

The new Electric Transmission & Distribution business segment reported EBIT of \$259 million for the first quarter of 2002. This reflected EBIT of \$104 million for the regulated electric transmission and distribution business, EBIT of \$ 14 million from sales during the transition period as discussed above and EBIT of \$141 million associated with certain generation-related regulatory assets (ECOM, or Excess Cost Over Market, true-up) recorded pursuant to the Texas restructuring law as explained below.

Under the deregulation law, each power generator that is unbundled from an integrated electric utility in Texas has an obligation to conduct state-mandated capacity auctions of 15 percent of its capacity. In addition, under a master separation agreement between Reliant Energy and Reliant Resources, Texas Genco is contractually obligated to auction all capacity in excess of the state-mandated capacity auctions. The auctions conducted periodically between September 2001 and March 2002 were consummated at prices below those assumed by the ECOM model of the Public Utility Commission of Texas (Texas Utility Commission). Under the Texas electric restructuring law, a regulated utility may recover any difference between market prices received through the state-mandated auctions and the Texas Utility Commission's earlier estimates of those market prices. This difference, recorded as a regulatory asset, produced \$141 million of EBIT in the first quarter of 2002.

In the Electric Transmission and Distribution business segment, throughput declined 5 percent compared to the first quarter of 2001 due to reduced energy delivery in the industrial sector. Customer growth was strong with an addition of 7,000 metered customers since December 31, 2001, or approximately 2 percent growth on an annualized basis.

Operation and maintenance expenses for the first quarter of 2002 decreased by \$12 million compared to the same period in 2001. The decrease was primarily due to the elimination of factoring expense and fewer plant outages in 2002, partially offset by higher benefits expense.

Depreciation and amortization expense in the first quarter of 2002 increased \$25 million compared to the same period in 2001. The increase was primarily due to the discontinuance of redirection of depreciation expense to generation assets for financial reporting purposes, offset by decreased amortization of the book impairment loss recorded in June 1999, which was fully amortized in December 2001.

Other operating expense in the first quarter of 2002 decreased \$28 million compared to the same period in 2001. The decrease was primarily due to lower franchise fees and gross receipts taxes.

NATURAL GAS DISTRIBUTION

Our Natural Gas Distribution business segment's operations consist of intrastate natural gas sales to, and natural gas transportation for residential, commercial and industrial customers in Arkansas, Louisiana, Minnesota, Mississippi, Oklahoma and Texas and some non-rate regulated retail marketing of natural gas.

For information regarding factors that may affect the future results of operations of our Natural Gas Distribution business segment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of RERC's Operations" in the Reliant Energy Form 10-K, which is incorporated herein by reference.

The following table provides summary data, including EBIT, of our Natural Gas Distribution business segment for the three months ended March 31, 2001 and 2002:

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS)	
Operating Revenues	\$ 2,323	\$ 1,180
Operating Expenses:		
Natural Gas	1,977	885
Operation and Maintenance	133	131
Depreciation and Amortization	36	30
Other Operating Expenses	42	28
Total Operating Expenses	2,188	1,074
Operating Income	135	106
Other Income, net	2	4
Earnings Before Interest and Income Taxes	\$ 137	\$ 110
	=====	=====
Throughput Data (in Bcf(1)):		
Residential and Commercial Sales	153	132
Industrial Sales	11	11
Transportation	15	15
Retail	132	121
Total Throughput	311	279
	=====	=====

(1) Billion cubic feet.

Our Natural Gas Distribution business segment's EBIT decreased \$27 million for the first quarter of 2002 as compared to the same period in 2001. This decrease was largely due to significantly milder weather, lower gas prices and decreased usage in 2002 as compared to 2001 and a related decrease in forfeited discounts, late payment fees and recoverable franchise taxes. Depreciation and amortization expense decreased approximately \$6 million in the first quarter of 2002 compared to the same period in 2001 primarily as a result of the discontinuance of goodwill amortization in accordance with SFAS No. 142 as further discussed in Note 6 to our Interim Financial Statements. Goodwill amortization in the first quarter of 2001 was \$8 million. Other operating expenses, primarily franchise taxes, decreased \$14 million in the first quarter of 2002 as compared to the same period in 2001 primarily due to reduced revenues subject to taxes, and were offset by reduced revenue recovery as discussed above.

PIPELINES AND GATHERING

Our Pipelines and Gathering business segment operates two interstate natural gas pipelines as well as provides gathering and pipeline services.

For information regarding factors that may affect the future results of operations of our Pipelines and Gathering business segment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of RERC's Operations" in the Reliant Energy Form 10-K, which is incorporated herein by reference.

The following table provides summary data, including EBIT, of our Pipelines and Gathering business segment for the three months ended March 31, 2001 and 2002:

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS)	
Operating Revenues	\$ 130	\$ 92
Operating Expenses:		
Natural Gas	45	7
Operation and Maintenance	28	34
Depreciation and Amortization	14	10
Other Operating Expenses	4	4
Total Operating Expenses	91	55
Operating Income	39	37
Other Income, net	--	1
Earnings Before Interest and Income Taxes	\$ 39	\$ 38
Throughput Data (in Bcf):		
Natural Gas Sales	6	5
Transportation	246	238
Gathering	70	71
Eliminations(1)	(1)	--
Total Throughput	321	314

(1) Elimination of volumes both transported and sold.

Our Pipelines and Gathering business segment's EBIT for the first quarter of 2002 declined slightly to \$38 million compared to \$39 million for the same period in 2001. Depreciation and amortization expense decreased \$4 million as a result of the discontinuance of goodwill amortization in accordance with SFAS No. 142 as further discussed in Note 6 to our Interim Financial Statements.

WHOLESALE ENERGY

Our Wholesale Energy business segment, which is conducted through Reliant Resources, includes our non-rate regulated power generation operations in the United States and our wholesale energy trading, marketing, origination and risk management operations in North America. Trading and marketing purchases fuel to supply existing generation assets, sells the electricity produced by these assets, and manages the day-to-day trading and dispatch associated with these portfolios.

For information regarding factors that may affect the future results of operations of our Wholesale Energy business segment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations" in the Reliant Energy Form 10-K, which is incorporated herein by reference.

The following table provides summary data, including EBIT, of our Wholesale Energy business segment for the three months ended March 31, 2001 and 2002:

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS)	
Operating Revenues	\$ 8,362	\$ 5,533
Operating Expenses:		
Fuel and Cost of Gas Sold	5,654	2,732
Purchased Power	2,316	2,474
Operation and Maintenance	133	156
Depreciation and Amortization	41	50
Other Operating Expenses	2	13
Total Operating Expenses	8,146	5,425
Operating Income	216	108
Other Income:		
Income of Equity Investment of Unconsolidated Subsidiaries	13	4
Other, net	--	2
Earnings Before Interest and Income Taxes	\$ 229	\$ 114
Operations Data:		
Electricity Wholesale Power Sales (in thousand MWh (1))	55,994	120,534
Natural Gas Sales (in Bcf)	767	1,017

(1) Megawatt hours.

Our Wholesale Energy business segment's EBIT decreased by \$115 million for the three months ended March 31, 2002 compared to the same period in 2001. The decrease in EBIT is primarily due to decreases in gross margin (revenues less fuel and cost of gas sold and purchased power), increases in operating expenses and decreases in other income as further discussed below. These decreases in EBIT were partially offset by changes in the provisions related to energy sales in California. In the first quarter of 2002, \$33 million of a previously accrued credit provision for energy sales in California was reversed. The reversal resulted from collections of outstanding receivables during the period coupled with a determination that credit risk had been reduced on the remaining outstanding receivables as a result of payments in 2002 to the California Power Exchange. In the first quarter of 2001, our Wholesale Energy business segment recorded a \$38 million provision against receivable balances related to energy sales in the West region.

Our Wholesale Energy business segment's revenues decreased by \$2.8 billion (34%) in the first quarter of 2002 compared to the same period in 2001. The decreased revenues were primarily due to decreased prices for natural gas sales (approximately \$4.5 billion) and decreased prices for power sales (approximately \$3.7 billion) compared to 2001. These decreases in revenues were partially offset by increased volumes for natural gas (approximately \$1.7 billion) and increased volumes for power sales (approximately \$3.6 billion), including those attributed to our February 19, 2002 acquisition of Orion Power. Our Wholesale Energy business segment's cost of gas sold and fuel and purchased power decreased by \$2.8 billion in the first quarter of 2002, largely due to decreased prices for natural gas and purchased power compared to 2001. These decreases in cost of gas sold and fuel and purchased power were partially offset by increased volumes for natural gas and purchased power.

Our Wholesale Energy business segment's gross margins decreased by \$65 million in the first quarter of 2002 compared to the same period in 2001 primarily due to decreased margins from both our power generation operations

and our trading and marketing activities, partially offset by changes in provisions related to energy sales in California totaling \$71 million, as discussed above. Margins on power sales from our generation facilities, decreased by \$158 million partially offset by \$87 million from the Orion Power acquisition that closed in February 2002. Favorable market conditions in the first three months of 2001 in the West region resulting from a combination of factors, including reduction in available hydroelectric generation resources, increased demand and decreased electric imports, positively impacted our Wholesale Energy business segment's operating margins. We do not expect these favorable conditions to return in 2002 in the West region, because, among other reasons, prices are now subject to Federal Energy Regulatory Commission price mitigation controls. Trading and marketing gross margins decreased \$66 million from \$113 million in 2001 to \$47 million in 2002 primarily as a result of natural gas and power trading activities. Higher natural gas and power volatility levels provided for greater trading opportunities in the first quarter of 2001 compared to the first quarter of 2002, particularly in the West region.

The following table provides further summary data regarding gross margins by commodity of our Wholesale Energy business segment for the three months ended March 31, 2001 and 2002:

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS)	
Gas revenues	\$ 5,290	\$ 2,490
Power revenues	3,055	3,039
Other commodity revenues	17	4
Total revenues	8,362	5,533
Cost of gas sold	5,211	2,437
Fuel and purchased power	2,749	2,764
Other commodity costs	10	5
Total cost of sales	7,970	5,206
Gross margin	\$ 392	\$ 327

Operation and maintenance expenses for our Wholesale Energy business segment increased \$23 million in the first quarter of 2002 compared to the same period in 2001, primarily due to \$35 million of operation and maintenance expenses of generating plants related to the Orion Power acquisition in February 2002.

Depreciation and amortization expense increased by \$9 million in the first quarter of 2002 compared to the same period in 2001 primarily as a result of depreciation expense related to our Orion Power plants, and other generating plants placed into service during 2001, partially offset by a decrease in amortization of air emissions regulatory allowances of \$21 million. For the three months ended March 31, 2001, our Wholesale Energy business segment recorded \$1 million in amortization expense related to goodwill. For information regarding the discontinuance of goodwill amortization in accordance with SFAS No. 142, please read Note 6 to our Interim Financial Statements.

Our Wholesale Energy business segment reported income from equity investments for the three months ended March 31, 2002 of \$4 million compared to \$13 million in the same period in 2001. The equity income in both periods primarily resulted from an investment in an electric generation plant in Boulder City, Nevada. The equity income related to our investment in the plant declined primarily due to reduced power prices realized by the project company in 2002.

For information regarding the reserve against receivables and uncertainties in the California wholesale energy market, please read Notes 13(a) and 13(d) to our Interim Financial Statements.

EUROPEAN ENERGY

Our European Energy business segment, which is conducted through Reliant Resources, generates and sells power from its generation facilities in the Netherlands and participates in the emerging wholesale energy trading and power origination industry in Northwest Europe.

For information regarding factors that may affect the future results of operations of our European Energy business segment, please read "Management's Discussion and Analysis of Financial Condition and Results of

Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our European Energy Operations" in the Reliant Energy Form 10-K, which is incorporated herein by reference.

The following table provides summary data, including EBIT, of our European Energy business segment for the three months ended March 31, 2001 and 2002:

EUROPEAN ENERGY		

THREE MONTHS ENDED MARCH 31,		

	2001	2002

(IN MILLIONS)		
Operating Revenues	\$ 248	\$ 535
Operating Expenses:		
Fuel	101	80
Purchased Power	81	391
Operation and Maintenance	29	35
Depreciation and Amortization	19	13
	-----	-----
Total Operating Expenses	230	519
	-----	-----
Operating Income	18	16
Other Income, net	3	2
	-----	-----
Earnings Before Interest and Income Taxes	\$ 21	\$ 18
	=====	=====
Electricity (in thousand MWh):		
Wholesale Sales	3,765	4,565
Trading Sales	3,010	15,079

Our European Energy business segment's EBIT decreased \$3 million for the three months ended March 31, 2002 compared to the same period in 2001.

Our European Energy business segment's operating revenues increased \$287 million for the first quarter of 2002 compared to the same period in 2001. The increase was primarily due to increased trading volumes associated with our participation in the Dutch, Scandinavian, German, Austrian and United Kingdom power markets, fuels trading and to a lesser extent increased volumes of electric generation sales, which increased 21% in the first quarter of 2002 compared to the same period in 2001. The increases in revenues due to increases in volumes related to trading and power generation sales were partially offset by decreases in power prices, which decreased approximately 13% period to period. Fuel and purchased power costs increased \$289 million in the first quarter of 2002 compared to the same period in 2001 primarily due to increased purchased power for trading activities, certain non-recurring costs related to out-of-market contracts totaling \$4 million, and to a lesser extent, increased fuel costs due to increased output from our generating facilities. Partially offsetting the increase in fuel costs was a \$19 million gain related to changes in the valuation of certain out-of-market contracts in the first quarter of 2002 recorded in fuel expense. For further discussion of these out-of-market contracts, please read Note 5 and Note 14(h) to the Reliant Energy 10-K Notes, which notes are incorporated herein by reference and Note 13(e) to our Interim Financial Statements.

Gross margins (revenues less fuel and purchased power) decreased \$2 million in the first quarter of 2002 compared to the same period in 2001 primarily due to decreased margins from (a) ancillary services of \$3 million, (b) district heating sales of \$4 million, and (c) other changes in power generation gross margins totaling \$8 million primarily due to reduced power prices and increased fuel and fuel-related costs in 2002 compared to 2001. In addition, the first quarter of 2001 results included activity under a protocol agreement under which the Dutch generators provided capacity and energy to distributors in exchange for regulated production payments. Further contributing to the decline in gross margins were unscheduled plant outages at certain of our electric generating facilities in the first quarter of 2002. We estimate that these unplanned outages resulted in losses of approximately \$7 million. A \$19 million net gain recognized in fuel expense related to the changes in valuation of certain out-of-market contracts partially offset the overall decline in gross margin. In addition, trading and power origination gross margins increased by \$2 million from \$1 million in the first quarter of 2001 compared to \$3 million in the first quarter of 2002, primarily due to a significant increase in power trading volumes and trading origination transactions.

Operation and maintenance expenses increased by \$6 million for the three months ended March 31, 2002 compared to the same period in 2001. These expenses increased primarily due to the reversal of an accrual for environmental tax subsidies receivable in 2001 of \$4 million and a \$2 million accrual recorded in the first quarter of 2002 for environmental expenditures.

Depreciation and amortization expenses decreased during the first quarter of 2002 compared to the same period in 2001 primarily due to the discontinuance of goodwill amortization effective January 1, 2002. During the three months ended March 31, 2001, our European Energy business segment recorded \$6 million in amortization expense related to goodwill. For additional discussion regarding the discontinuance of goodwill amortization in accordance with SFAS No. 142, please read Note 6 to our Interim Financial Statements.

Other non-operating income primarily relates to the amortization of the deferred gains related to cross border lease transactions. In addition, during the first quarter of 2002, our European Energy business segment recognized a gain of \$1 million related to the termination of certain cross border lease agreements. For additional information regarding these cross border lease transactions, please read Note 14(c) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

RETAIL ENERGY

Our Retail Energy business segment, which is conducted by Reliant Resources, provides energy products and services to end-use customers, ranging from residential and small commercial customers to large commercial, industrial and institutional customers. In addition, our Retail Energy business segment provided billing, customer service, credit and collection services to our Electric Operations business segment and remittance services to our Electric Operations business segment and two of the divisions of our Natural Gas Distribution business segment. The service agreement governing these services terminated on December 31, 2001. Our Retail Energy business segment charged the regulated electric and natural gas utilities for these services at cost. Our Retail Energy business segment acquired approximately 1.7 million electric retail customers in the Houston metropolitan area when the Texas market opened to full competition in January 2002. During the first half of 2002, the Texas electric retail market will be largely focused on the extensive efforts necessary to transition customers from the utilities to the affiliated retail electric providers.

For information regarding factors that may affect the future results of operations of our Retail Energy business segment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Retail Energy Operations" in the Reliant Energy Form 10-K, which is incorporated herein by reference.

The following table provides summary data, including EBIT, of our Retail Energy business segment for the three months ended March 31, 2001 and 2002:

	RETAIL ENERGY	
	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(IN MILLIONS)	
Operating Revenues	\$ 27	\$ 979
Operating Expenses:		
Fuel and Purchased Power	--	843
Operation and Maintenance	28	83
Depreciation and Amortization	2	5
Total Operating Expenses	30	931
Operating (Loss) Income	(3)	48
Other, net	--	--
(Loss) Earnings Before Interest and Income Taxes	\$ (3)	\$ 48

THREE MONTHS
ENDED
MARCH 31, 2002

Operations Data:

Electric Sales (Gwh):

Residential	3,155
Small commercial	3,287
Large commercial, industrial and institutional	4,395

Total	10,837
	=====

Customers (in thousands, metered locations):

Residential	1,463
Small commercial	213
Large commercial, industrial and institutional	17

Total	1,693
	=====

Our Retail Energy business segment's EBIT increased \$51 million in the first quarter of 2002 compared to the same period in 2001. The increase in EBIT was primarily due to increased gross margins (revenues less fuel and purchased power) related to retail electric sales to residential and small commercial customers and, to a lesser extent, retail electric sales to large commercial, industrial and institutional customers due to the Texas retail market opening to full competition in January 2002. The increase in gross margins was partially offset by increased operating expenses as further discussed below.

Operating revenues increased \$952 million in the first quarter of 2002 compared to the same period in 2001, due to revenues of \$730 million from retail electric sales in the Texas retail market which opened to full competition in January 2002. Trading activities related to the selling of energy in Texas contributed to \$235 million of the increase in revenues. Cost of sales increased \$843 million due to costs of \$609 million associated with the retail electric sales and \$234 million associated with trading activities. Our Wholesale Energy business segment purchases and manages our Retail Energy business segment's wholesale energy supply requirements to fulfill its retail energy commitments. Our Wholesale Energy business segment charges our Retail Energy business segment for its energy supply requirements at its actual cost and charges an administrative fee for such services. During the first quarter of 2002, our Wholesale Energy business segment charged an administrative fee of \$2 million for such services.

Our Retail Energy business segment's gross margins increased \$109 million in the first quarter of 2002 compared to the same period in 2001 primarily due to increased margins of \$127 million from retail electric sales. Contracted energy sales to large commercial, industrial and institutional customers are accounted for under the mark-to-market method of accounting. These energy contracts are recorded at fair value in revenues upon contract execution. The net changes in their market values are recognized in the income statement in revenues in the period of the change. Mark-to-market gains related to these contracts were \$5.5 million in the first quarter of 2002 compared to \$3.6 million in the same period in 2001. For information regarding the accounting for contracted energy sales to large commercial, industrial and institutional customers, please read Notes 2(d) and 5 to the Reliant Energy 10-K Notes, which notes are incorporated herein by reference.

In addition, in the first quarter of 2001, \$13 million of revenues was recorded for the services provided to the Electric Operations and Natural Gas Distribution business segments, for which the associated costs are included in operation and maintenance expenses. The service agreement governing these services terminated on December 31, 2001.

Operation and maintenance expenses increased \$55 million in the first quarter of 2002 compared to the same period in 2001, primarily due to (a) increased gross receipts taxes of \$14 million, (b) personnel and employee related costs and other administrative costs of \$26 million due to the Texas retail market opening to full competition in January 2002, (c) increased bad debt reserves of \$10 million associated with increased retail electric sales and (d) increased marketing costs of \$5 million due to the Texas retail market opening to full competition.

Depreciation and amortization expense increased \$3 million in the first quarter of 2002 compared to the same period in 2001 primarily due to depreciation of information systems developed and placed in service to meet the needs of our retail businesses. In addition, for the three months ended March 31, 2001, our Retail Energy business

segment recorded \$1 million in amortization expense related to goodwill. For information regarding the discontinuance of goodwill amortization in accordance with SFAS No. 142, please read Note 6 to our Interim Financial Statements.

We are dependent on the local transmission and distribution utilities for the reading of our customers' energy meters. We are required to rely on the local utility or, in some cases, the independent transmission system operator, to provide us with our customers' information regarding energy usage, and we may be limited in our ability to confirm the accuracy of the information. The provision of inaccurate information or delayed provision of such information by the local utilities or system operators could have a material negative impact on our business and results of operations and cash flows.

The Electric Reliability Council of Texas (ERCOT) independent system operator (ERCOT ISO) is the independent system operator responsible for maintaining reliable operations of the bulk electric power supply system in the ERCOT market. Its responsibilities include ensuring that information relating to a customer's choice of retail electric provider is conveyed in a timely manner to anyone needing the information. Problems in the flow of information between the ERCOT ISO, the transmission and distribution utilities and the retail electric providers have resulted in delays in switching and billing customers. While the flow of information is improving, operational problems in the new systems and processes are still being worked out.

The ERCOT ISO is also responsible for handling scheduling and settlement for all electricity supply volumes in the Texas deregulated electricity market. In addition, the ERCOT ISO plays a vital role in the collection and dissemination of metering data from the transmission and distribution utilities to the retail electric providers. We and other retail electric providers schedule volumes based on forecasts. As part of settlement, the ERCOT ISO communicates the actual volumes delivered compared to the forecast volumes scheduled. The ERCOT ISO calculates an additional charge or credit based on the difference between the actual and forecast volumes, based on a market clearing price for the difference. Settlement charges also include allocated costs such as unaccounted-for energy. Preliminary settlement information is due from ERCOT within two months after electricity is delivered. Final settlement information is due from ERCOT six months after electricity is delivered. As a result, we must record our supply costs using scheduled supply volumes and adjust those costs upon receipt of settlement information.

The Texas Utility Commission regulations allow Reliant Resources to adjust the fuel factor in their price to beat to their Houston residential and small commercial customers based on the percentage change in the price of natural gas. In addition, Reliant Resources may also request an adjustment as a result of changes in the price of purchased energy. On May 2, 2002, Reliant Resources filed a request with the Texas Utility Commission to increase the fuel factor in their price to beat. Reliant Resources' price to beat was initially set by the Texas Utility Commission in November 2001 at the then average forward 12 month gas prices strip of approximately \$3.11/mmbtu. Since the initial setting, the market price of natural gas has increased 20% to \$3.73/mmbtu during April 2002. The earliest the new price could go into effect would be June 17, 2002.

OTHER OPERATIONS

Our Other Operations business segment includes the operations of Reliant Energy Thermal Systems, Inc., Reliant Energy Power Systems, Inc., new ventures businesses, various real estate used in business operations, remaining operations in Latin America and unallocated corporate costs. After Restructuring and Distribution, our Other Operations business segment will consist primarily of Reliant Energy Thermal Systems, Inc., Reliant Energy Power Systems, Inc., office buildings and other real estate used in our business operations and unallocated corporate costs.

The following table shows EBIT of Other Operations for the three months ended March 31, 2001 and 2002:

OTHER OPERATIONS		
THREE MONTHS ENDED MARCH 31,		
	2001	2002
(IN MILLIONS)		
Operating Revenues	\$ 30	\$ 2
Operating Expenses	163	3
Operating Loss	(133)	(1)
Other Income (Expense), net	2	(12)
Loss Before Interest and Income Taxes	\$ (131)	\$ (13)

Other Operation's loss before interest and income taxes decreased by \$118 million for the three months ended March 31, 2002 compared to the same period in 2001. The decline in loss before interest and income taxes is primarily due to a \$101 million pre-tax, non-cash charge related to the redesign of certain of our benefit plans in anticipation of our separation from Reliant Resources incurred in 2001, partially offset by an increased non-cash unrealized loss of \$16 million on our AOL Time Warner investment and related indexed debt securities.

TRADING AND MARKETING OPERATIONS

We trade and market power, natural gas and other energy-related commodities and provide related risk management services to our customers. We apply mark-to-market accounting for all of our energy trading, marketing, power origination and risk management services activities. For information regarding mark-to-market accounting, please read Notes 2(d) and 5(a) to the Reliant Energy 10-K, which notes are incorporated herein by reference. These trading activities consist of:

- the domestic energy trading, marketing, power origination and risk management services operations of our Wholesale Energy business segment;
- the European energy trading and power origination operations of our European Energy business segment; and
- the large commercial, industrial and institutional customers under retail electricity contracts of our Retail Energy business segment.

Our domestic and European energy trading and marketing operations enter into derivative transactions with goals of optimizing our current power generation asset position and taking a market position.

Our realized and unrealized trading, marketing and risk management services margins are as follows:

THREE MONTHS ENDED MARCH 31,		
	2001	2002
(IN MILLIONS)		
Realized	\$ 102	\$ 76
Unrealized	16	(20)
Total	\$ 118	\$ 56

Below is an analysis of our net trading and marketing assets and liabilities for 2002 (in millions):

Fair value of contracts outstanding at December 31, 2001.....	\$ 218
Fair value of new contracts when entered into during the period.....	20
Contracts realized or settled during the period.....	(76)
Changes in fair values attributable to changes in valuation techniques and assumptions.....	--
Changes in fair value attributable to market price and other market changes.....	41
Fair value of contracts outstanding at March 31, 2002.....	\$ 203

During the three months ended March 31, 2002, our Retail Energy business segment entered into contracts with large commercial, industrial and institutional customers ranging from one-half to four years in duration. We recorded a \$20 million dealer profit upon the origination of these contracts.

The dealer profit was determined by comparing the contractual pricing to the market price for the retail energy delivery and applying the estimated volumes under the provisions of these contracts. This calculation involves estimating the customer's anticipated load volume, and using the forward ERCOT over-the-counter (OTC) commodity prices, adjusted for the customer's anticipated load pattern. Load characteristics in the valuation model include: the customer's expected hourly electricity usage profile, the potential variability in the electricity usage profile (due to weather or operational uncertainties), and the electricity usage limits included in the customer's contract. In addition, estimates include anticipated delivery costs, such as regulatory and transmission charges, electric line losses, ERCOT system operator administrative fees and other market interaction charges, estimated credit risk and administrative costs to serve. The weighted-average duration of these transactions is approximately twenty months.

Below are the maturities of our contracts related to our trading and marketing assets and liabilities as of March 31, 2002 (in millions):

FAIR VALUE OF CONTRACTS AT MARCH 31, 2002							
SOURCE OF FAIR VALUE	2002	2003	2004	2005	2006	2007 AND THEREAFTER	TOTAL FAIR VALUE
Prices actively quoted ...	\$ (18)	\$ 5	\$ (10)	\$ --	\$ --	\$ --	\$ (23)
Prices provided by other external sources	158	80	12	5	8	--	263
Prices based on models and other valuation methods	(14)	(35)	1	(6)	(2)	19	(37)
Total	\$ 126	\$ 50	\$ 3	\$ (1)	\$ 6	\$ 19	\$ 203

The "prices actively quoted" category represents our New York Mercantile Exchange (NYMEX) futures positions in natural gas and crude oil. At March 31, 2002, NYMEX had quoted prices for natural gas and crude oil for the next 60 and 36 months, respectively.

The "prices provided by other external sources" category represents our forward positions in natural gas and power at points for which OTC broker quotes are available. On average, OTC quotes for natural gas and power extend 60 and 36 months into the future, respectively. We value these positions against internally developed forward market price curves that are constantly validated and recalibrated against OTC broker quotes. This category also includes some transactions whose prices are obtained from external sources and then modeled to hourly, daily or monthly prices, as appropriate.

The "prices based on models and other valuation methods" category contains (a) the value of our valuation adjustments for liquidity, credit and administrative costs, (b) the value of options not quoted by an exchange or OTC broker, (c) the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, and (d) the value of structured transactions. In certain instances, structured transactions can be composed and modeled by us as simple forwards and options based on prices actively quoted. Options are typically valued using Black-Scholes option valuation models. Although the valuation of the simple structures might not be different from the valuation of contracts in other categories, the effective model price for any given period is a combination of prices from two or more different instruments and therefore has been included in this category due to the complex nature of these transactions.

The fair values in the above table are subject to significant changes based on fluctuating market prices and conditions. Changes in the assets and liabilities from trading, marketing, power origination and price risk management services result primarily from changes in the valuation of the portfolio of contracts, newly originated transactions and the timing of settlements. The most significant parameters impacting the value of our portfolio of contracts include natural gas and power forward market prices, volatility and credit risk. For the Retail Energy business segment sales discussed above, significant variables affecting contract values also include the variability in electricity consumption patterns due to weather and operational uncertainties (within contract parameters). Market prices assume a normal functioning market with an adequate number of buyers and sellers providing market liquidity. Insufficient market liquidity could significantly affect the values that could be obtained for these contracts, as well as the costs at which these contracts could be hedged. Please read "Quantitative and Qualitative Disclosures About Market Risk" in Item 7A of the Reliant Energy Form 10-K for further discussion and measurement of the market exposure in the trading and marketing businesses and discussion of credit risk management.

For additional information, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations - Price Volatility," and " - Risks Associated with Our Hedging and Risk Management Activities" in Item 7 of the Reliant Energy Form 10-K.

For a description of accounting policies for our trading and marketing activities, please read Notes 2(d) and 5 to the Reliant Energy 10-K Notes, which notes are incorporated herein by reference.

We seek to monitor and control our trading risk exposures through a variety of processes and committees. For additional information, please read "Quantitative and Qualitative Disclosures About Market Risk - Risk Management Structure" in Item 7A of the Reliant Energy Form 10-K.

CERTAIN FACTORS AFFECTING OUR FUTURE EARNINGS

For information on other developments, factors and trends that may have an impact on our future earnings, including information relating to an anticipated decline in earnings of our electric business segments due to deregulation of the Texas electric industry, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings" in the Reliant Energy Form 10-K, which is incorporated herein by reference. For additional information regarding (a) the California wholesale market and related litigation, please read Notes 13(a) and 13(d) to our Interim Financial Statements, and (b) the Dutch stranded costs, please read Note 13(e) to our Interim Financial Statements.

FINANCIAL CONDITION

The following table summarizes the net cash provided by (used in) operating, investing and financing activities for the three months ended March 31, 2001 and 2002:

	THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(in millions)	
Cash provided by (used in):		
Operating activities	\$ 120	\$ 236
Investing activities	(497)	(3,324)
Financing activities	278	3,231

Net cash provided by operating activities during the three months ended March 31, 2002 increased \$116 million compared to the same period in 2001 primarily due to (a) an increase in recovered fuel costs by our Electric Transmission and Distribution business segment; (b) a reduction in lease prepayments related to the Reliant Energy Mid-Atlantic Power Holdings, LLC (REMA) sale-leaseback agreements; (c) a decrease in restricted cash related to Reliant Resources' REMA operations and Reliant Resources' Orion Power operations partially offset by restricted escrow funds related to the settlement of an indemnity agreement for certain energy obligations (please read Note 13(e) to our Interim Financial Statements); (d) the return of collateral deposits related to an equipment financing structure; and (e) cash flows provided by our Retail Energy business segment for retail sales in the first quarter of 2002 due to the Texas retail market opening to full competition in January 2002. These items were partially offset by decreased cash flows provided by our Wholesale Energy and Natural Gas Distribution business segments in the first quarter of 2002 compared to the same period in 2001 as a result of decreased operating income.

Net cash used in investing activities increased \$2.8 billion during the three months ended March 31, 2002 compared to the same period in 2001 primarily due to funding of the acquisition of Orion Power for \$2.9 billion on February 19, 2002, partially offset by a decrease in capital expenditures related to the construction of domestic power generation projects during the three months ended March 31, 2002.

Cash flows provided by financing activities increased \$3.0 billion during the three months ended March 31, 2002 compared to the same period in 2001 primarily due to an increase in short-term borrowings used to fund the acquisition of Orion Power and repurchase of customer accounts receivable, partially offset by a decrease in proceeds from long-term debt.

FUTURE SOURCES AND USES OF CASH FLOWS

The following discussion regarding future sources and uses of cash over the next twelve months is presented separately for our regulated businesses and unregulated businesses consistent with the separate liquidity plans that our management has developed for CenterPoint Energy and Reliant Resources. We believe that our borrowing capability combined with cash flows from operations will be sufficient to meet the operational needs of our businesses for the next twelve months.

RELIANT ENERGY (TO BECOME CENTERPOINT ENERGY SUBSEQUENT TO THE RESTRUCTURING)

Credit Facilities. As of March 31, 2002, we had credit facilities, including facilities of Houston Industries FinanceCo LP (FinanceCo) and RERC Corp., that provided for an aggregate of \$5.2 billion in committed credit. As of March 31, 2002, \$3.6 billion was outstanding under these facilities including \$2.1 billion of commercial paper supported by the facilities, borrowings of \$1.5 billion and letters of credit of \$2.5 million.

The following table summarizes amounts available under these credit facilities at March 31, 2002 and commitments expiring in 2002 (in millions):

BORROWER	TYPE OF FACILITY	TOTAL COMMITTED CREDIT	UNUSED AMOUNT AT 3/31/02	AMOUNT OF COMMITMENTS EXPIRING IN 2002
-----	-----	-----	-----	-----
Reliant Energy	Revolver	\$ 400	\$ --	\$ 400
FinanceCo.....	Revolvers	4,300	1,256	4,300
RERC Corp.....	Revolver	350	347	--
RERC Corp.....	Receivables	150	--	150
		-----	-----	-----
Total		\$ 5,200	\$ 1,603	\$ 4,850
		=====	=====	=====

The RERC Corp. receivables facility was reduced from \$350 million to \$150 million in January 2002. Proceeds for the repayment of \$196 million of advances under the facility were obtained from bank borrowings and the sale of commercial paper.

The revolving credit facilities contain various business and financial covenants requiring us to, among other things, maintain leverage (as defined in the credit facilities) below specified ratios. We are in compliance with the covenants under all of these credit agreements. For additional discussion, please read Note 8 to our Interim Financial Statements.

The revolving credit facilities support commercial paper programs. The maximum amount of outstanding commercial paper of an issuer is limited to the amount of the issuer's aggregate revolving credit facilities less any direct loans or letters of credit obtained under its revolvers. Due to an inability to consistently satisfy all short-term borrowing needs by issuing commercial paper, short-term borrowing needs have been met with a combination of commercial paper and bank loans. The extent to which commercial paper will be issued in lieu of bank loans will depend on market conditions and our credit ratings.

Pursuant to the terms of the existing agreements (but subject to certain conditions precedent which we anticipate will be met) the revolving credit agreements aggregating \$4.3 billion of FinanceCo will terminate and CenterPoint Energy revolving credit facilities of the same amount and with the same termination dates will become effective on the date of Restructuring.

We are currently in negotiations with banks to replace an aggregate of \$4.7 billion of existing credit facilities of Reliant Energy and FinanceCo which expire on July 12, 2002. The anticipated maturity dates of these new facilities range from four months to 364 days. The terms of any new credit facilities are expected to be adversely affected by the leverage of Reliant Energy, the amount of bank capacity utilized by Reliant Energy, any delay in the date of Restructuring and Distribution and conditions in the bank market. These same factors are expected to make the syndication of new credit facilities more difficult. Proceeds from any issuance of debt in the capital markets are expected to be used to retire a portion of our short-term debt and reduce our need for committed revolving credit facilities.

Credit Ratings. On May 20, 2002, Moody's Investors Service announced it is revising its outlook for Reliant Energy (Baa1 Senior Unsecured), Reliant Energy Finance Co. II LP (Baa1 Senior Unsecured), RERC Corp. (Baa2 Senior Unsecured) and CenterPoint Energy (indicative rating Baa2 Senior Unsecured) to negative from stable in response to ratings pressure originating in Reliant Energy's 83% ownership interest of Reliant Resources.

Shelf Registrations. The following table lists shelf registration statements existing at March 31, 2002 for securities expected to be sold in public offerings (in millions).

REGISTRANT -----	SECURITY -----	AMOUNT(1) -----	TERMINATING ON DATE OF RESTRUCTURING -----
Reliant Energy.....	Preferred Stock	\$230	Yes
Reliant Energy.....	Debt Securities	480	Yes
Reliant Energy.....	Common Stock	387	No
REI Trust II/.....	Trust Preferred and related Junior		
Reliant Energy....	Subordinated Debentures	125	Yes
RERC Corp.....	Debt Securities	50	No

(1) The amount reflects the principal amount of debt securities, the aggregate liquidation value of trust preferred securities and the estimated market value of common stock based on the number of shares registered as of March 31, 2002 and the closing market price of Reliant Energy common stock on that date.

We expect to register \$2.5 billion of debt securities, some or all of which may be issued either by Reliant Energy prior to the Restructuring or by CenterPoint Energy after the Restructuring. Debt securities aggregating approximately \$500 million may also be issued by the transmission and distribution subsidiary of CenterPoint Energy following the Restructuring. Proceeds from the sale of these debt securities are expected to be used to repay short-term borrowings. The amount actually issued will depend on interest rates and other market conditions.

Debt Service Requirements. Excluding the repayments expected to be made on the transition bonds described in Note 4(a) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference, we have maturing long-term debt in 2002 aggregating \$500 million. Maturing debt is expected to be refinanced with new debt. In addition, Reliant Energy has \$175 million of 5.20% pollution control bonds that are expected to be remarketed in 2002 as multi-year fixed-rate debt.

Debt service requirements will be affected by the overall level of interest rates in 2002 and credit spreads applicable to the various issuers of debt in 2002. Up to \$3.2 billion of long-term debt is expected to be issued or remarketed in 2002, and we expect to have large amounts of short-term floating-rate debt in 2002. At March 31, 2002, we had entered into five-year forward starting interest rate swaps having an aggregate notional amount of \$1.5 billion to hedge the interest rate on an anticipated 2002 offering of five-year notes. The weighted average rate on the swaps was 5.7%. At March 31, 2002, we also had entered into interest rate swaps to fix the rate on \$1.5 billion of our floating rate debt. The weighted average rate on these swaps was 3.9% and the swaps expire in 2002 through 2004. While we have, in some instances, hedged our exposure to changes in interest rates by entering into interest rate swaps, the swaps leave us exposed to changes in our credit spread relative to the market indices reflected in the swaps.

Money Fund. We have a "money fund" through which Reliant Energy and participating subsidiaries can borrow or invest on a short-term basis. Funding needs are aggregated and external borrowing or investing is based on the net cash position. The money fund's net funding requirements are generally met with commercial paper and/or bank loans. At March 31, 2002, Reliant Resources had \$432 million invested in the money fund. Reliant Resources is expected to withdraw its investment from the money fund on or before the Distribution. Funds for repayment of the notes payable to Reliant Resources will be obtained from bank loans or the issuance of commercial paper.

Environmental Issues. We anticipate investing up to \$397 million in capital and other special project expenditures between 2002 and 2006 for environmental compliance. Of this amount, we anticipate expenditures to be approximately \$234 million and \$132 million in 2002 and 2003, respectively. For additional information related to environmental issues, please read Note 13(b) to our Interim Financial Statements.

Initial Public Offering of Texas Genco. In 2002, approximately 20% of Texas Genco is expected to be sold in an initial public offering or distributed to holders of CenterPoint Energy common stock. The decision whether to distribute the Texas Genco shares or to sell the shares in an initial public offering will depend on numerous factors, including market conditions. Proceeds, if any, are expected to be used to retire short-term debt.

Fuel Filing. As of March 31, 2002, Reliant Energy HL&P was under-collected on fuel recovery by \$62 million. Reliant Energy plans to file its final fuel reconciliation with the Texas Utility Commission in July 2002. The filing will cover the period August 1997 through the end of regulation. Under the Texas electric restructuring law, the final fuel balance will be included in the 2004 true-up proceeding.

Reliant Energy HL&P Rate Matters. An order issued by the Texas Utility Commission on October 3, 2001 (October 3, 2001 Order) established the transmission and distribution rates that became effective in January 2002. The Texas Utility Commission determined that Reliant Energy HL&P had overmitigated its stranded costs by redirecting transmission and distribution depreciation and by accelerating depreciation of generation assets as provided under the 1998 transition to competition plan (Transition Plan) and Texas electric restructuring law. In this final order, Reliant Energy HL&P was required to reverse the amount of redirected depreciation and accelerated depreciation taken for regulatory purposes as allowed under the Transition Plan and the Texas electric restructuring law. Per the October 3, 2001 Order, our Electric Transmission and Distribution business segment recorded a regulatory liability to reflect the prospective refund of the accelerated depreciation. Our Electric Transmission and Distribution business segment began refunding excess mitigation credits with the January 2002 unbundled bills, to be refunded over a seven year period. The annual cash flow impact of the reversal of both redirected and accelerated depreciation is a decrease of approximately \$225 million. Under the Texas electric restructuring law, a final settlement of these stranded costs will occur in 2004. For further discussion, please read Note 4(a) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

Treasury Stock Purchases. As of March 31, 2002, we were authorized under our common stock repurchase program to purchase an additional \$271 million of our common stock. Our purchases under our repurchase program depend on market conditions, might not be announced in advance and may be made in open market or privately negotiated transactions. CenterPoint Energy has no current plans to engage in a significant stock buy-back program, but may seek to repurchase shares in the open market for use in various benefit and employee compensation plans, or to maintain a targeted balance of outstanding shares to the extent that original issue stock is used for such purposes.

Pension and Postretirement Benefits Funding. We make contributions to achieve adequate funding of company sponsored pension and postretirement benefits in accordance with applicable regulations and rate orders. Based on current estimates, we expect to have funding requirements, excluding Reliant Resources, of approximately \$330 million for the period 2002-2006.

RELIANT RESOURCES - UNREGULATED BUSINESSES

Credit Facilities. As of March 31, 2002, Reliant Resources had \$8.2 billion in committed credit facilities, including facilities of subsidiaries of Reliant Energy Power Generation, Inc. (REPG), Orion Power and REPG, of which \$1.9 billion remained unused. Credit facilities aggregating \$5.4 billion were unsecured. As of March 31, 2002, letters of credit outstanding under these facilities aggregated \$571 million. As of March 31, 2002, borrowings of \$5.8 billion were outstanding under these facilities of which \$591 million were classified as long-term debt, based upon the availability of committed credit facilities and management's intention to maintain these borrowings in excess of one year.

Of the committed credit facilities described above, \$6.3 billion will expire by March 31, 2003. To the extent that Reliant Resources still needs these facilities, Reliant Resources expects to be able to renew or replace them on normal commercial terms prior to their expiration.

As a result of the Orion Power acquisition, Reliant Resources' consolidated debt obligations increased by the amount of Orion Power's debt obligations of \$2.4 billion (\$2.1 billion net of restricted cash pursuant to debt covenants) as of February 19, 2002. For additional information regarding these debt obligations, please read Note 5 to our Interim Financial Statements.

Liquidity Concerns. As of March 31, 2002, Reliant Resources has \$2.8 billion of committed credit facilities which will expire in 2002. To the extent that Reliant Resources continues to need access to this amount of committed credit, Reliant Resources expects to extend or replace these facilities. The credit environment currently impacting Reliant Resources' industry may require Reliant Resources' future facilities to include terms that are more restrictive or burdensome or at higher borrowing rates than those of their current facilities. In addition, the terms of

any new credit facilities may be adversely affected by any delay in the date of the Distribution. For a discussion of other factors affecting Reliant Resources' sources of cash and liquidity, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources" in the Reliant Energy Form 10-K, which is incorporated herein by reference, and Note 5 to our Interim Financial Statements.

Orion Power and its Subsidiaries Credit Facilities. The Orion Credit Agreements contain various business and financial covenants requiring Orion NY or Orion Midwest to, among other things, maintain a debt service coverage ratio of at least 1.5 to 1.0. For the three months ended March 31, 2002, Orion Midwest did not meet its debt service coverage ratio, and alternatively made a \$25 million prepayment on March 22, 2002, as permitted by the Midwest Credit Agreement in order to maintain compliance. Orion Midwest may not be able to meet this debt service coverage ratio for the quarter ending June 30, 2002. It is Reliant Resources' current intention to arrange for the repayment, refinancing or amendment of these facilities prior to June 30, 2002. If the Midwest Credit Agreement facility is not repaid, refinanced or amended prior to that date, and if a waiver is required under this credit facility, Reliant Resources believes that they will be able to obtain such a waiver. However, Reliant Resources currently has no assurance that they will be able to obtain such a waiver or amendment from the lender group if required under the Midwest Credit Agreement.

The senior credit facility of Orion Power contains various business and financial covenants that require Orion Power to, among other things, maintain a debt service coverage ratio of at least 1.4 to 1.0. Orion Power did not meet the debt service coverage ratio for the quarter ended March 31, 2002. In the event that Orion Power is unable to meet this financial covenant for a second consecutive fiscal quarter it would constitute a default under its credit facility. It is Reliant Resources' current intention to arrange for the repayment, refinancing or amendment of this facility prior to June 30, 2002. If this facility is not repaid, refinanced or amended prior to that date, and if a waiver is required under this credit facility, Reliant Resources believes that they will be able to obtain such a waiver. However, Reliant Resources currently has no assurance that they will be able to obtain such a waiver or amendment from the lender groups if required under this credit facility.

For additional information regarding Orion Power and its subsidiaries' debt obligations, please read Note 5 to our Interim Financial Statements.

California Trade Receivables. As of March 31, 2002, Reliant Resources was owed a total of \$267 million by the California Independent System Operator, the California Power Exchange, the California Department of Water Resources and California Energy Resources Scheduling for energy sales in the California wholesale market during the fourth quarter of 2000 through March 31, 2002. From March 31, 2002 through May 10, 2002, Reliant Resources has collected \$3 million of these receivable balances. As of March 31, 2002, Reliant Resources had a pre-tax provision of \$35 million against these receivable balances. For additional information regarding uncertainties in the California wholesale market, please read Notes 13(a) and 13(d) to our Interim Financial Statements and Notes 14(f) and 14(g) to the Reliant Energy 10-K Notes, which notes are incorporated herein by reference.

Acquisition of Orion Power Holdings, Inc. On February 19, 2002, Reliant Resources acquired all of the outstanding shares of common stock of Orion Power for \$26.80 per share in cash for an aggregate purchase price of \$2.9 billion. As of February 19, 2002, Orion Power's debt obligations were \$2.4 billion (\$2.1 billion net of restricted cash pursuant to debt covenants). Reliant Resources funded the purchase of Orion Power with a \$2.9 billion credit facility and \$41 million of cash on hand.

Generating Projects. As of March 31, 2002, Reliant Resources had five generating facilities under construction. Total estimated costs of constructing these facilities are \$1.5 billion. As of March 31, 2002, Reliant Resources had incurred \$1.1 billion of the total projected costs of these projects, which were funded primarily from equity and debt facilities. Of this \$1.1 billion, \$315 million had been incurred by Orion Power related to two of these projects as of February 19, 2002. In addition, Reliant Resources has commitments to purchase additional power generation equipment, consisting of steam and combustion turbines and heat recovery steam generators, for a total estimated cost of \$697 million, with a remaining commitment of \$533 million. Reliant Resources is actively attempting to market this equipment, having determined that it is in excess of its current needs. In addition to these facilities, Reliant Resources is constructing facilities as construction agents under construction agency agreements, which permit it to lease or buy each of these facilities at the conclusion of their construction.

Construction Agency Agreement and Equipment Financing Structure. In 2001, Reliant Resources, through several of its subsidiaries, entered into operative documents with special purpose entities to facilitate the development, construction, financing and leasing of several power generation projects. These special purpose entities are not consolidated by Reliant Resources. For information regarding these transactions, please read Note 13(f) to our Interim Financial Statements. In addition, Reliant Resources, through its subsidiary, REPG, has entered into an agreement with a bank whereby the bank, as owner, entered or will enter into contracts for the purchase and construction of power generation equipment and REPG, or its subagent, acts as the bank's agent in connection with administering the contracts for such equipment.

Payment to Reliant Energy. To the extent that Reliant Resources' price for providing retail electric service to residential and small commercial customers in Reliant Energy's Houston service territory during 2002 and 2003, which price is mandated by the Texas electric restructuring law, exceeds the market price of electricity, Reliant Resources may be required to make a payment to Reliant Energy in early 2004 unless the Texas Utility Commission determines that, on or prior to January 1, 2004, 40% or more of the amount of electric power that was consumed in 2000 by residential or small commercial customers, as applicable, within Reliant Energy's electric utility's Houston service territory as of January 1, 2002 is committed to be served by retail electric providers other than Reliant Resources.

Treasury Stock Purchases. On December 6, 2001, Reliant Resources' Board of Directors authorized the purchase of up to 10 million additional shares of their common stock through June 2003. Purchases will be made on a discretionary basis in the open market or otherwise at times and in amounts as determined by management subject to market conditions, legal requirements and other factors. Since the date of this authorization through May 10, 2002, Reliant Resources has not purchased any shares of their common stock under this program.

Credit Ratings. Credit ratings impact Reliant Resources' ability to obtain short-term and long-term financing, the cost of such financing and the execution of their commercial strategies. As of May 17, 2002, Reliant Resources' credit ratings for their senior unsecured debt were as follows:

DATE ASSIGNED -----	RATING AGENCY -----	RATING -----
March 22, 2002	Moody's (1)	Baa3, review for potential downgrade
February 14, 2002	Fitch (2)	BBB, Rating Watch Negative
March 21, 2002	Standard & Poor's (3)	BBB, Credit Watch with negative implications

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- (1) On May 13, 2002, Moody's placed Reliant Resources on review for potential downgrade. Moody's action was in response to Reliant Resources' decision to cancel a private placement of \$500 million of debt securities on May 10, 2002, in order to review the financial or other implications of certain trading transactions (see discussion in Note 1 to our Interim Financial Statements).
 - (2) On May 17, 2002, Fitch placed Reliant Resources' ratings on Rating Watch Negative. Fitch's rating action primarily related to the continuing adverse impact on Reliant Resources' financial flexibility resulting from the negative market reaction to Reliant Resources' recent disclosure of certain trading transactions (see discussion in Note 1 to our Interim Financial Statements).
 - (3) On May 13, 2002, Standard & Poor's placed Reliant Resources' ratings on Credit Watch with negative implications, reflecting the concern that a lack of market confidence or the risk that another rating agency would lower Reliant Resources' ratings to non-investment grade could create liquidity issues as counterparties demand increased collateral to maintain trading relationships.

Reliant Resources cannot assure you that these ratings will remain in effect for any given period of time or that one or more of these ratings will not be lowered or withdrawn entirely by a rating agency. Reliant Resources notes that these credit ratings are not recommendations to buy, sell or hold their securities and may be revised or withdrawn at any time by such rating agency. Each rating should be evaluated independently of any other rating. Any future reduction or withdrawal of one or more of Reliant Resources' credit ratings could have a material adverse impact on Reliant Resources' ability to access capital on acceptable terms.

Reliant Resources has commercial contracts and/or guarantees related to their trading, marketing and risk management and hedging operations that require Reliant Resources to maintain an investment grade credit rating. If Reliant Resources' credit rating declines below investment grade, Reliant Resources estimates that they could be

obligated to provide significant credit support to the counterparties in the form of a pledge of cash collateral, a letter of credit or other similar credit support.

Furthermore, if Reliant Resources' credit ratings decline below an investment grade credit rating, Reliant Resources' trading partners may refuse to trade with them or trade only on terms less favorable to them. As of March 31, 2002, Reliant Resources had \$66 million of margin deposits on energy trading and hedging activities posted as collateral with counterparties. As of March 31, 2002, Reliant Resources had \$1.6 billion available under their credit facilities to satisfy future commodity obligations.

In addition, certain of Reliant Resources' retail electricity contracts with large commercial, industrial and institutional customers of their Retail Energy business segment provide the customers the ability to terminate their contracts early upon the occurrence of Reliant Resources' credit ratings for their unsecured debt ratings falling below investment grade or if their investment grade rating is withdrawn entirely by a rating agency.

Termination of Debt Offering. On May 10, 2002, Reliant Resources canceled their \$500 million, ten-year debt private placement when they became aware subsequent to the pricing of the debt offering, that Reliant Resources had likely engaged in round trip trades. See Note 1 to our Interim Financial Statements for more information regarding round trip trades.

Other Sources/Uses of Cash. Reliant Resources' liquidity and capital requirements are affected primarily by the results of operations, capital expenditures, debt service requirements and working capital needs. Reliant Resources expects to grow through the construction of new generation facilities and the acquisition of generation facilities, the expansion of its energy trading and marketing activities and the expansion of its energy retail business. Reliant Resources expects any resulting capital requirements to be met with cash flows from operations, and proceeds from debt and equity offerings, project financings, securitization of assets, other borrowings and off-balance sheet financings. Additional capital expenditures, some of which may be substantial, depend to a large extent upon the nature and extent of future project commitments which are discretionary. Reliant Resources believes that its current level of cash and borrowing capability, along with its future anticipated cash flows from operations and assuming successful refinancings of credit facilities as they mature, will be sufficient to meet the existing operational needs of its business for the next 12 months. If cash generated from operations is insufficient to satisfy its liquidity requirements, Reliant Resources may seek to sell either equity or debt securities or obtain additional credit facilities or long-term financings from financial institutions.

OFF-BALANCE SHEET TRANSACTIONS

Construction Agency Agreements. In 2001, Reliant Resources, through several of its subsidiaries, entered into operative documents with special purpose entities to facilitate the development, construction, financing and leasing of several power generation projects. The special purpose entities are not consolidated by the Company. The special purpose entities have an aggregate financing commitment from equity and debt participants (Investors) of \$2.5 billion of which the last \$1.1 billion is currently available only if cash collateralized. The availability of the commitment is subject to satisfaction of various conditions, including the obligation to provide cash collateral for the loans and letters of credit outstanding on November 29, 2004. Reliant Resources, through several of its subsidiaries, acts as construction agent for the special purpose entities and is responsible for completing construction of these projects by December 31, 2004, but Reliant Resources has generally limited its risk during construction to an amount not in excess of 89.9% of costs incurred to date, except in certain events. Upon completion of an individual project and exercise of the lease option, Reliant Resources' subsidiaries will be required to make lease payments in an amount sufficient to provide a return to the Investors. If Reliant Resources does not exercise its option to lease any project upon its completion, they must purchase the project or remarket the project on behalf of the special purpose entities. Reliant Resources' ability to exercise the lease option is subject to certain conditions. Reliant Resources must guarantee that the Investors will receive an amount at least equal to 89.9% of their investment in the equipment in the case of a remarketing sale at the end of construction. At the end of an individual project's initial operating lease term (approximately five years from construction completion), Reliant Resources' subsidiary lessees have the option to extend the lease with the approval of Investors, purchase the project at a fixed amount equal to the original construction cost, or act as a remarketing agent and sell the project to an independent third party. If the lessees elect the remarketing option, they may be required to make a payment of an amount not to exceed 85% of the project cost, if the proceeds from remarketing are not sufficient to repay the Investors. Reliant Resources has guaranteed the performance and payment of its subsidiaries' obligations during the construction periods and, if the

lease option is exercised, each lessee's obligations during the lease period. At any time during the construction period or during the lease, Reliant Resources may purchase a facility by paying an amount approximately equal to the outstanding balance plus costs. As of March 31, 2002, the special purpose entities had property, plant and equipment of \$798 million, net other liabilities of \$1 million and debt obligations of \$766 million. As of March 31, 2002, the special purpose entities had equity from unaffiliated third parties of \$31 million.

Equipment Financing Structure. Reliant Resources, through its subsidiary, REPG, has entered into an agreement with a bank whereby the bank, as owner, entered or will enter into contracts for the purchase and construction of power generation equipment and REPG, or its subagent, acts as the bank's agent in connection with administering the contracts for such equipment. Under the agreement, the bank has agreed to provide up to a maximum aggregate amount of \$650 million. REPG and its subagents must cash collateralize their obligation to administer the contracts. This cash collateral is approximately equivalent to the total payments by the bank for the equipment, interest and other fees. As of March 31, 2002, the bank had assumed contracts for the purchase of three turbines, two heat recovery steam generators and one air cooled condenser with an aggregate cost of \$140 million. REPG, or its designee, has the option at any time to purchase, or, at equipment completion, subject to certain conditions, including the agreement of the bank to extend financing, to lease the equipment, or to assist in the remarketing of the equipment under terms specified in the agreement. All costs, including the purchase commitment on the turbines, are the responsibility of the bank. The cash collateral is deposited by REPG or an affiliate into a collateral account with the bank and earns interest at the London inter-bank offered rate (LIBOR) less 0.15%. Under certain circumstances, the collateral deposit or a portion of it, will be returned to REPG or its designee. Otherwise, it will be retained by the bank. At December 31, 2001 and March 31, 2002, REPG and its subsidiary had deposited \$230 million and \$100 million, respectively, into the collateral account. In January 2002, the bank sold to the parties to the construction agency agreements discussed above, equipment contracts with a total contractual obligation of \$258 million, under which payments and interest during construction totaled \$142 million. Accordingly, \$142 million of Reliant Resources' collateral deposits were returned to Reliant Resources. As of March 31, 2002, there were equipment contracts with a total contractual obligation of \$140 million under which payments during construction totaled \$99.5 million. Currently this equipment is not designated for current planned power generation construction projects. Therefore, Reliant Resources anticipates that it will either purchase the equipment, assist in the remarketing of the equipment or negotiate to cancel the related contracts.

CRITICAL ACCOUNTING POLICIES

A critical accounting policy is one that is both important to the portrayal of our financial condition and results of operations and requires management to make difficult, subjective or complex judgments. The circumstances that make these judgments difficult, subjective and/or complex have to do with the need to make estimates about the effect of matters that are inherently uncertain. Estimates and assumptions about future events and their effects cannot be perceived with certainty. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments. These estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes.

We believe the following are the most significant estimates used in the preparation of our consolidated financial statements.

ACCOUNTING FOR RATE REGULATION

SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), provides that rate-regulated entities account for and report assets and liabilities consistent with the recovery of those costs in rates if the rates established are designed to recover the costs of providing the regulated service and if the competitive environment makes it probable that such rates can be charged and collected. Our rate-regulated businesses follow the accounting and reporting requirements of SFAS No. 71. Certain expenses and revenues subject to utility regulation or rate determination normally reflected in income are deferred on the balance sheet and are recognized in income as the related amounts are included in service rates and recovered from or refunded to customers. The total amounts of regulatory assets and liabilities reflected in the Consolidated Balance Sheets are \$3.2 billion and \$1.1 billion at March 31, 2002, and \$3.3 billion and \$1.4 billion at December 31, 2001, respectively.

Application of SFAS No. 71 to the generation portion of our business was discontinued as of June 30, 1999. Only the electric transmission and distribution business, the natural gas distribution companies and one of our interstate pipelines are subject to SFAS No. 71 after January 1, 2002. We have recorded regulatory assets and liabilities related to stranded costs associated with our electric generation operations. Under the Texas electric restructuring law, a final settlement of these stranded costs will occur in 2004. In the event that regulation significantly changes the probability for us to recover our costs in the future, a write-down of all or a portion of our existing regulatory assets and liabilities could result.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, which include property, plant and equipment, goodwill and other intangibles and equity investments comprise a significant amount of our total assets. We make judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. Additionally, the carrying values of these assets are periodically reviewed for impairment or whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recorded in the period in which it is determined that the carrying amount is not recoverable. This requires us to make long-term forecasts of future revenues and costs related to the assets subject to review. These forecasts require assumptions about demand for our products and services, future market conditions and regulatory developments. Significant and unanticipated changes to these assumptions could require a provision for impairment in a future period.

UNBILLED ENERGY REVENUES

Revenues related to the sale of energy are generally recorded when service is rendered or energy is delivered to customers. However, the determination of the energy sales to individual customers is based on the reading of their meters which are read on a systematic basis throughout the month. At the end of each month, amounts of energy delivered to customers since the date of the last meter reading are estimated and the corresponding unbilled revenue is estimated. This unbilled electric revenue is estimated each month based on daily generation volumes, line losses and applicable customer rates based on analyses reflecting significant historical trends and experience. Unbilled natural gas sales are estimated based on estimated purchased gas volumes, estimated lost and unaccounted for gas and tariffed rates in effect. Accrued unbilled revenues recorded in the Consolidated Balance Sheet as of March 31, 2002 were \$72 million related to our Electric Transmission and Distribution business segment, \$342 million related to our Retail Energy business segment and \$63 million related to our Natural Gas Distribution business segment. Accrued unbilled revenues recorded in the Consolidated Balance Sheet as of December 31, 2001 were \$33 million related to our Electric Transmission and Distribution business segment, \$19 million related to our Retail Energy business segment and \$188 million related to our Natural Gas Distribution business segment.

ACCOUNTING FOR DERIVATIVES AND HEDGING INSTRUMENTS

SFAS No. 133 established accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires an entity to recognize the fair value of derivative instruments held as assets or liabilities on the balance sheet. In accordance with SFAS No. 133, the effective portion of the change in the fair value of a derivative instrument designated as a cash flow hedge is reported in other comprehensive income, net of tax. Amounts in accumulated other comprehensive income are ultimately recognized in earnings when the related hedged forecasted transaction occurs. The change in the fair value of the ineffective portion of the derivative instrument designated as a cash flow hedge is recorded in earnings. Derivative instruments that have not been designated as hedges are adjusted to fair value through earnings.

We utilize derivative instruments such as futures, physical forward contracts, swaps and options to mitigate the impact of changes in electricity, natural gas and fuel prices on our operating results and cash flows. We utilize cross-currency swaps, forward contracts and options to hedge our net investments in and cash flows of our foreign subsidiaries, interest rate swaps to mitigate the impact of changes in interest rates and other financial instruments to manage various other market risks.

The determination of fair values of trading and marketing assets and liabilities for our energy trading, marketing and price risk management operations and non-trading derivative assets and liabilities, including stranded cost obligations related to our European Energy operations, are based on estimates. For further discussion, please read

-- Trading and Marketing Operations" and "Quantitative and Qualitative Disclosure About Market Risk" in Item 3 of this Form 10-Q and Note 4 to our Interim Financial Statements.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued SFAS No. 141 "Business Combinations" (SFAS No. 141). SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against these new criteria and may result in certain intangibles being transferred to goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. We adopted the provisions of the statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 on January 1, 2002. The adoption of SFAS No. 141 did not have a material impact on our historical results of operations or financial position.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 provides new guidance on the recognition of impairment losses on long-lived assets to be held and used or to be disposed of and also broadens the definition of what constitutes a discontinued operation and how the results of a discontinued operation are to be measured and presented. SFAS No. 144 supercedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," while retaining many of the requirements of these two statements. Under SFAS No. 144, assets held for sale that are a component of an entity will be included in discontinued operations if the operations and cash flows will be or have been eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations prospectively. SFAS No. 144 did not materially change the methods used by us to measure impairment losses on long-lived assets, but may result in additional future dispositions being reported as discontinued operations than was previously permitted. We adopted SFAS No. 144 on January 1, 2002.

See Note 4 to our Interim Financial Statements for a discussion of our adoption of SFAS No. 133 on January 1, 2001 and adoption of subsequent cleared guidance. See Note 6 to our Interim Financial Statements for a discussion of our adoption of SFAS No. 142, "Goodwill and Other Intangible Assets".

During the first quarter of 2002, the Financial Accounting Standards Board (FASB) considered proposed approaches related to identifying and accounting for special-purpose entities. The current proposal being considered by the FASB is likely to limit special purpose entities used by a company for financing and other purposes not being consolidated with its results of operations. One criterion being considered is to require consolidation of a special purpose entity if the equity investments held by third-party owners in the special purpose entity are less than 10% of capitalization. The FASB likely will not grandfather special purpose entities existing at the date the final interpretation is issued. Special purpose entities in existence at the date of adoption of this interpretation will likely be consolidated by the primary beneficiary. For information regarding special purpose entities affiliated with Reliant Resources, please read Notes 13(f) and (g) to our Interim Financial Statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

COMMODITY PRICE RISK

We assess the risk of our non-trading derivatives (Energy Derivatives) using a sensitivity analysis method, and we assess the risk of our trading derivatives (Trading Derivatives) using the value-at-risk (VAR) method, in order to maintain our total exposure within management-prescribed limits.

The sensitivity analysis performed on our Energy Derivatives measures the potential loss in earnings based on a hypothetical 10% movement in energy prices. A decrease of 10% in the market prices of energy commodities from their March 31, 2002 levels would have decreased the fair value of our Energy Derivatives from their levels on those respective dates by \$60 million, excluding non-trading derivatives liabilities associated with our European Energy business segment's out-of-market import contracts.

Our European Energy business segment's out-of-market import contracts have exposure to commodity price movements. For information regarding these contracts, please read Notes 4 and 13(e) to our Interim Financial Statements. A decrease of 10% in market prices of energy commodities from their March 31, 2002 levels would result in a loss of \$90 million.

We utilize the variance/covariance model of VAR, which is a probabilistic model that measures the estimated risk of loss to earnings in market sensitive instruments based on historical experience. With respect to Trading Derivatives, our highest, lowest and average monthly VAR were \$28 million, \$15 million and

\$19 million, respectively, during the first quarter of 2002 based on a 95% confidence level and primarily a one day holding

period. During the first quarter of 2001, our highest, lowest and average monthly VAR were \$18 million, \$4 million and \$9 million, respectively, based on a 95% confidence level and primarily a one day holding period.

We cannot assure you that market volatility, failure of counterparties to meet their contractual obligations, transactions entered into after the date of this Form 10-Q or a failure of risk controls will not lead to significant losses from our trading, marketing and risk management activities.

INTEREST RATE RISK

We have issued long-term debt and have obligations under bank facilities which subject us to the risk of loss associated with movements in market interest rates.

We have outstanding long-term debt and commercial paper obligations under bank facilities, mandatory redeemable preferred securities of subsidiary trusts holding solely our junior subordinated debentures (Trust Preferred Securities), securities held in our nuclear decommissioning trust, some lease obligations and our obligations under the 2.0% Zero-Premium Exchangeable Subordinated Notes due 2029 (ZENS) that subject us to the risk of loss associated with movements in market interest rates. We utilize interest-rate swaps in order to hedge portions of our floating-rate debt and to hedge a portion of the interest rate applicable to future offerings of long-term debt.

Our floating-rate obligations borrowed from third parties aggregated \$9.3 billion at March 31, 2002. If the floating rates were to increase by 10% from March 31, 2002 rates, our combined interest expense to third parties would increase by a total of \$2.4 million each month in which such increase continued.

At March 31, 2002, we had outstanding fixed-rate debt (excluding indexed debt securities) and Trust Preferred Securities aggregating \$7.0 billion in principal amount and having a fair value of \$6.9 billion. These instruments are fixed-rate and, therefore, do not expose us to the risk of loss in earnings due to changes in market interest rates. However, the fair value of these instruments would increase by approximately \$913 million if interest rates were to decline by 10% from their levels at March 31, 2002. In general, such an increase in fair value would impact earnings and cash flows only if we were to reacquire all or a portion of these instruments in the open market prior to their maturity.

As discussed in Note 14(k) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference, we contributed \$14.8 million in 1999, 2000 and 2001 to a trust established to fund our share of the decommissioning costs for the South Texas Project. In 2002, we will begin contributing \$2.9 million per year to this trust. The securities held by the trust for decommissioning costs had an estimated fair value of \$168 million as of March 31, 2002, of which approximately 45% were fixed-rate debt securities that subject us to risk of loss of fair value with movements in market interest rates. If interest rates were to increase by 10% from their levels at March 31, 2002, the decrease in fair value of the fixed-rate debt securities would decrease by approximately \$11 million. In addition, the risk of an economic loss is mitigated. Any unrealized gains or losses are accounted for in accordance with SFAS No. 71 as a regulatory asset/liability because we believe that our future contributions, which are currently recovered through the ratemaking process, will be adjusted for these gains and losses. For further discussion regarding the recovery of decommissioning costs pursuant to the Texas electric restructuring law, please read Note 4(a) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference.

As discussed in Note 10(b) to the Reliant Energy 10-K Notes, which note is incorporated herein by reference, RERC Corp.'s \$500 million aggregate principal amount of 6 3/8% Term Enhanced Remarketable Securities include an embedded option to remarket the securities. The option is expected to be exercised in the event that the ten-year Treasury rate in 2003 is below 5.66%. At March 31, 2002, we could terminate the option at a cost of \$15 million. A decrease of 10% in the March 31, 2002 level of interest rates would increase the cost of termination of the option by approximately \$13 million.

As discussed in Note 8 to the Reliant Energy 10-K Notes, which note is incorporated herein by reference, upon adoption of SFAS No. 133 effective January 1, 2001, the ZENS obligation was bifurcated into a debt component of \$122 million and a derivative component of \$788 million. The debt component of \$122 million is a fixed-rate obligation and, therefore, does not expose us to the risk of loss in earnings due to changes in market interest rates. However, the fair value of the debt component would increase by approximately \$18 million if interest rates were to

decline by 10% from levels at March 31, 2002. Changes in the fair value of the derivative component will be recorded in our Statements of Consolidated Income and, therefore, we are exposed to changes in the fair value of the derivative component as a result of changes in the underlying risk-free interest rate. If the risk-free interest rate were to increase by 10% from March 31, 2002 levels, the fair value of the derivative component would increase by approximately \$9 million, which would be recorded as a loss in our Statements of Consolidated Income.

As of March 31, 2002, we hold interest rate swaps having an aggregate notional amount of \$2.7 billion to fix the interest rate applicable to floating rate short-term debt and long-term debt. At March 31, 2002, the swaps relating to short-term and long-term debt could be terminated at a cost of \$16 million. Of these swaps, \$1.5 billion relating to short-term debt do not qualify as cash flow hedges under SFAS No. 133, and are marked to market in the Company's Consolidated Balance Sheets with changes reflected in interest expense in the Statements of Consolidated Income. The remaining \$1.2 billion in swaps relating to both short-term and long-term debt qualify for hedge accounting under SFAS No. 133 and the periodic settlements are recognized as an adjustment to interest expense in the Statements of Consolidated Income over the term of the swap agreements. A decrease of 10% in the March 31, 2002 level of interest rates would increase the cost of terminating the swaps related to short-term debt and long-term debt outstanding at March 31, 2002 by \$20 million.

As of March 31, 2002, we have entered into forward-starting interest rate swaps having an aggregate notional amount of \$2.5 billion to hedge the interest rate on future offerings of long-term fixed-rate notes. At March 31, 2002, these swaps could be terminated at a cost of \$17 million. These swaps qualify as cash flow hedges under SFAS No. 133. Should the expected issuance of the debt no longer be probable, any deferred amount will be recognized immediately into income. A decrease of 10% in the March 31, 2002 level of interest rates would increase the cost of terminating these swaps by \$40 million.

FOREIGN CURRENCY EXCHANGE RATE RISK

As of March 31, 2002, we have entered into foreign currency swaps and foreign exchange forward contracts and have issued Euro-denominated debt to hedge our net investment in our European Energy business segment. Changes in the value of the swaps, forwards and debt are recorded as foreign currency translation adjustments as a component of accumulated other comprehensive income (loss) in stockholders' equity. As of March 31, 2002, we have recorded a \$106 million loss in cumulative net translation adjustments. The cumulative translation adjustments will be realized in earnings and cash flows only upon the disposition of the related investments.

As of March 31, 2002, our European Energy business segment had entered into transactions to purchase approximately \$263 million at fixed exchange rates in order to hedge future fuel purchases payable in U.S. dollars. As of March 31, 2002, the fair value of these financial instruments was an \$8 million asset. An increase in the value of the Euro of 10% compared to the U.S. dollar from its March 31, 2002 level would result in a loss in the fair value of these foreign currency financial instruments of \$28 million. For information regarding the accounting for these financial instruments, see Note 4 to our Interim Financial Statements and Note 5(b) to the Reliant Energy 10-K Notes, which is incorporated by reference herein.

Our European Energy business segment's out-of-market import contracts have foreign currency exposure. An increase of 10% in the U.S. dollar relative to the Euro from their March 31, 2002 levels would result in a loss of \$10 million.

EQUITY MARKET VALUE RISK

We are exposed to equity market value risk through our ownership of approximately 26 million shares of AOL TW Common, which we hold to facilitate our ability to meet our obligations under the ZENS. Please read Note 8 to the Reliant Energy 10-K Notes, which is incorporated by reference herein, for a discussion of the effect of adoption of SFAS No. 133 on our ZENS obligation and our historical accounting treatment of our ZENS obligation. Subsequent to adoption of SFAS No. 133, a decrease of 10% from the March 31, 2002 market value of AOL TW Common would result in a net loss of approximately \$3 million, which would be recorded as a loss in our Statements of Consolidated Income.

As discussed above under "-- Interest Rate Risk," we contribute to a trust established to fund our share of the decommissioning costs for the South Texas Project, which held debt and equity securities as of March 31, 2002. The

equity securities expose us to losses in fair value. If the market prices of the individual equity securities were to decrease by 10% from their levels at March 31, 2002, the resulting loss in fair value of these securities would not be material to us. Currently, the risk of an economic loss is mitigated as discussed above under "-- Interest Rate Risk."

We have an investment in Itron, Inc. (Itron), which is classified as "available-for-sale" under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". As of March 31, 2002, the value of the Itron investment was \$9 million. The Itron investment exposes us to losses in the fair value of Itron common stock. A 10% decline in the market value per share of Itron common stock from the March 31, 2002 level would decrease the fair value by \$1 million.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting Reliant Energy, please read Note 13 to our Interim Financial Statements, the discussion under "Our Business -- Environmental Matters" and Item 3 of the Reliant Energy Form 10-K and Notes 4 and 14 to the Reliant Energy 10-K Notes, all of which are incorporated herein by reference.

Restatement of Second and Third Quarter 2001 Results of Operations.

On February 5, 2002, Reliant Energy announced that it was restating its earnings for the second and third quarters of 2001. As more fully described in Reliant Energy's March 15, 2002 Current Report on Form 8-K, the restatement related to a correction in accounting treatment for a series of four structured transactions that were inappropriately accounted for by Reliant Resources as cash flow hedges for the period of May 2001 through September 2001, rather than as derivatives with changes in fair value recognized through the income statement. Each structured transaction involved a series of forward contracts to buy and sell an energy commodity in 2001 and to buy and sell an energy commodity in 2002 or 2003.

At the time of the public announcement of Reliant Energy's intention to restate its reporting of the structured transactions, the Audit Committee of each of the Boards of Directors of Reliant Energy and Reliant Resources instructed Reliant Resources to conduct an internal audit review to determine whether there were any other transactions included in the asset books as cash flow hedges that failed to meet the cash flow hedge requirements under SFAS No. 133. This targeted internal audit review found no other similar transactions.

The Audit Committees also directed an internal investigation by outside legal counsel of the facts and circumstances leading to the restatement, which investigation has been completed. In connection with the restatement and related investigations, the Audit Committees have met eight times to hear and assess reports from the investigative counsel regarding its investigation and contacts with the Staff of the SEC. To address the issues identified in the investigation process, the Audit Committees and management have begun analyzing and implementing remedial actions, including, among other things, changes in organizational structure and enhancement of internal controls and procedures.

On April 5, 2002, Reliant Resources was advised that the Staff of the Division of Enforcement of the SEC is conducting an informal inquiry into the facts and circumstances surrounding the restatement. Reliant Resources is cooperating with this inquiry. Before releasing its 2001 earnings, Reliant Energy received concurrence from the SEC's accounting staff on the accounting treatment of the restatement, which increased its earnings for the two quarters by a total of \$107 million. At this time, we cannot predict the outcome of the SEC's inquiry. In addition, we cannot predict what effect the inquiry may have on our pending application to the SEC under the 1935 Act, which is required for our Restructuring. For more information about our Restructuring, please read "Our Business - Status of Business Separation" and " - Business Separation" in Item 1 of the Reliant Energy Form 10-K, which is incorporated herein by reference.

The Staff of the Division of Enforcement of the SEC has indicated it may expand the scope of its inquiry to include the round trip trades as described in Note 1 to our Interim Financial Statements.

ITEM 5. OTHER INFORMATION.

Forward-Looking Statements. From time to time, we make statements concerning our expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are not historical facts. These statements are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those expressed or implied by these statements. You can generally identify our forward-looking statements by the words "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "should," "will," "forecast," "goal," "objective," "projection," or other similar words.

We have based our forward-looking statements on our management's beliefs and assumptions based on

information available to our management at the time the statements are made. We caution you that assumptions, beliefs, expectations, intentions and projections about future events may and often do vary materially from actual results. Therefore, we cannot assure you that actual results will not differ materially from those expressed or implied by our forward-looking statements.

The following are some of the factors that could cause actual results to differ materially from those expressed or implied in forward-looking statements:

- state, federal and international legislative and regulatory developments, including deregulation; re-regulation and restructuring of the electric utility industry; and changes in, or application of environmental, siting and other laws and regulations to which we are subject;
- timing of the implementation of our business separation plan, including the receipt of necessary approvals from the Securities and Exchange Commission and an extension relating to a private letter ruling from the Internal Revenue Service;
- the effects of competition, including the extent and timing of the entry of additional competitors in our markets;
- industrial, commercial and residential growth in our service territories;
- our pursuit of potential business strategies, including acquisitions or dispositions of assets or the development of additional power generation facilities;
- state, federal and other rate regulations in the United States and in foreign countries in which we operate or into which we might expand our operations;
- the timing and extent of changes in commodity prices, particularly natural gas;
- weather variations and other natural phenomena;
- political, legal and economic conditions and developments in the United States and in foreign countries in which we operate or into which we might expand our operations, including the effects of fluctuations in foreign currency exchange rates;
- financial market conditions and the results of our financing efforts;
- ramifications from the bankruptcy filing of Enron Corp.;
- any direct or indirect effect on our business resulting from the September 11, 2001 terrorist attacks or any similar incidents or responses to such incidents;
- the performance of our projects; and
- other factors we discuss in the Reliant Energy Form 10-K, including those outlined in "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings."

You should not place undue reliance on forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statements.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

Exhibit 99 Items incorporated by reference from the Reliant Energy Form 10-K: Item 1 "Business," Item 3 "Legal Proceedings," Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Certain Factors Affecting Our Future Earnings" and "- Liquidity and Capital Resources" and Notes 1 (Background and Basis of Presentation), 2(d) (Revenues), 2(e) (Long-Lived Assets and Intangibles), 2(f) (Regulatory Assets and Liabilities), 3 (Business Acquisitions), 4 (Regulatory Matters), 5 (Derivative Financial Instruments), 6 (Jointly Owned Electric Utility Plant), 8 (Indexed Debt Securities (ACES and ZENS) and AOL Time Warner Securities), 10 (Long-term Debt and Short-term Borrowings), 11 (Trust Preferred Securities), 14 (Commitments and Contingencies), 21 (Bankruptcy of Enron Corp. and its Affiliates) and 22 (Subsequent Events) of the Reliant Energy 10-K Notes.

(b) Reports on Form 8-K.

On January 11, 2002, we filed a Current Report on Form 8-K dated December 18, 2001, relating to the execution of a settlement agreement regarding European stranded cost indemnification.

On February 5, 2002, we filed a Current Report on Form 8-K dated February 5, 2002, regarding a delay in the release of earnings and restatement of 2001 results.

On March 6, 2002, we filed a Current Report on Form 8-K dated February 19, 2002, regarding Reliant Resources' acquisition of Orion Power Holdings, Inc.

On March 15, 2002, we filed a Current Report on Form 8-K dated March 15, 2002, regarding our 2001 earnings and the effects of our restatement.

On April 8, 2002, we filed a Current Report on Form 8-K dated April 5, 2002, announcing the SEC informal inquiry.

On April 29, 2002, we filed a Current Report on Form 8-K dated April 29, 2002, relating to the announcement of first quarter 2002 results.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RELIANT ENERGY, INCORPORATED
(Registrant)

By: /s/ Mary P. Ricciardello

 Mary P. Ricciardello
Senior Vice President and Chief Accounting Officer

Date: May 20, 2002

EXHIBIT INDEX

EXHIBIT NUMBER -----	DESCRIPTION -----
99	Items incorporated by reference from the Reliant Energy Form 10-K: Item 1 "Business," Item 3 "Legal Proceedings," Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Certain Factors Affecting Our Future Earnings" and "- Liquidity and Capital Resources" and Notes 1 (Background and Basis of Presentation), 2(d) (Revenues), 2(e) (Long-Lived Assets and Intangibles), 2(f) (Regulatory Assets and Liabilities), 3 (Business Acquisitions), 4 (Regulatory Matters), 5 (Derivative Financial Instruments), 6 (Jointly Owned Electric Utility Plant), 8 (Indexed Debt Securities (ACES and ZENS) and AOL Time Warner Securities), 10 (Long-term Debt and Short-term Borrowings), 11 (Trust Preferred Securities), 14 (Commitments and Contingencies), 21 (Bankruptcy of Enron Corp. and its Affiliates) and 22 (Subsequent Events) of the Reliant Energy 10-K Notes.

ITEM 1. BUSINESS

OUR BUSINESS

GENERAL

We are a diversified international energy services and energy delivery company that provides energy and energy services primarily in North America and Western Europe. Reliant Energy, Incorporated (Reliant Energy), a Texas corporation incorporated in 1906, is the parent company of our consolidated group of companies and is a utility holding company that conducts electric utility operations in Texas. Reliant Energy owns all of the common stock of Reliant Energy Resources Corp. (RERC Corp.), which conducts natural gas distribution and pipeline operations, and of CenterPoint Energy, Inc. (CenterPoint Energy), which does not currently conduct any operations. RERC Corp. is a Delaware corporation that was incorporated in 1996. CenterPoint Energy is a Texas corporation that was incorporated in August 2001 to become the holding company for Reliant Energy following the Restructuring (as defined below). Reliant Energy also owns approximately 83% of the common stock of Reliant Resources, Inc. (Reliant Resources), which conducts non-utility wholesale and retail energy operations. Reliant Resources is a Delaware corporation that was incorporated in August 2000. In this Form 10-K, unless the context indicates otherwise,

- references to "we," "us" or similar terms mean Reliant Energy and its subsidiaries prior to the Restructuring described below and CenterPoint Energy and its subsidiaries after the Restructuring; and
- we refer to RERC Corp. and its subsidiaries as "RERC."

The executive offices of Reliant Energy are located at 1111 Louisiana, Houston, TX 77002 (telephone number 713-207-3000).

STATUS OF BUSINESS SEPARATION

We are in the process of separating our regulated and unregulated businesses into two unaffiliated publicly traded companies. In December 2000, we transferred a significant portion of our unregulated businesses to Reliant Resources, which, at the time, was a wholly owned subsidiary. Reliant Resources conducted an initial public offering of approximately 20% of its common stock in May 2001. In December 2001, our shareholders approved an agreement and plan of merger by which the following will occur (which we refer to as the Restructuring):

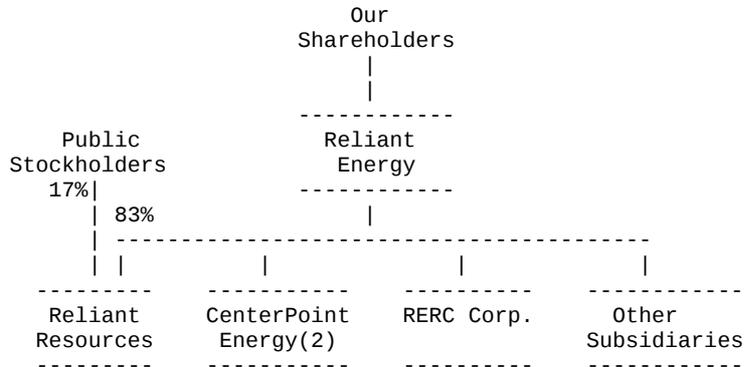
- CenterPoint Energy will become the holding company for Reliant Energy and its subsidiaries;
- Reliant Energy and its subsidiaries will become subsidiaries of CenterPoint Energy; and
- each share of Reliant Energy common stock will be converted into one share of CenterPoint Energy common stock.

After the Restructuring, we plan, subject to further corporate approvals, market and other conditions, to complete the separation of our regulated and unregulated businesses by distributing the shares of common stock of Reliant Resources that we own to our shareholders (Distribution). Our goal is to complete the Restructuring and subsequent Distribution as quickly as possible after all the necessary conditions are fulfilled, including receipt of an order from the SEC granting the required approvals under the Public Utility Holding Company Act of 1935 (1935 Act) and an extension from the IRS for a private letter ruling we have obtained regarding the tax-free treatment of the Distribution. Although receipt or timing of regulatory approvals cannot be assured, we believe we meet the standards for such approvals. Please read "-- Regulation -- Public Utility Holding Company Act of 1935" in Item 1 of this Form 10-K. We currently expect to complete the Restructuring and Distribution in the summer of 2002. Please read "-- Business Separation" in Item 1 of this Form 10-K. For information about an informal inquiry by the staff of the Division of Enforcement of the SEC in connection with an earnings restatement by Reliant Energy that might impact the approval process, please read "Restatement of Second and Third Quarter 2001 Results of Operations" in Item 3 of this Form 10-K.

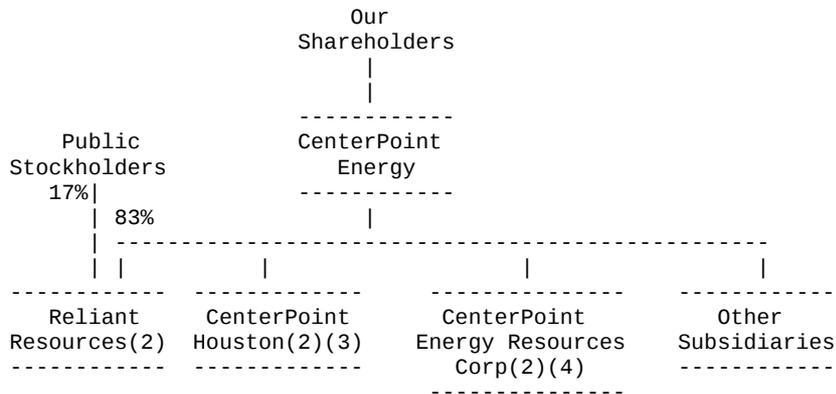
We have entered into a number of separation agreements with Reliant Resources in anticipation of the Restructuring and the Distribution. For information about these agreements, please read "Reliant Energy's Relationship with Reliant Resources" in Item 1 of this Form 10-K.

The diagrams on the following page depict our current structure, our structure after the Restructuring and our structure after the Distribution. Unless otherwise indicated, ownership interests shown below are 100%. Other ownership interests indicated below are approximate.

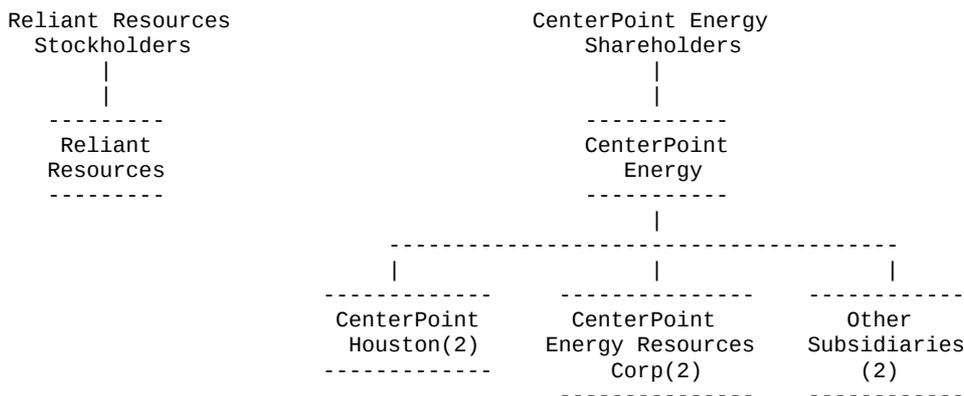
CURRENT STRUCTURE(1)



STRUCTURE AFTER RESTRUCTURING



STRUCTURE AFTER DISTRIBUTION



(1) As of April 1, 2002.

(2) Owned indirectly through another subsidiary of Reliant Energy or CenterPoint Energy.

(3) Reliant Energy will become CenterPoint Energy Houston Electric, LLC (CenterPoint Houston) in the Restructuring. Please read "-- Business Separation -- Restructuring -- Reliant Energy Conversion" in Item 1 of this Form 10-K.

(4) RERC Corp. will be renamed CenterPoint Energy Resources Corp. as part of the Restructuring.

BUSINESS SEGMENT OVERVIEW

We conducted our operations in 2001 through the following business segments:

- Electric Operations;
- Natural Gas Distribution;
- Pipelines and Gathering;
- Wholesale Energy;
- European Energy;
- Retail Energy;
- Latin America; and
- Other Operations.

During 2001, our Electric Operations business segment included our regulated electric generation, transmission and distribution, and retail electric sales functions, all of which were operated as an integrated utility under Reliant Energy HL&P, an unincorporated division of Reliant Energy. As of January 1, 2002, the generation and retail electric sales functions were deregulated. Retail electric sales involve the sale of electricity and related services to end users of electricity, including industrial, commercial and residential customers. Retail electric sales are now part of the Retail Energy business segment, which is owned by Reliant Resources. The generation facilities now operated as a division of Reliant Energy will be operated by a separate indirect subsidiary of CenterPoint Energy following the Restructuring and will comprise a new business segment, Electric Generation. The transmission and distribution functions, which will be conducted through a separate subsidiary, will remain regulated and will also comprise a new business segment, Electric Transmission and Distribution. In addition to Retail Energy, the Wholesale Energy, European Energy and several of the operations in the Other Operations business segments are currently owned by Reliant Resources. Once we complete the Distribution, those business segments and operations will no longer be part of our business. For more information about our business after deregulation and the completion of the Distribution, please read "Our Business Going Forward" in Item 1 of this Form 10-K.

For information about the revenues, operating income, assets and other financial information relating to our business segments, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations by Business Segment" in Item 7 of this Form 10-K and Note 18 to our consolidated financial statements, which, together with the notes related to those statements, we refer to in this Form 10-K as our "consolidated financial statements."

DEREGULATION

In 1999, the Texas legislature adopted the Texas Electric Choice Plan (Texas Electric Restructuring Law), which substantially amended the regulatory structure governing electric utilities in Texas in order to allow retail electric competition for all customers. Retail pilot projects, allowing competition for up to 5% of each utility's energy demand, or "load" in all customer classes, began in August 2001 and retail electric competition for all other customers began in January 2002. Under the Texas Electric Restructuring Law:

- electric utilities in Texas, including Reliant Energy HL&P, have restructured or are in the process of restructuring their businesses in order to separate power generation, transmission and distribution, and retail electric provider activities into separate units;
- since January 1, 2002, most retail customers of investor-owned electric utilities in Texas, including the customers of Reliant Energy HL&P, have been entitled to purchase their electricity from any of a number of "retail electric providers" that have been certified by the Public Utility Commission of Texas (Texas Utility Commission);

- retail electric providers, who may not themselves own any generation assets, obtain their electricity from power generation companies, exempt wholesale generators and other generating entities and provide services at generally unregulated rates, except that the prices that may be charged to residential and small commercial customers by retail electric providers affiliated with a utility within their affiliated electric utility's service area are set by the Texas Utility Commission (price to beat) until certain conditions in the Texas Electric Restructuring Law are met;
- the transmission and distribution of power are performed by transmission and distribution utilities at rates that continue to be regulated by the Texas Utility Commission; and
- transmission and distribution utilities in Texas whose generation assets were "unbundled" pursuant to the Texas Electric Restructuring Law, including the transmission and distribution utility successor to Reliant Energy HL&P, may recover generation-related

(i) "regulatory assets," which consist of the Texas jurisdictional amount reported by the electric utilities as regulatory assets and liabilities (offset by specified amounts) in their audited financial statements for 1998; and

(ii) "stranded costs," which consist of the positive excess of the net regulatory book value of generation assets over the market value of the assets, taking specified factors into account.

We filed our initial business separation plan with the Texas Utility Commission in January 2000 and filed amended plans in April 2000 and August 2000. In December 2000, the Texas Utility Commission approved our amended business separation plan (Business Separation Plan) providing for the separation of our generation, transmission and distribution, and retail operations into three different companies and for the separation of our regulated and unregulated businesses into two publicly traded companies. On October 15, 2001, we filed an update to the Business Separation Plan with the Texas Utility Commission indicating that full implementation of the plan could not be achieved until all regulatory approvals had been received. Since not all regulatory approvals had been received by the beginning of retail competition on January 1, 2002, we have not fully implemented the Business Separation Plan. However, beginning January 1, 2002, our generation, transmission and distribution, and retail electric sales operations have been functionally separated and are conducted independently as if the Business Separation Plan were completed.

The Texas Electric Restructuring Law permits utilities to recover regulatory assets and stranded costs through non-bypassable charges authorized by the Texas Utility Commission, to the extent that such assets and costs are established in certain regulatory proceedings. The law also authorizes the Texas Utility Commission to permit utilities to issue securitization bonds based on the securitization of that charge. On May 31, 2001, the Texas Utility Commission issued a financing order pursuant to the Texas Electric Restructuring Law authorizing the issuance of \$740 million of transition bonds, plus approximately \$10 million in qualified costs, to recover certain Reliant Energy HL&P regulatory assets. Pursuant to the financing order, we, through a special purpose subsidiary, issued \$749 million aggregate principal amount of transition bonds in October 2001 and used the proceeds to reduce our recoverable regulatory assets by repaying outstanding indebtedness. For more information regarding the transition bonds issuance and recovery of our regulatory assets, please read Note 4(a) to our consolidated financial statements. For information regarding the manner in which we plan to recover our stranded costs, please read "Regulation -- State and Local Regulations -- Texas -- Electric Operations -- Stranded Costs and Regulatory Assets" in Item 1 of this Form 10-K and Note 4(a) to our consolidated financial statements.

For additional information regarding the Texas Electric Restructuring Law, retail competition in Texas and its application to our operations and structure, please read "-- Business Separation," "Electric Operations" and "Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" below, "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Electric Operations" in Item 7 of this Form 10-K and Note 4 to our consolidated financial statements.

BUSINESS SEPARATION

Pursuant to the Business Separation Plan, we plan to separate our businesses into two publicly traded companies (CenterPoint Energy and Reliant Resources) in order to separate (i) our unregulated businesses from our regulated businesses and (ii) our generation, transmission and distribution and retail electric sales functions from each other as required by the Texas Electric Restructuring Law. Below is an outline of the significant transactions through which the business separation will be accomplished, some of which have been completed. In this Form 10-K, we sometimes collectively refer to the transactions described below, including the transfers of assets to Reliant Resources, the Reliant Resources offering, the Restructuring and the Distribution as the "Separation."

Reliant Resources Transfers. In December 2000, we transferred substantially all of our unregulated businesses to Reliant Resources, including the operations conducted by our:

- Wholesale Energy business segment;
- European Energy business segment;
- Retail Energy (retail electricity business) business segment;
- Communications business; and
- New Ventures group.

In connection with the transfer of our unregulated businesses to Reliant Resources, we entered into a number of agreements with Reliant Resources, including the master separation agreement, providing for, among other things, the transfer of assets and liabilities to Reliant Resources, as well as interim and ongoing relationships with Reliant Resources, including the provision by Reliant Energy of various interim services to Reliant Resources. For information about these agreements, please read "Reliant Energy's Relationship With Reliant Resources" in Item 1 of this Form 10-K.

In May 2001, Reliant Resources conducted an initial public offering of approximately 20% of its outstanding common stock. Pursuant to the master separation agreement, \$1.7 billion of debt owed by Reliant Resources to Reliant Energy was converted into equity as a capital contribution to Reliant Resources in connection with the initial public offering.

Restructuring -- Holding Company Formation. After having received the necessary regulatory approvals, CenterPoint Energy will become the holding company for Reliant Energy and its subsidiaries as a result of the merger of a CenterPoint Energy subsidiary with and into Reliant Energy. In the merger, each outstanding share of Reliant Energy common stock will be converted automatically into one share of CenterPoint Energy common stock. For information regarding the special shareholders' meeting at which the merger agreement providing for the holding company formation was approved, please read Item 4 of this Form 10-K.

Restructuring -- Texas Genco Transfers. In December 2001, we formed Texas Genco, LP, a Texas limited partnership, as an indirect, wholly owned subsidiary. In this Form 10-K, we refer to Texas Genco, LP and the subsidiary entities through which we own Texas Genco, LP individually and collectively as "Texas Genco," as the context requires. We plan to transfer Reliant Energy HL&P's Texas generating assets and liabilities associated with those assets to Texas Genco immediately prior to the consummation of the holding company formation. Texas Genco will operate our formerly regulated generating assets as a power generation company selling generation at market prices to Reliant Resources and other power purchasers in accordance with the separation agreements and the Texas Electric Restructuring Law and will comprise our new Electric Generation business segment.

In accordance with provisions of the Texas Electric Restructuring Law relating to the determination of stranded costs, we plan for Texas Genco to conduct an initial public offering of approximately 20% of its capital stock by the end of 2002. If we do not conduct the initial public offering, we may distribute approximately 20% of Texas Genco's capital stock to our shareholders in a transaction taxable both to us and our shareholders as part of the valuation of stranded costs. Reliant Resources holds an option, subject to the completion of the Distribution, exercisable in 2004 to purchase the Texas Genco stock owned by CenterPoint

Energy after the initial public offering or distribution. For additional information regarding Texas Genco and Reliant Resources' option to purchase Texas Genco stock, please read "Reliant Energy's Relationship With Reliant Resources" and "Electric Operations -- Generation" in Item 1 of this Form 10-K.

Restructuring -- Reliant Energy Conversion. As a result of the holding company formation and transfer of assets to Texas Genco, Reliant Energy will become a wholly owned subsidiary of CenterPoint Energy, will hold the transmission and distribution assets previously held by Reliant Energy HL&P and will operate those assets subject to regulation by the Texas Utility Commission. Immediately after the holding company formation, Reliant Energy will convert from a Texas corporation to CenterPoint Houston, a Texas limited liability company.

Distribution. As a result of the holding company formation, CenterPoint Energy will become the owner of all of the shares of Reliant Resources' common stock currently owned by Reliant Energy. We anticipate that, upon completion of the Restructuring and subject to board approval, market and other conditions, CenterPoint Energy will distribute all of the stock it owns in Reliant Resources to CenterPoint Energy's shareholders, effecting the separation of our operations into two unaffiliated publicly traded corporations. We have obtained a private letter ruling from the IRS providing for the tax-free treatment of the Distribution that is predicated on the completion of the Distribution by April 30, 2002. We have requested an extension of this deadline. While there can be no assurance that we will receive the extension, we anticipate that we will receive an extension that allows us to proceed with the Distribution after April 30, 2002.

Please see "-- Status of Business Separation" in Item 1 of this Form 10-K for diagrams depicting various stages of the Separation.

RERC CORP. RESTRUCTURING

Following the Restructuring, CenterPoint Energy will be a utility holding company under the 1935 Act and as such will be required to register under the 1935 Act unless it qualifies for an exemption. In order to enable CenterPoint Energy to comply with the requirements in the exemption in Section 3(a)(1) of the 1935 Act, we plan to divide the gas distribution businesses conducted by RERC Corp.'s three unincorporated divisions, Reliant Energy Entex (Entex), Reliant Energy Arkla (Arkla) and Reliant Energy Minnegasco (Minnegasco), among three separate business entities. For more information regarding our application under the 1935 Act and regulation under the 1935 Act, please read "Regulation -- Public Utility Holding Company Act of 1935" in Item 1 of this Form 10-K. The entity that will hold the Entex assets will also hold RERC Corp.'s natural gas pipelines and gathering businesses. For more information regarding RERC Corp.'s divisions and their operations, please read "Natural Gas Distribution" and "Pipelines and Gathering" in Item 1 of this Form 10-K. In addition to regulatory approvals we have obtained, this restructuring will require approval of the public service commissions of Louisiana, Oklahoma and Arkansas.

RELIANT ENERGY'S RELATIONSHIP WITH RELIANT RESOURCES

INTERCOMPANY AGREEMENTS

Prior to the initial public offering of Reliant Resources' common stock, Reliant Energy entered into agreements with Reliant Resources providing for the separation of their businesses. These agreements generally provided for the transfer by Reliant Energy of assets relating to Reliant Resources' businesses and the assumption by Reliant Resources of associated liabilities. Reliant Energy also entered into other agreements governing various ongoing relationships between it and Reliant Resources.

Master Separation Agreement. The master separation agreement provides for the separation of Reliant Energy's assets and businesses from those of Reliant Resources. It contains agreements relating to subsequent transactions and several agreements governing the relationship between Reliant Energy and Reliant Resources in the future. The master separation agreement also provides for cross-indemnities intended to place sole financial responsibility on Reliant Resources and its subsidiaries for all liabilities associated with the current and historical businesses and operations they conduct, regardless of the time those liabilities arise, and to place sole financial responsibility for liabilities associated with Reliant Energy's other businesses with Reliant

Energy and its other subsidiaries. Reliant Energy and Reliant Resources also agreed to assume and be responsible for specified liabilities associated with activities and operations of the other party and its subsidiaries to the extent performed for or on behalf of their respective current or historical business. The master separation agreement also contains indemnification provisions under which Reliant Energy and Reliant Resources will each indemnify the other with respect to breaches by the indemnifying party of the master separation agreement or any ancillary agreements.

The master separation agreement provides for the Restructuring and Distribution, including the formation of Texas Genco, although it does not obligate Reliant Energy to effect the Distribution. The agreement requires Texas Genco (and, prior to the Restructuring, Reliant Energy) to auction capacity remaining after it conducts the mandated auctions of its capacity required by the Texas Electric Restructuring Law. After certain deductions, Reliant Resources has the right to purchase 50% (but no less than 50%) of the capacity that would otherwise be auctioned at the prices to be established in the auctions required by the master separation agreement. For more information on these auctions, please read "-- Electric Operations -- Generation -- State Mandated Capacity Auctions" and "-- Contractually Mandated Capacity Auctions" in Item 1 of this Form 10-K.

The master separation agreement also requires Reliant Resources to make a payment to Reliant Energy equal to the amount, if any, required to be credited to Reliant Energy by Reliant Energy's affiliated retail electric provider pursuant to the Texas Electric Restructuring Law. This payment, which is sometimes referred to as the "clawback" payment, will be required unless 40% or more of the amount of electric power that was consumed before the onset of retail competition by residential or small commercial customers within Reliant Energy HL&P's service territory is being served by retail electric providers other than Reliant Resources by January 1, 2004. The payment by Reliant Resources will be the lesser of (a) the amount that the price to beat, less non-bypassable delivery charges, is in excess of the prevailing market price of electricity during such period per customer or (b) \$150, multiplied by the number of residential or small commercial customers in Reliant Energy HL&P's service territory that are buying electricity at the price to beat on January 1, 2004 less the number of new customers obtained by Reliant Resources outside Reliant Energy HL&P's service area. Amounts received from Reliant Resources with respect to the clawback payment, if any, will be included in the 2004 stranded cost true-up as a reduction of stranded costs. For additional information regarding this payment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources -- Reliant Resources -- unregulated business -- "clawback" Payment to Reliant Energy" in Item 7 of this Form 10-K. For discussion of the 2004 true-up proceedings, please read Note 4(a) to our consolidated financial statements.

The master separation agreement contains provisions relating to certain nuclear decommissioning assets, the exchange of information, provision of information for financial reporting purposes, dispute resolution, and provisions limiting competition between the parties in certain business activities and provisions allocating responsibility for the conduct of regulatory proceedings and limiting positions that may be taken in legislative, regulatory or court proceedings in which the interests of both parties may be affected. For additional information regarding the nuclear decommissioning assets, please read "Regulation -- Nuclear Regulatory Commission" in Item 1 of this Form 10-K.

Texas Genco Option Agreement. Reliant Energy and Reliant Resources also entered into an agreement under which, subject to the completion of the Distribution, Reliant Resources will have an option to purchase all of the shares of capital stock of Texas Genco owned by CenterPoint Energy after the initial public offering or distribution of no more than 20% of Texas Genco's capital stock (Texas Genco Option). The Texas Genco Option may be exercised between January 10, 2004 and January 24, 2004. The per share exercise price under the option will be the average daily closing price on the national exchange for publicly held shares of common stock of Texas Genco for the 30 consecutive trading days with the highest average closing price during the 120 trading days immediately ending January 9, 2004, plus a control premium, up to a maximum of 10%, to the extent a control premium is included in the valuation determination made by the Texas Utility Commission relating to the market value of Texas Genco's common stock equity. The exercise price is also subject to adjustment based on the difference between the cash dividends paid during the period there is a public ownership interest in Texas Genco and Texas Genco's earnings during that period. For additional

information regarding recovery of stranded costs, please read "Regulation -- State and Local Regulations -- Texas -- Electric Operations -- Stranded Costs and Regulatory Assets" in Item 1 of this Form 10-K and Note 4(a) to our consolidated financial statements.

If Reliant Resources exercises the Texas Genco Option and purchases CenterPoint Energy's shares of Texas Genco common stock, Reliant Resources will also be required to purchase all notes and other receivables from Texas Genco then held by CenterPoint Energy, at their principal amount plus accrued interest. Similarly, if Texas Genco holds notes or receivables from CenterPoint Energy, Reliant Resources will assume those obligations in exchange for a payment to Reliant Resources by CenterPoint Energy of an amount equal to the principal plus accrued interest. If Reliant Resources does not exercise the Texas Genco Option, CenterPoint Energy may continue to operate Texas Genco or sell or otherwise dispose of its operations. If CenterPoint Energy continues to operate Texas Genco after 2005, it will need to replace or enter into a new arrangement for the provision of technical services for the operation of Texas Genco's facilities, which services are currently being provided by Reliant Resources under the technical services agreement, which is described below and expires upon Reliant Resources' purchase of Texas Genco shares if it exercises the Texas Genco Option or in 2005 if the Texas Genco Option is not exercised, subject to additional conditions.

The purchase of the shares of Texas Genco common stock upon exercise of the Texas Genco Option by Reliant Resources will be subject to various regulatory approvals, including Hart-Scott-Rodino antitrust clearance and United States Nuclear Regulatory Commission (NRC) license transfer approval.

Technical Services Agreement. Reliant Resources provides engineering and technical support services and environmental, safety and industrial health services to support operation and maintenance of the generation facilities to be transferred to Texas Genco under the technical services agreement. Reliant Resources also provides systems, technical, programming and consulting support services and hardware maintenance (but excluding plant-specific hardware) necessary to provide dispatch planning, dispatch and settlement and communication with the independent system operator, as well as general information technology services for the generation facilities to be transferred to Texas Genco. The fees Reliant Resources charges for these services allow it to recover its fully allocated direct and indirect costs and reimbursement of all out-of-pocket expenses. Expenses associated with capital investment in systems and software that benefit both the operation of the generation facilities to be transferred to Texas Genco and Reliant Resources' facilities in other regions are allocated on an installed megawatt basis.

Other Agreements. Reliant Energy and Reliant Resources entered into several other agreements pursuant to the master separation agreement. These agreements include an employee matters agreement, which addresses asset and liability allocation relating to Reliant Resources' employees and their continued participation in Reliant Energy's benefit plans, and a tax allocation agreement, which governs the allocation of U.S. income tax liabilities and sets forth agreements with respect to other tax matters. These agreements, along with the master separation agreement, the Texas Genco Option agreement and the technical services agreement, are filed as exhibits to this Form 10-K.

COMMON DIRECTORS ON RELIANT RESOURCES' AND RELIANT ENERGY'S BOARD OF DIRECTORS AND STOCK OWNERSHIP OF MANAGEMENT

Three of Reliant Energy's directors are also directors of Reliant Resources. One of these directors is Reliant Energy's chairman, president and chief executive officer. These directors owe fiduciary duties to the stockholders of each company. As a result, in connection with any transaction or other relationship involving both companies, these directors may need to recuse themselves and not participate in any board action relating to these transactions or relationships. It is anticipated that at the time of Distribution, one of these directors will resign as a director of Reliant Energy. In addition, members of Reliant Energy's board of directors and management own stock in Reliant Resources, and vice versa.

ELECTRIC OPERATIONS

GENERAL

Our Electric Operations business segment and the discussion in this section include only our electric utility operations that traditionally have been subject to regulation by the Texas Utility Commission and do not include operations in other states or operations in the state of Texas that are not regulated by the Texas Utility Commission. For information about our other power-related operations, please read "Wholesale Energy" in Item 1 of this Form 10-K. In 2001, Reliant Energy HL&P conducted our electric operations as a traditional integrated electric utility, including generation, transmission and distribution, and retail electric sales operations. Retail electric sales involve the sale of electricity and related services to end users of electricity, including industrial, commercial and residential customers. We generated, purchased for resale, transmitted, distributed and sold electricity to approximately 1.7 million customers in a 5,000-square mile area on the Texas Gulf Coast, including Houston, through the operations of this business segment.

As contemplated by the Texas Electric Restructuring Law, full retail competition began in Texas on January 1, 2002. In response to the Texas Electric Restructuring Law and as part of the Separation, we have functionally separated our generation, transmission and distribution operations and are in the process of separating those operations among different business entities. In December 2000, prior to the beginning of retail competition, we transferred our retail electric sales operations to subsidiaries of Reliant Resources, though our retail customers remained customers of Reliant Energy HL&P until their first meter reading following the onset of full retail competition on January 1, 2002. After that date those customers have been entitled to purchase their electricity from any of a number of certified retail electric providers, including Reliant Resources. Residential and small commercial customers who did not select another retail electric provider became customers of Reliant Resources, where the bulk of those customers have remained to date. For information about the retail operations we conduct through Reliant Resources, please read "Retail Energy" in Item 1 of this Form 10-K.

The generation operations in our Electric Operations business segment remained part of Reliant Energy HL&P throughout 2001, but are now operated independently of the retail electric sales and transmission and distribution operations. In this Form 10-K, we sometimes collectively refer to the generating facilities and operations to be transferred to Texas Genco in the Restructuring as our "Texas generation business." If Reliant Resources exercises the Texas Genco Option, the Texas Genco operations will cease to be part of our business in 2004. If Reliant Resources does not exercise the Texas Genco Option, we may continue to operate Texas Genco or dispose of its operations. For more information about the Texas Genco Option, please read "Reliant Energy's Relationship With Reliant Resources -- Intercompany Agreements -- Texas Genco Option Agreement" in Item 1 of this Form 10-K.

After the Restructuring, our transmission and distribution operations, which also were part of Reliant Energy HL&P throughout 2001, will comprise substantially all of the ongoing operations of the entity now known as Reliant Energy. As described above in "-- Business Separation," that entity will become CenterPoint Houston, a limited liability company. In this Form 10-K, we refer to our transmission and distribution operations, operated since January 1, 2002, as a functionally separate unit by Reliant Energy and as they will be operated by CenterPoint Houston after the Restructuring, as the "T&D Utility."

ERCOT MARKET FRAMEWORK

The state of Texas, other than a portion of the panhandle and a portion of the eastern part of the state bordering on Louisiana, constitutes a single reliability council (ERCOT market). On July 31, 2001, as part of the transition to deregulation in Texas, the Electric Reliability Council of Texas, Inc. (ERCOT) changed its operations from ten control areas, each managed by one of the utilities in the state, to a single control area managed by ERCOT. The ERCOT independent system operator (ERCOT ISO) is responsible for maintaining reliable operations of the bulk electric power supply system in the ERCOT market. Its responsibilities include ensuring that information relating to a customer's choice of retail electric provider is conveyed in a timely manner to anyone needing the information. It is also responsible for ensuring that electricity production and delivery are accurately accounted for among the generation resources and wholesale

buyers and sellers in the ERCOT market. Unlike independent systems operators in other regions of the country, ERCOT is not a centrally dispatched power pool and the ERCOT ISO does not procure energy on behalf of its members other than to maintain the reliable operations of the transmission system. Members are responsible for contracting their energy requirements bilaterally. ERCOT also serves as agent for procuring ancillary services for those who elect not to provide their own ancillary service requirement.

Members of ERCOT include retail customers, investor and municipally owned electric utilities, rural electric co-operatives, river authorities, independent generators, power marketers and retail electric providers. The ERCOT market operates under the reliability standards set by the North American Electric Reliability Council. The Texas Utility Commission has primary jurisdiction over the ERCOT market to ensure the adequacy and reliability of electricity across the state's main interconnected power grid. For information regarding ERCOT systems problems and delays, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Retail Energy Operations -- Operational Risks" in Item 7 of this Form 10-K.

As part of the change to a single control area, ERCOT initially established three congestion zones: north, west and south. These congestion zones are determined by physical constraints on the ERCOT transmission system that make it difficult or impossible at times to move power from a zone on one side of the constraint to the zone on the other side of the constraint. ERCOT will perform an annual analysis of the transmission capability and constraints in ERCOT to determine if changes to the congestion zones are required. Any required changes will take effect January 1 of the following year. Such an analysis was performed in the fall of 2001 and as a result, ERCOT was reorganized into four congestion zones on January 1, 2002. The current zones are north, south, west and Houston. In addition, ERCOT conducts annual and monthly auctions of Transmission Congestion Rights (TCR) which provide the entity owning TCRs the ability to financially hedge price differences between zones (basis risk). Entities are currently limited to owning a maximum of 25% of the available TCRs. The transmission and distribution, generation and retail load that were formerly conducted under or served by Reliant Energy HL&P are predominately in the Houston zone. For additional information regarding these operations, please read "-- Transmission and Distribution," and "-- Generation" in Item 1 of this Form 10-K. For additional information regarding the retail load obligations of our Retail Energy business segment, please read "Retail Energy -- Retail Energy Supply" in Item 1 of this Form 10-K.

TRANSMISSION AND DISTRIBUTION

All of the transmission and distribution operating properties in our Electric Operations business segment are located in the State of Texas. Our transmission system carries electricity from power plants to substations and from one substation to another. These substations serve to connect the power plants, the high voltage transmission lines and the lower voltage distribution lines. Unlike the transmission system, which carries high voltage electricity over long distances, distribution lines carry lower voltage power from the substation to customers. The distribution system consists of primary distribution lines, transformers, secondary distribution lines and service wires.

Under the Texas Electric Restructuring Law, our T&D Utility cannot buy or sell electricity (except for its own consumption) and thus is no longer subject to commodity risk. Rates for the T&D Utility will continue to be set by the Texas Utility Commission, and we will be allowed to provide services under approved tariffs. Pursuant to the Texas Electric Restructuring Law, the Texas Utility Commission issued an order (Docket No. 22355) setting rates for the T&D Utility, which became effective on January 1, 2002. In our appeal of certain aspects of the order, the Travis County District Court generally upheld the Texas Utility Commission's order. We may appeal the district court's decision in the Texas Court of Appeals, but have not yet filed such an appeal. For additional information regarding those rates, please read "Regulation -- State and Local Regulations -- Texas -- Electric Operations -- Rate Case" in Item 1 of this Form 10-K.

Historically, Reliant Energy HL&P paid the incorporated municipalities in its service territory a franchise fee based on a formula that was usually a percentage of revenues received from electricity sales for consumption within each municipality. Since January 1, 2002, the T&D Utility has become responsible for Reliant Energy HL&P's obligations under these franchise arrangements. Pursuant to the Texas Electric

Restructuring Law, the franchise fee payable by the T&D Utility to each municipality is based on the megawatt hours (MWh) delivered to customers within each municipality in 2002 and beyond. The amount per MWh payable by the T&D Utility is based on the franchise fees paid and the MWh consumed within each municipality in 1998. We expect the franchise fees payable by the T&D Utility to remain consistent with the fees paid by Reliant Energy HL&P; however, the new fees could be higher if electricity sales increase. The T&D Utility would be able to adjust its rates to recover such an increase only through a general T&D Utility rate case in which all of its expenses and revenues were subject to review.

Electric Lines -- Overhead. As of December 31, 2001, we owned 25,998 pole miles of overhead distribution lines and 3,606 circuit miles of overhead transmission lines, including 452 circuit miles operated at 69,000 volts, 2,095 circuit miles operated at 138,000 volts and 1,059 circuit miles operated at 345,000 volts.

Electric Lines -- Underground. As of December 31, 2001, we owned 12,701 circuit miles of underground distribution lines and 15.6 circuit miles of underground transmission lines, including 4.5 circuit miles operated at 69,000 volts and 11.1 circuit miles operated at 138,000 volts.

Substations. As of December 31, 2001, we owned 223 major substation sites (252 substations) having total installed rated transformer capacity of 64,783 megavolt amperes.

GENERATION

As of December 31, 2001, we owned and operated through our Texas generation business 12 power generating stations (62 generating units) with a net generating capacity of 14,095 megawatts (MW), including a 30.8% interest in the South Texas Project Electric Generating Station (South Texas Project). The South Texas Project is a nuclear generating station with two 1,250 MW nuclear generating units. For additional information regarding the South Texas Project, please read Note 6 to our consolidated financial statements. After the Restructuring, our Texas generation business will be owned by Texas Genco. Effective January 1, 2002, our Texas generation business will be reported separately as a new business segment, Electric Generation. Beginning January 1, 2002, our Texas generation business has been operated as an independent power producer, with output sold at market prices to a variety of purchasers, which include Reliant Resources and its subsidiaries. Because of this change, historical operating data, such as demand and fuel data, may not accurately reflect the operation of this business subsequent to December 31, 2001.

The Texas market currently has a surplus of generating capacity, which helps to facilitate a competitive wholesale market. Generators in ERCOT added 6,925 MW of new capacity in 2001. Due to the large quantity of generation built recently, it is anticipated that the wholesale market in Texas will be extremely competitive for the next three to five years.

The table below contains information regarding the system capability at peak demand of our generation facilities, which, during the periods shown, were dedicated to providing generation for Reliant Energy HL&P's service territory. Sales of electricity by our Electric Operations business segment during the summer months have generally been higher than sales during other months of the year due to the reliance on air conditioning by customers in Houston and in other parts of Reliant Energy HL&P's service territory.

INSTALLED FIRM NET PURCHASED MAXIMUM HOURLY CALCULATED CAPABILITY POWER TOTAL NET FIRM DEMAND % CHANGE RESERVE AT PEAK CONTRACTS CAPABILITY				
	1997	1998	1999	
	(MW)	(MW)	(MW)	DATE
	(1)	(2)	(3)	PRIOR YEAR
	(%)	(%)	(%)	
1997.....	13,960	445	14,405	
August 21	12,246	4.7		
	17.6			
1998.....	14,040	320	14,360	
August 3	13,006	6.2		
	10.4			
1999.....	14,052	320	14,372	

August 20 13,053 0.4
10.1
2000.....
14,040 770(4) 14,810
September 5 14,569
11.6 1.7
2001.....
14,040 320 14,360
August 17 13,228
(9.2) 8.6

- (1) Excludes loads on interruptible service tariffs, residential direct load control and commercial/industrial load cooperative capability. Including these loads, the maximum hourly demand served was 14,272 MW in 1998, 14,642 MW in 1999, 15,505 MW in 2000 and 14,210 MW in 2001.
- (2) Maximum hourly firm demand in 1998 and 2000 was influenced by customer growth and hotter than normal weather at the time of the system peak. The extremely hot weather conditions at peak periods in Reliant Energy HL&P's service area during the summer of 2000 increased system peak load by approximately 1,100 MW.
- (3) At any given time we have the ability to enter, and have entered, into non-firm contracts for purchased power on the spot market within ERCOT, to provide additional total capacity. The addition of 6,925 MW of capacity in ERCOT in 2001, during which we experienced normal weather conditions, resulted in ERCOT reserve margins of 28%, significantly more than the 15% ERCOT minimum requirement. Although ERCOT historically has set operating reserve margins for its participants in the Texas market, ERCOT is in the process of reviewing its reserve margin protocols as a result of changes in the Texas market since the implementation of the Texas Electric Restructuring Law. In order to assure capacity to meet future demand requirements, both ERCOT and the Texas Utility Commission are reviewing procedures which would require market participants to provide adequate planning reserves.
- (4) Includes 450 MW of firm capacity purchased to meet peak demand.

Facilities. The assets in our Texas generation business are described in the table below.

NET GENERATING CAPACITY
AS OF DECEMBER 31, 2001
GENERATION FACILITIES
(IN MW) DISPATCH TYPE(1)
PRIMARY/SECONDARY FUEL -

----- W. A.
Parish(2).....
3,661 Base, Inter,
Cyclic, Peak Coal/Gas
Limestone(3).....
1,532 Base Lignite South
Texas Project(4)... 770
Base Nuclear San
Jacinto(5).....
162 Inter Gas Cedar
Bayou.....
2,260 Inter Gas/Oil P.
H. Robinson.....
2,213 Inter Gas T. H.
Wharton.....
1,254 Cyclic, Peak
Gas/Oil S. R.
Bertron..... 844
Cyclic, Peak Gas/Oil
Greens
Bayou..... 760
Cyclic, Peak Gas/Oil
Webster.....
387 Cyclic, Peak Gas
Deepwater.....
174 Cyclic, Peak Gas H.
O. Clarke.....
78 Peak Gas -----
Total.....
14,095 =====

- (1) The designations "Base," "Inter," "Cyclic" and "Peak" indicate whether the units at the stations described are base-load, intermediate, cyclic or peaking units, respectively.
- (2) The capacity of the W.A. Parish facility was uprated from 3,606 MW to 3,661 MW on November 1, 2001.
- (3) The capacity of the Limestone facility was uprated from 1,532 MW to 1,612 MW on January 1, 2002.
- (4) We own a 30.8% interest in the South Texas Project electric generating

station, a nuclear generating plant consisting of two 1,250 MW generating units.

(5) This facility is a "cogeneration" facility. Please read the discussion below.

Power generation facilities can generally be categorized by their variable cost to produce electricity, which determines the order in which they are utilized to meet fluctuations in electricity demand. The largest component of variable cost is fuel cost. "Base-load" facilities are those that typically have low fuel costs to

generate electricity and provide power at all times. Base-load facilities are used to satisfy the base level of demand for power, or "load," that is not dependent upon time of day or weather. "Peaking" facilities generally have the highest fuel costs to generate electricity and typically are used only during periods of highest demand for power. "Intermediate" and "cyclic" facilities have cost and usage characteristics in between those of base-load and peaking facilities. Cyclic facilities generally operate with frequent starts and stops, and generally at lower efficiencies and higher operating costs than base-load plants. The various tiers of base-load, intermediate, cyclic and peaking facilities serving a particular region are often referred to as the "supply curve" or "dispatch curve" for that region. Power generation facilities can also be categorized as "cogeneration" facilities. Cogeneration is the combined production of steam and electricity in a generation facility. Cogeneration facilities typically operate at base load and higher thermal efficiency than other forms of fossil-fuel-fired generation facilities.

For information regarding the possible impairment for accounting purposes of these generating assets after the transition to market based rates and the recovery of these amounts, please read Notes 2(e) and 4(a) to our consolidated financial statements.

Market Framework. Historically, most power generation in Texas came from integrated utilities and was sold to retail customers at regulated rates. However, since 1996, independent power producers have been permitted to sell their entire load of electricity, capacity and ancillary services to wholesale purchasers at unregulated rates. Since January 1, 2002, any wholesale producer of electricity that qualifies as a "power generation company" under the Texas Electric Restructuring Law and that can access the ERCOT electric grid is allowed to sell power in the Texas market at unregulated rates. Transmission capacity, which may be limited, is needed to effect power sales. In the Texas market, buyers and sellers may negotiate bilateral wholesale capacity, energy and ancillary services contracts. Also, companies or business units whose power generation facilities were formerly part of integrated utilities, like our Texas generation business, must auction entitlements to 15% of their capacity as described below. Furthermore, buyers and sellers may participate in the spot market.

Operations and Capacity Auctions Generally. Since January 1, 2002, we have operated our Texas generation business solely in the wholesale market. We are required by the Texas Electric Restructuring Law to auction 15% of the capacity of our Texas generation business and by the master separation agreement to auction the remainder of the capacity of our Texas generation business. We may satisfy these capacity auction obligations either by producing electricity in our own power plants or by purchasing power in wholesale transactions. Our auction products are only entitlements to capacity dispatched from base, intermediate, cyclic or peaking units and do not convey a right to receive power from a particular unit. This enables us to dispatch our commitments in the most cost-effective manner, but also exposes us to the risk that, depending upon the availability of our units, we could be required to supply energy from a higher cost unit, such as an intermediate unit, to meet an obligation for lower cost generation, such as base-load generation or to obtain the energy on the open market. In addition, from time to time, we may be required to purchase power from qualifying facilities under the Public Utility Regulatory Policies Act of 1978 (PURPA). For information about purchased power obligations, please read "-- Fuel and Purchased Power -- Purchased Power Supply" in Item 1 of this Form 10-K.

Revenues from capacity auctions come from two sources: capacity payments and fuel payments. Capacity payments are based on the final clearing prices, in dollars per kilowatt-month, determined during the auctions. We bill for these payments on a monthly basis just prior to the month of the entitlement. Fuel payments consist of a variety of charges related to the fuel and ancillary services scheduled through the auctioned products. We invoice for these fuel payments on a monthly basis in arrears. Please read "-- Fuel and Purchased Power" in Item 1 of this Form 10-K.

State Mandated Capacity Auctions. Under the Texas Electric Restructuring Law, each power generator that is unbundled from an integrated electric utility in Texas, including our Texas generation business, is required to sell at auction 15% of the output of its installed generating capacity (state mandated auctions). This obligation to conduct state mandated auctions will continue until January 1, 2007, unless before that date the Texas Utility Commission determines that at least 40% of the electric power consumed before the onset of

competition by residential and small commercial customers in the T&D Utility's service area is being served by retail electric providers not affiliated or formerly affiliated with us as an integrated utility. The Texas Utility Commission has determined Reliant Resources is our affiliate and will be an affiliate of Texas Genco for this purpose. Reliant Resources is not permitted under the Texas Electric Restructuring Law to purchase capacity sold by us or by Texas Genco in the state mandated auctions.

The products we are, and Texas Genco will be, required to offer in the state mandated auctions are determined by rules adopted by the Texas Utility Commission. The aggregate products sold under the state mandated auctions consist of 700 MW of base-load, 875 MW of intermediate, 400 MW of cyclic and 150 MW of peaking capacity. These products are sold in the form of "entitlements," which consist of obligations to provide 25 MW of capacity for terms of one month, one year and two years. Texas Utility Commission rules require 50% of available auctioned products to consist of one-month entitlements, 30% to consist of one-year strips and 20% to consist of two-year strips. Purchasers of products offered in the state mandated auctions may resell them to third parties other than an affiliated retail electric provider.

Contractually Mandated Capacity Auctions. Pursuant to the master separation agreement, and subject to the permitted reductions described below, we are, and Texas Genco will be, contractually obligated to auction to third parties, including Reliant Resources, all of the capacity and related ancillary services available in excess of amounts included in the state mandated auctions until the date on which the Texas Genco Option either is exercised or expires (contractually mandated auctions). We and Texas Genco are permitted to reduce the amount of capacity sold in the contractually mandated auctions by the amount required to satisfy:

- our operational requirements associated with the capacity sold pursuant to the Texas Utility Commission rules, including the rules associated with state mandated auctions and the price to beat; or
- our obligations to another party under an existing spinning reserve service agreement.

Texas Utility Commission rules do not restrict the types of products we and Texas Genco may offer in the contractually mandated auctions. Therefore, we set the terms of the products offered in these auctions. We structure the products in the contractually mandated auctions to correspond with operating characteristics of the underlying generating units, such as heat rates and minimum load levels. Pursuant to the master separation agreement, Reliant Resources is entitled to purchase, prior to our submission of capacity to auction, 50% (but not less than 50%) of the capacity we have available to auction in the contractually mandated auctions at the prices bid by third parties in the contractually mandated auctions. Whether or not Reliant Resources exercises this right, Reliant Resources may submit bids to purchase in the contractually mandated auctions as well.

Initial Auctions. We conducted state mandated auctions in September 2001 and March 2002 and contractually mandated auctions in October and December 2001 and March 2002. Excluding reserves for planned and forced outages, as a result of these auctions, our Texas generation business has sold entitlements to all of its capacity through August 2002, an average of 72% per month of its capacity through December 2002 and 10% of its capacity for each month in 2003. In the contractually mandated auctions held so far, Reliant Resources has purchased, on average, 72% per month of the 2002 capacity sold by us and 58% per month of our 2003 capacity sold in the auctions. These purchases have been made either through the exercise by Reliant Resources of its contractual rights or through the submission of bids.

The capacity auctions were consummated at market-based prices that are substantially below the historical regulated return on the facilities in our Texas generation business. The Texas Electric Restructuring Law provides for the recovery in a "true-up" proceeding of any difference between market power prices received in the capacity auctions and the Texas Utility Commission's earlier estimates of those market prices. For additional information regarding the capacity auctions and the related true-up proceeding, please read Note 4 to our consolidated financial statements.

We intend to conduct an auction in July 2002 to sell the remaining available capacity for September through December 2002. Beginning in September 2002, we intend to hold auctions to sell remaining capacity for the year 2003.

FUEL AND PURCHASED POWER

We rely primarily on natural gas, coal and lignite to fuel the facilities in our Texas generation business. For information regarding our fuel contracts, please read Note 14(a) to our consolidated financial statements. The 2000 and 2001 historical energy mix for our Texas generation business is set forth below. These figures represent the generation and purchased power used to meet system load and for off-system sales:

HISTORICAL ENERGY MIX(%)	-----	2000	2001	----	----
	Natural				
gas.....				37	25
	Coal and				
lignite.....				35	32
Nuclear.....					
	8 8 Purchased				
power.....				20	35
	- - - -				
Total.....				100	
	100	===	===		

As a result of new air emissions standards imposed by federal and state law, we anticipate longer plant outages in 2002 and higher levels of plant maintenance in 2003 and subsequent years associated with the installation of environmental equipment on our generating facilities. These factors could affect the fuel mix of our Texas generation business. We anticipate that the capital investment incurred through May 2003 to comply with these air emissions requirements will be recoverable through the Texas Utility Commission's determination of stranded costs. Please read "-- Environmental Matters" in Item 1 of this Form 10-K and Note 4 to our consolidated financial statements.

Through December 31, 2001, the Texas Utility Commission provided for the recovery of most fuel and purchased power costs from customers through a fixed fuel factor included in electric rates. Following the transition to retail competition in January 2002, the energy sales of our Texas generation business are based on the generation capacity entitlement auctions described above. Power generated from the intermediate, cyclic or peaking entitlements in the capacity auctions includes a fuel cost component that is tied to the indexed cost of gas, reducing the risk associated with the price of gas for our Texas generation business. Successful bidders in these auctions are able to dispatch energy from their entitlements within the operational constraints of the generating units supporting the capacity entitlement product they purchased. Under the terms of the capacity auctions, successful bidders are required to absorb the corresponding fuel cost for the energy dispatched so that, in effect, we will recover our dispatch-based fuel costs from these bidders. For additional information regarding our ability to recover these costs from customers before and after the inception of retail electric competition, please read "Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" in Item 1 of this Form 10-K and Note 4(a) to our consolidated financial statements.

Natural Gas Supply. We obtain our long-term natural gas supply under contracts with El Paso Merchant Energy-Gas L.P., HPL Resources Company and Kinder Morgan Texas Pipeline, Inc. Our contract with Kinder Morgan is nearing the end of its term and we are in the process of negotiating another long-term contract with them, which we expect to sign in the second quarter of 2002. Substantially all of our long-term natural gas supply contracts contain pricing provisions based on fluctuating spot market prices. In 2001, 61% of the natural gas requirements for our Texas generation business was purchased under these long-term contracts, including 34% under the contract with Kinder Morgan. The remaining 39% of natural gas requirements in 2001 was purchased on the spot market. Based on current market conditions, we believe we will be able to replace the supplies of natural gas covered under our long-term contracts when they expire with gas purchased on the spot market or under new long-term or short-term contracts if we continue to own Texas

Genco after 2004. The natural gas consumption and cost information for our Texas generation business in the year 2001 was as follows:

2001 average daily consumption.....	535	Bbtu (1)
2001 peak daily consumption.....	1,282	Bbtu
Average cost of natural gas.....	\$ 4.23	per MMBtu (2)

- - - - -

(1) Billion British thermal units (Bbtu).

(2) Compared to \$3.98 per million British thermal units (MMBtu) in 2000 and \$2.47 per MMBtu in 1999.

Our natural gas requirements are generally more volatile than our other fuel requirements because we use natural gas to fuel intermediate, cyclic and peaking facilities and other more economical fuels to fuel base-load facilities. Although natural gas supplies have been sufficient in recent years, available supplies are subject to potential disruption due to weather conditions, transportation constraints and other events. As a result of these factors, supplies of natural gas may become unavailable from time to time or prices may increase rapidly in response to temporary supply constraints or other factors. In 2001, prices for natural gas became more volatile due to market conditions.

Coal and Lignite Supply. We purchased approximately 80% of the fuel requirements for our four coal-fired generating units at our W.A. Parish facility under two fixed-quantity, long-term supply contracts with Kennecott Energy. Kennecott Energy supplies subbituminous coal under these contracts from mines in the Powder River Basin of Wyoming. The first of these contracts is scheduled to expire in 2010, and the second is scheduled to expire in 2011. The price for coal is fixed under one of these contracts through the end of 2002, after which the price will be tied to spot market prices. The price for coal under the second contract was approximately three times greater than the spot market prices for coal as of December 31, 2001. We purchased our remaining coal requirements for the W.A. Parish facility under short-term contracts. We have long-term rail transportation contracts with the Burlington Northern Santa Fe Railroad Company and the Union Pacific Railroad Company to transport coal to the W.A. Parish facility.

We obtain the lignite used to fuel the two generating units of the Limestone facility from a surface mine adjacent to the facility. We own the mining equipment and facilities and a portion of the lignite reserves located at the mine. During the first six months of 2002, we will obtain our lignite requirements under a long-term, cost-plus agreement with Westmoreland Coal Company. We expect to blend petroleum coke with lignite to fuel the Limestone facility in this period. Beginning July 2002, we will obtain our lignite requirements under an agreement with Westmoreland Coal Company at a fixed price determined annually that results in a cost of generation at the Limestone facility equivalent to the cost of generating with Wyoming coal. We expect the lignite reserves will be sufficient to provide all of the lignite requirements of this facility through 2015.

During 2000, we conducted a successful test burn of Wyoming coal at the Limestone facility. We anticipate using a blend of lignite and Wyoming coal to fuel the Limestone facility beginning in July 2002 as a component of our nitrogen oxides (NOx) control strategy. A fuel unloading and handling system is being installed at the Limestone facility to accommodate the delivery of Wyoming coal. We expect to obtain Wyoming coal and rail transportation services through spot and long-term market-priced contracts.

Nuclear Fuel Supply. The South Texas Project satisfies its fuel supply requirements by acquiring uranium concentrates, converting uranium concentrates into uranium hexafluoride, enriching uranium hexafluoride and fabricating nuclear fuel assemblies.

We are a party to numerous contracts covering a portion of nuclear fuel needs of the South Texas Project for uranium, conversion services, enrichment services and fuel fabrication. Other than a fuel fabrication agreement that extends for the life of the South Texas Project plant, these contracts have varying expiration dates, and most are short to medium term (less than seven years). Management believes that sufficient capacity for nuclear fuel supplies and processing exists to permit normal operations of the South Texas Project's nuclear generating units.

Purchased Power Supply. Prior to January 1, 2002, Reliant Energy HL&P purchased power from various qualifying facilities exercising their rights under PURPA. These purchases were generally at the discretion of the qualifying facilities and were made pursuant to a pricing methodology defined in tariffs approved by the Texas Utility Commission and pursuant to agreements between Reliant Energy HL&P and the qualifying facilities. Reliant Energy HL&P purchased a total of 16.4 million MWh and 19 million MWh from qualifying facilities in 2000 and 2001, respectively. Reliant Energy HL&P terminated all but two of its agreements with the qualifying facilities in 2001 pursuant to the terms of the agreements. The remaining two agreements expire March 31, 2005. The rights and obligations under the two remaining agreements will be assigned to Texas Genco in the Restructuring if they are not assigned to third parties.

As a result of the separation of Reliant Energy HL&P's utility functions, the T&D Utility will not be subject to PURPA and the Texas Utility Commission-approved tariffs in place before January 1, 2002 will no longer be effective. However, our Texas generation business and the retail electric providers under Reliant Resources will remain subject to PURPA. On January 23, 2002, certain qualifying facilities, including qualifying facilities that have traditionally delivered power to Reliant Energy HL&P, filed an enforcement action with the Federal Energy Regulatory Commission (FERC) seeking to force the Texas Utility Commission to implement PURPA for Texas entities subject to PURPA (FERC Docket No. EL02-55). On February 15, 2002, FERC filed notice of its intention not to act on this enforcement action. These qualifying facilities have the right to appeal this decision in federal court. In the meantime, the Texas Utility Commission is in the midst of a rulemaking proceeding to determine whether it has the authority to regulate the PURPA obligations of any entity and, if so, how such entity will implement its obligations, including a methodology for pricing of these purchases. We anticipate that this rulemaking will conclude in the second quarter of 2002. The proposed rule published by the Texas Utility Commission does not apply to Texas generation businesses. If the final rule is the same in this respect, our Texas generation business will self-implement its PURPA obligations and will not be required to seek approval of its pricing methodology from the Texas Utility Commission.

COMPETITION

The T&D Utility's operations are regulated by the Texas Utility Commission and are conducted within its service territory pursuant to a Certificate of Convenience and Necessity issued by the Texas Utility Commission. In order for another provider of transmission and distribution services to provide such services in the T&D Utility's territory, it would be required to obtain a Certificate of Convenience and Necessity in proceedings before the Texas Utility Commission. Our Texas generation business competes with other power generation companies, including the now-unregulated generating facilities of other electric utilities, independent power producers who own generation facilities for the purpose of selling power in wholesale markets and power produced by cogenerators and other qualified facilities. Due to the large quantity of generation built recently in ERCOT, it is anticipated that the wholesale power market in Texas in which our Texas generation business competes will be extremely competitive for the next three to five years.

Please read "Electric Operations -- ERCOT Market Framework" in Item 1 of this Form 10-K and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Electric Operations" in Item 7 of this Form 10-K, which sections are incorporated herein by reference.

NATURAL GAS DISTRIBUTION

Our Natural Gas Distribution business segment consists of intrastate natural gas sales to, and natural gas transportation for, residential, commercial and industrial customers in Arkansas, Louisiana, Minnesota, Mississippi, Oklahoma and Texas and some non-rate regulated retail gas marketing operations.

We conduct intrastate natural gas sales to, and natural gas transportation for, residential, commercial and industrial customers through three unincorporated divisions of RERC Corp.: Arkla, Entex and Minnegasco. These operations are regulated as gas utility operations in the jurisdictions served by these divisions.

- Arkla. Arkla provides natural gas distribution services in over 245 communities in Arkansas, Louisiana, Oklahoma and Texas. The largest metropolitan areas served by Arkla are Little Rock, Arkansas and Shreveport, Louisiana. In 2001, approximately 65% of Arkla's total throughput was attributable to retail sales of gas and approximately 35% was attributable to transportation services.
- Entex. Entex provides natural gas distribution services in over 500 communities in Louisiana, Mississippi and Texas. The largest metropolitan area served by Entex is Houston, Texas. In 2001, approximately 97% of Entex's total throughput was attributable to retail sales of gas and approximately 3% was attributable to transportation services.
- Minnegasco. Minnegasco provides natural gas distribution services in over 240 communities in Minnesota. The largest metropolitan area served by Minnegasco is Minneapolis, Minnesota. In 2001, approximately 97% of Minnegasco's total throughput was attributable to retail sales of gas and approximately 3% was attributable to transportation services.

The demand for intrastate natural gas sales to, and natural gas transportation for, residential, commercial and industrial customers is seasonal. In 2001, approximately 62% of our Natural Gas Distribution business segment's total throughput occurred in the first and fourth quarters. These patterns reflect the higher demand for natural gas for heating purposes during those periods. For information about our plan to separate the operations of Arkla, Entex and Minnegasco among different business entities, please read "Our Business -- RERC Corp. Restructuring" in Item 1 of this Form 10-K.

COMMERCIAL AND INDUSTRIAL MARKETING SALES

Our Natural Gas Distribution business segment's commercial and industrial marketing sales group provides comprehensive natural gas products and services to commercial and industrial customers in the region from Southern Texas to the panhandle of Florida, as well as in the Midwestern United States. In 2001, approximately 96% of total throughput was attributable to the sale of natural gas and approximately 4% was attributable to transportation services. Typical customer contract terms for natural gas sales range from one day to three years. Our commercial and industrial marketing sales groups' operations may be affected by seasonal weather changes and the relative price of natural gas. In 2000, the commercial and industrial marketing sales group exited all retail gas markets in non-strategic areas of the Northeast and Mid-Atlantic, allowing us to focus resources and efforts in our core geographical areas of the Gulf South and Midwest.

SUPPLY AND TRANSPORTATION

Arkla. In 2001, Arkla purchased approximately 53% of its natural gas supply from Reliant Energy Services, 29% pursuant to third-party contracts, with terms varying from three months to one year, and 18% on the spot market. Arkla's major third-party natural gas suppliers in 2001 included Oneok Gas Marketing Company, Tenaska Marketing Ventures, Marathon Oil Company and BP Energy Company. Arkla transports substantially all of its natural gas supplies under contracts with our pipeline subsidiaries.

Entex. In 2001, Entex purchased virtually all of its natural gas supply pursuant to term contracts, with terms varying from one to five years. Entex's major third-party natural gas suppliers in 2001 included AEP Houston Pipeline, Kinder Morgan Texas Pipeline, L.P., Gulf Energy Marketing, Island Fuel Trading and Koch Energy Trading. Entex transports its natural gas supplies on both interstate and intrastate pipelines under long-term contracts with terms varying from one to five years.

Minnegasco. In 2001, Minnegasco purchased approximately 74% of its natural gas supply pursuant to term contracts, with terms varying from one to ten years, with more than 20 different suppliers. Minnegasco purchased the remaining 26% on the daily or spot market. Most of the natural gas volumes under long-term contracts are committed under terms providing for delivery during the winter heating season, which extends from November through March. Minnegasco purchased approximately 67% of its natural gas requirements from four suppliers in 2001: Tenaska Marketing Ventures, Reliant Energy Services, Pan-Alberta Gas Ltd., and TransCanada Gas Services Inc. Minnegasco transports its natural gas supplies on various interstate pipelines under long-term contracts with terms varying from one to five years.

For additional information regarding our ability to pass through changes in natural gas prices to our customers, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Competitive and Other Factors Affecting RERC Operations -- Natural Gas Distribution" in Item 7 of this Form 10-K.

Arkla and Minnegasco use various leased or owned natural gas storage facilities to meet peak-day requirements and to manage the daily changes in demand due to changes in weather. Minnegasco also supplements contracted supplies and storage from time to time with stored liquefied natural gas and propane-air plant production.

Minnegasco owns and operates a 7.0 billion cubic feet (Bcf) underground storage facility, having a working capacity of 2.1 Bcf available for use during a normal heating season and a maximum daily withdrawal rate of 50 million cubic feet (MMcf) per day. Minnegasco also owns ten propane-air plants with a total capacity of 191 MMcf per day and on-site storage facilities for 11 million gallons of propane (1.0 Bcf gas equivalent). Minnegasco owns a liquefied natural gas facility with a 12 million-gallon liquefied natural gas storage tank (1.0 Bcf gas equivalent) with a send-out capability of 72 MMcf per day.

Although available natural gas supplies have exceeded demand for several years, currently supply and demand appear to be more balanced. Our Natural Gas Distribution business segment has sufficient supplies and pipeline capacity under contract to meet its firm customer requirements. However, from time to time, it is possible for limited service disruptions to occur due to weather conditions, transportation constraints and other events. As a result of these factors, supplies of natural gas may become unavailable from time to time or prices may increase rapidly in response to temporary supply constraints or other factors.

ASSETS

As of December 31, 2001, we owned approximately 61,000 linear miles of gas distribution mains, varying in size from one-half inch to 24 inches in diameter. Generally, in each of the cities, towns and rural areas served by our Natural Gas Distribution business segment, we own the underground gas mains and service lines, metering and regulating equipment located on customers' premises and the district regulating equipment necessary for pressure maintenance. With a few exceptions, the measuring stations at which we receive gas from our suppliers are owned, operated and maintained by others, and our distribution facilities begin at the outlet of the measuring equipment. These facilities, including odorizing equipment, are usually located on the land owned by suppliers.

COMPETITION

Please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Competitive and Other Factors Affecting RERC Operations -- Natural Gas Distribution" in Item 7 of this Form 10-K, which section is incorporated herein by reference.

PIPELINES AND GATHERING

Our Pipelines and Gathering business segment operates two interstate natural gas pipelines as well as gas gathering and pipeline services. Our pipeline operations are primarily conducted by two wholly owned interstate pipeline subsidiaries of RERC Corp., Reliant Energy Gas Transmission Company (REGT) and Mississippi River Transmission Corporation (MRT). Our gathering and pipeline services operations are conducted by a wholly owned gas gathering subsidiary, Reliant Energy Field Services, Inc. (REFS), and a wholly owned pipeline services subsidiary, Reliant Energy Pipeline Services, Inc. (REPS).

Through REFS, we provide natural gas gathering and related services, including related liquids extraction and other well operating services. As of December 31, 2001, REFS operated approximately 4,300 miles of gathering pipelines, which collect natural gas from more than 300 separate systems located in major producing fields in Arkansas, Louisiana, Oklahoma and Texas. Through REPS, we provide pipeline project management and facility operation services to affiliates and third parties.

In 2001, approximately 25% of our Pipelines and Gathering business segment's total operating revenue was attributable to services provided by REGT to Arkla, and approximately 10% of its total operating revenue was attributable to services provided by MRT to Laclede Gas Company (Laclede), an unaffiliated distribution company that provides natural gas utility service to the greater St. Louis metropolitan area in Illinois and Missouri. An additional 20% of our Pipelines and Gathering business segment's operating revenues was attributable to the transportation of gas marketed by Reliant Energy Services. Our Pipelines and Gathering business segment provides service to Arkla and Laclede under several long-term firm storage and transportation agreements. REGT and Arkla have entered into various contracts for firm transportation in Arkla's major service areas that are currently scheduled to expire in 2005. In February 2002, MRT negotiated an agreement to extend its existing service relationship with Laclede for a five-year period subject to acceptance by the FERC.

The business and operations of our Pipelines and Gathering business segment may be affected by seasonal changes in the demand for natural gas, the relative price of natural gas in the Midcontinent and Gulf Coast natural gas supply regions and, to a lesser extent, general economic conditions.

ASSETS

We own and operate approximately 8,100 miles of gas transmission lines. We also own and operate six natural gas storage fields with a combined daily deliverability of approximately 1.2 Bcf per day and a combined working gas capacity of approximately 55.8 Bcf. REGT also owns a 10% interest, with Gulf South Pipeline Company, LP, in the Bistineau storage facility with 68.8 Bcf of working gas capacity and 1.1 Bcf per day of deliverability. REGT's storage capacity in the Bistineau facility is 18 Bcf (8 Bcf of working gas) with 100 MMcf per day of deliverability. Most of our storage operations are in north Louisiana and Oklahoma. We also own and operate approximately 4,300 miles of gathering pipelines that collect gas from more than 300 separate systems located in major producing fields in Arkansas, Louisiana, Oklahoma and Texas.

COMPETITION

Please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors affecting Our Future Earnings -- Competitive and Other Factors Affecting RERC Operations -- Pipelines and Gathering" in Item 7 of this Form 10-K, which section is incorporated herein by reference.

WHOLESALE ENERGY

Our Wholesale Energy business segment, which is conducted through Reliant Resources, provides energy and energy services with a focus on the competitive wholesale segment of the United States energy industry. We acquire, develop and operate electric power generation facilities that are not subject to traditional cost-based regulation and therefore can generally sell power at prices determined by the market, subject to regulatory limitations in certain regions. We also trade and market power, natural gas, natural gas transportation capacity and other energy-related commodities and provide related risk management services. Our Wholesale Energy business segment will remain with Reliant Resources in the Separation and will not be part of our business after the Distribution.

POWER GENERATION OPERATIONS

As of December 31, 2001, our Wholesale Energy business segment owned or leased electric power generation facilities with an aggregate net generating capacity of 11,109 MW located in five regions of the United States. We also had 3,587 MW (3,391 MW, net of 196 MW to be retired upon completion of one facility) of net generating capacity under construction as of that date. In addition, by acquiring Orion Power Holdings, Inc. (Orion Power) in February 2002, we added 81 power plants with an aggregate net generating capacity of 5,644 MW and two development projects with an additional 804 MW of capacity under construction to our regional portfolios.

The following table describes our Wholesale Energy business segment's electric power generation facilities by region as of December 31, 2001.

REGIONAL SUMMARY OF OUR GENERATION FACILITIES
(AS OF DECEMBER 31, 2001)

NUMBER OF TOTAL NET GENERATION GENERATING REGION FACILITIES(1) CAPACITY (MW) DISPATCH TYPE(2) FUEL TYPE - ----- ----- -----	
NORTHEAST	
Operating(3).....	21 4,262 Base, Inter, Peak Gas/Coal/Oil/Hydro Under
Construction(4)(5)(6)....	1 1,120 Base, Inter, Peak Gas/Oil/Coal -----
Combined.....	22 5,382
MIDWEST	
Operating.....	2 1,063 Peak Gas Under
Construction(7).....	-- 154 Peak Gas -----
Combined.....	2 1,217
SOUTHEAST	
Operating(8).....	3 979 Inter, Peak, CoGen Gas/Oil Under
Construction(5)(9)....	1 958 Base, Inter, Peak Gas/Oil -----
Combined.....	4 1,937
WEST	
Operating(7).....	7 4,635 Base, Inter, Peak Gas Under
Construction.....	1 548 Base, Peak Gas -----
Combined.....	8 5,183
ERCOT(10)	
Operating.....	1 170 Base, CoGen Gas Under
Construction(4).....	-- 611 Base, CoGen Gas -----
Combined.....	1 781
TOTAL	
Operating.....	34 11,109 Under
Construction.....	3 3,391 -----
Combined.....	37 14,500 =====

(1) Unless otherwise indicated, we own a 100% interest in each facility listed.

(2) We use the designations "Base," "Inter," "Peak" and "CoGen" to indicate whether the facilities described are base-load, intermediate, peaking or cogeneration facilities, respectively.

(3) We lease a 100%, 16.67% and 16.45% interest in three Pennsylvania facilities having 613 MW, 285 MW and 281 MW, respectively, through facility lease agreements having terms of 26.5 years, 33.75 years and 33.75 years, respectively.

(4) One of our two construction projects in this region will replace one of our existing facilities upon completion. Therefore, this project is not included in the facility count for the "Under Construction" group of this region.

(5) Our two construction projects in the Northeast region and one of our projects in the Southeast region are owned by off-balance sheet special purpose entities and are being constructed under construction agency agreements pursuant to synthetic leasing arrangements. We expect that we will lease these facilities from their owners upon completion.

- (6) The 1,120 MW of net capacity under construction is based on 1,316 MW of capacity currently under construction less 196 MW of operating capacity that will be retired upon completion of one of the projects.
- (7) Five of the six generating units of one of the facilities in this region are operational while the sixth unit is under construction. This partially operational facility is included in the facility count for the "Operating" group of this region.
- (8) We own a 50% interest in one of these facilities. An independent third party owns the other 50%.
- (9) Two of the three generating units of one of the facilities in this region are operational while the third unit is under construction. This partially operational facility is included in the facility count for the "Operating" group of this region.
- (10) For information about the Texas Genco Option, please read "Reliant Energy's Relationship with Reliant Resources -- Intercompany Agreements -- Texas Genco Option Agreement" in Item 1 of this Form 10-K and Note 4(b) to our consolidated financial statements.

The following table describes our Orion Power electric power generation facilities by region as of February 28, 2002.

REGIONAL SUMMARY OF OUR ORION POWER FACILITIES
(AS OF FEBRUARY 28, 2002)

NUMBER OF TOTAL NET GENERATION GENERATING REGION FACILITIES CAPACITY (MW) DISPATCH TYPE(1) FUEL TYPE - ----- - -----	
---	NORTHEAST
Operating(2).....	
78 4,174 Base, Inter, Peak Gas/Oil/Coal/Hydro Under Construction.....	2
804 Base, Inter Gas -- --	--
Combined.....	80 4,978 MIDWEST
Operating.....	
3 1,470 Base, Inter, Peak Coal/Gas TOTAL	
Operating(2).....	
81 5,644 Under Construction.....	2
804 -- -----	
Combined(2).....	83 6,448 == =====

- (1) We use the designations "Base," "Inter" and "Peak" to indicate whether the facilities described are base-load, intermediate or peaking, respectively.
- (2) Two hydro plants with a net generating capacity of approximately 5 MW are not currently operational.

NORTHEAST REGION

Facilities. As of December 31, 2001, we owned or leased 21 electric power generation facilities with an aggregate net generating capacity of 4,262 MW located in the control area of PJM Interconnection, L.L.C. (PJM ISO), the independent system operator in the Pennsylvania-New Jersey-Maryland market (PJM market). These facilities are owned or leased by subsidiaries of Reliant Energy Mid-Atlantic Power Holdings, LLC (REMA), a wholly owned subsidiary of Reliant Resources. The generating capacity of these facilities consists of approximately 40% of base-load, 40% of intermediate and 20% of peaking capacity, and represents approximately 7% of the total generation capacity located in the PJM ISO's control area. For additional information regarding our acquisition of these facilities, please read Note 3(a) to our consolidated financial statements.

By acquiring Orion Power in February 2002, we added 78 power generation facilities, of which 75 are currently operational, with an aggregate net generating capacity of 4,174 MW to our Northeast regional

portfolio. These facilities include 70 hydroelectric facilities, of which 68 are currently operational, located in central and northern New York State, three facilities located in New York City, one facility located in East Syracuse, New York, and four facilities, three of which are currently fully operational, located in Pennsylvania. The generating capacity of these facilities consists of approximately 45% of base-load, 35% of intermediate and 20% of peaking capacity. For a discussion of factors that may affect the future earnings generated by these Orion Power facilities, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Integration and Other Risks Associated With Our Orion Power Assets" and "-- Uncertainty Related to the New York Regulatory Environment" in Item 7 of this Form 10-K.

We have begun construction on a 795 MW gas-fired base-load and intermediate facility located in Pennsylvania. We expect this facility will begin commercial operation in the second quarter of 2003. We have also begun construction on a 521 MW coal-fired base-load facility, also located in Pennsylvania, that will replace one of our existing facilities. This facility will add 325 MW of additional capacity to our Northeast regional portfolio, net of the 196 MW of capacity of the currently existing facility that will be retired upon commencement of commercial operations of the new facility. We expect this facility will begin commercial operation near the end of 2004. These facilities are owned by off-balance sheet special purpose entities and are being constructed under the terms of separate construction agency agreements pursuant to synthetic leasing arrangements. Upon completion of the construction of these facilities, we expect that we will lease these facilities from their owners, purchase or remarket each facility. For additional information regarding the construction agency agreements, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources -- Future Sources and Uses of Cash -- Reliant Resources-unregulated businesses -- Consolidated Sources of Cash -- Off-Balance Sheet Transactions -- Construction Agency Agreements" in Item 7 of this Form 10-K and Note 14(1) to our consolidated financial statements.

By acquiring Orion Power in February 2002, we added two additional development projects with an additional 804 MW of capacity under construction. The first project is the construction of a 550 MW gas-fired base-load facility located south of Philadelphia, Pennsylvania. We expect this facility will begin commercial operation in the second quarter of 2002. The second project is the conversion and upgrade of a peaking facility located near downtown Pittsburgh, Pennsylvania. We expect this project will be completed by the third quarter of 2002 and will increase the aggregate generating capacity of this facility by 254 MW to a total capacity of 308 MW.

Market Framework. We currently sell the power generated by our Northeast regional facilities in the PJM market, the wholesale energy market of the State of New York (New York wholesale market) operated by the New York Independent System Operator (NYISO) and to buyers in adjacent power markets, such as the region covered by the East Central Area Reliability Coordinating Council (ECAR market). We also expect to sell power in a newly created extension of the PJM market in western Pennsylvania (PJM West market). Each of the PJM Market, the New York wholesale market and the PJM West market operate as centralized power pools with open-access, non-discriminatory transmission systems administered by independent system operators approved by the FERC. Although the transmission infrastructure within these markets is generally well developed and independently operated, transmission constraints exist between, and to a certain extent within, these markets. In particular, transmission of power from eastern Pennsylvania to western Pennsylvania and into New York City may be constrained from time to time. Depending on the timing and nature of transmission constraints, market prices may vary from market to market, or between sub-regions of a particular market. For example, as a result of transmission constraints into New York City, power prices are generally higher there than in other parts of the state.

In addition to managing the transmission system for each market, the respective independent system operator for each of the PJM market, the New York wholesale market and the PJM West market is responsible for maintaining competitive wholesale markets, operating the spot wholesale energy market and determining the market clearing price based on bids submitted by participating generators in each market. Each independent system operator generally matches sellers with buyers within a particular market that meet

specified minimum credit standards. We sell capacity, energy and ancillary services into the markets maintained by the applicable independent system operator for each of these types of products for both real-time sales and forward-sales for periods of up to one year. Our customers include the members of each market, consisting of municipalities, electric cooperatives, integrated utilities, transmission and distribution utilities, retail electric providers and power marketers. We also sell capacity, energy and ancillary services to customers in the Northeast region under negotiated bilateral contracts. Bilateral contracts, in addition to other physical and financial transactions enable us to hedge a portion of our generation portfolio. For a more complete description of our hedging strategy and a summary of the consolidated hedge position of our United States generating assets (other than those in our Texas generation business, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Risks Associated with Our Hedging and Risk Management Activities" in Item 7 of this Form 10-K.

Our markets in the Northeast region are subject to constant and significant regulatory oversight and control and the results of our operations in the region may be adversely affected by any changes or additions to the current regulatory structure. Our sales into markets administered by the PJM ISO are governed by the PJM ISO's operating agreements, tariffs and protocols (PJM Protocols). The PJM Protocols provide the structure, rules and pricing mechanisms for the PJM ISO's energy, capacity and ancillary services markets, and establish rates, terms and conditions for transmission service in the PJM ISO's control area and the PJM West market, including transmission congestion pricing. Wholesale energy prices in the markets administered by the PJM ISO are currently capped at \$1,000 per megawatt-hour. Lower caps are utilized in other regions and it is possible that this price cap might be lowered in the future.

Our sales into markets administered by the NYISO are governed by the NYISO's tariff and protocols (NYISO Protocols). The NYISO Protocols provide the structure, rules and pricing mechanisms for the NYISO's energy, capacity and ancillary services markets, and establish rates, terms and conditions for transmission service in the NYISO's control area. The NYISO Protocols allow load to respond to high prices in emergency and non-emergency situations. The lack of programs, however, to implement load response to prices has been cited as one of the primary reasons for retaining wholesale energy bid caps, which are currently set at \$1,000 per megawatt-hour. Lower price caps are utilized in other regions and it is possible that this price cap might be lowered in the future.

A capacity market has been established by the NYISO that ensures that there is enough generation capacity to meet retail energy demand and ancillary services requirements. All power retailers are required to demonstrate commitments for capacity sufficient to meet their peak forecasted load plus a reserve requirement, currently set at 18%. As an extra reliability measure, power retailers located in New York City are required to procure the majority of this capacity, currently 80% of their peak forecasted load, from generating units located in New York City. Because New York City is currently short of this capacity requirement and the existing capacity is owned by only a few entities, a price cap has been instituted for in-city generators.

For additional discussion of the impact of current regulations on the markets in the Northeast region and the related risks of re-regulation, please read "-- Regulation -- Federal Energy Regulatory Commission" and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Industry Restructuring, the Risk of Re-regulation and the Impact of Current Regulations" and "-- Uncertainty Related to the New York Regulatory Environment" in Item 7 of this Form 10-K.

MIDWEST REGION

Facilities. As of December 31, 2001, we owned two electric power generation facilities located in the State of Illinois with an aggregate net generating capacity of 1,063 MW in operation. One of these facilities is a 344 MW gas-fired peaking generation facility located in Shelby County, Illinois. The first phase of this facility was initially placed in commercial operation in June 2000 and the second phase was placed in commercial operation in May 2001. We also have an 873 MW gas-fired peaking generation facility under construction in Aurora, Illinois. As of December 31, 2001, five of the six generating units at this facility with

an aggregate net generating capacity of 719 MW had been placed in commercial operation. We expect the remaining unit at this facility will begin commercial operation in the second quarter of 2002.

By acquiring Orion Power in February 2002, we added three power generation facilities with an aggregate net generating capacity of 1,470 MW to our Midwest regional portfolio. Two of these facilities are located in Ohio and one is located in West Virginia. The generating capacity of these facilities consists of approximately 50% of base-load, 15% of intermediate and 35% of peaking capacity. For a discussion of the factors that may affect the future earnings generated by these Orion Power assets, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Integration and Other Risks Associated With Our Orion Power Assets" in Item 7 of this Form 10-K.

Market Framework. We sell the power generated by our Midwest regional facilities into the ECAR market and the region covered by the Mid-America Interconnected Network Reliability Council (MAIN market). These markets include all or portions of the states of Illinois, Wisconsin, Missouri, Indiana, Ohio, Michigan, Virginia, West Virginia, Tennessee, Maryland and Pennsylvania. These markets are currently in a state of transition and are in the process of establishing regional transmission organizations (RTO) that would define the rules and requirements around which competitive wholesale markets in the region would develop. The FERC has approved proposals by the Midwest Independent System Operator (Midwest ISO) to administer a substantial portion of the transmission facilities in the Midwest region. The FERC also has ordered the Alliance RTO, which had a separate proposal to be the RTO for parts of the Midwest region, to explore joining the Midwest ISO. As a result, the final market structure for the Midwest region remains unsettled. The timing of the development of RTO and the extent to which the Midwest ISO and the Alliance RTO would combine is currently unknown. In addition, some states within these markets have restructured their electric power markets to competitive markets from traditional utility monopoly markets, while others have not. Currently the transmission infrastructure in these markets is generally owned by non-independent market participants, some of which are our competitors, which has the potential to create market anomalies. Transmission constraints exist in these markets and have been managed by the owners of the transmission infrastructure, subject to transmission tariffs and protocols regulated by the FERC.

We currently sell power from our facilities in the Midwest region to customers under bilateral contracts that are generally non-standard with highly negotiated terms and conditions. Our customers include municipalities, electric cooperatives, integrated utilities, transmission and distribution utilities and power marketers. Direct customer sales, in addition to other physical and financial transactions enable us to hedge a portion of our generation portfolio. For a more complete description of our hedging strategy and a summary of the consolidated hedge position of our United States generating assets, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Risks Associated with Our Hedging and Risk Management Activities" in Item 7 of this Form 10-K.

FLORIDA AND OTHER SOUTHEASTERN MARKETS

Facilities. As of December 31, 2001, we owned, or owned interests in, three power generation facilities with an aggregate net generating capacity of 979 MW located in the states of Florida and Texas. These facilities include one gas and oil-fired generation facility with an aggregate net generating capacity of 619 MW located near Titusville, Florida. This facility can be operated as either an intermediate or a peaking facility. We also own a 464 MW gas and oil-fired peaking generation facility in Osceola County, Florida. Two of the three generating units of this plant with an aggregate net generating capacity of 310 MW commenced commercial operation in December 2001. We expect the remaining generating unit at this facility will begin commercial operation in the second quarter of 2002. In addition, we own a 50% interest in a 100 MW gas-fired base-load/cogeneration facility located in Orange, Texas. Air Liquide owns the other 50% interest in this plant which has been in commercial operation since December 1999.

We have begun construction on an 804 MW gas-fired intermediate/peaking facility in Choctaw County, Mississippi. We expect this facility will begin commercial operation in the second quarter of 2003. This facility

is being constructed under the terms of a construction agency agreement under a synthetic leasing arrangement. Upon completion of the construction of this facility, we will have the right to lease, purchase or remarket the facility. For additional information regarding the construction agency agreement, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources -- Future Sources and Uses of Cash -- Reliant Resources-unregulated businesses -- Consolidated Sources of Cash -- Off-Balance Sheet Transactions -- Construction Agency Agreements" in Item 7 of this Form 10-K, and Note 14(1) to our consolidated financial statements.

Market Framework. We currently conduct the majority of our Southeast regional operations in the state of Florida. The state of Florida, other than a portion of the western panhandle, constitutes a single reliability council and contains approximately 5% of the United States population. The transmission-owning utilities in Florida have proposed establishing an independent system operator to assume control of the transmission system and undertake to define the rules and requirements for a competitive wholesale market. The timing of the development of an independent system operator for the Florida market is currently unknown. Under its present structure, the Florida market is dominated by incumbent utilities. There are a number of statutory and regulatory restrictions that negatively impact the development of additional power generation facilities in the region.

We currently sell power from our facilities in the Florida market under bilateral contracts that are non-standard and highly negotiated for terms and conditions. Until the rules for system operations are established, we expect limited trading opportunities will exist in the Florida market. The customers who participate in power transactions in this region include municipalities, electric cooperatives and integrated utilities. We sell capacity and energy to customers in the Florida market, however a market for ancillary services has not developed. Forward hedging of a portion of our Florida portfolio is generally accomplished through customer-tailored, multi-year sale agreements as no liquid, over-the-counter or auction markets currently exist in Florida. For a more complete description of our hedging strategy and a summary of the consolidated hedge position of our United States generation assets, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Risks Associated with Our Hedging and Risk Management Activities" in Item 7 of this Form 10-K.

With respect to our facilities in East Texas and Mississippi, several of the transmission-owning utilities in the Southeast region have formed the SETrans Grid Company (SETrans RTO) that they are proposing to serve as the region's RTO. The proposed SETrans RTO would manage, but not own, the transmission grid in the region and operate forward and spot markets for energy. The SETrans RTO has filed a status report with the FERC, but has not filed tariffs or protocols and has not been approved as the region's RTO.

WEST REGION

Facilities. As of December 31, 2001, we owned, or owned interests in, seven electric power generation facilities with an aggregate net generating capacity of 4,635 MW located in the states of California, Nevada and Arizona. These facilities include approximately 20% of base-load, 75% of intermediate and 5% of peaking capacity. Our facilities in the West region include five facilities with an aggregate net generating capacity of 3,800 MW located in California. We also own a 50% interest in a 490 MW gas-fired, base-load, peaking facility located near Las Vegas, Nevada. Sempra Energy owns the other 50% interest in this plant. In addition, we own a 590 MW gas-fired, base-load, peaking generation facility in Casa Grande, Arizona. This facility was placed in commercial operation in the fourth quarter of 2001. We also have a 548 MW gas-fired, base-load, peaking generation facility under construction in Nevada. We expect this facility will begin commercial operation in the fourth quarter of 2003.

Market Framework. Our West regional market includes the states of Arizona, California, Oregon, Nevada, New Mexico, Utah and Washington. Generally we sell the power generated by our California and Nevada facilities to customers located in the Los Angeles basin of southern California. We also sell power generated by our Nevada facility to customers located in southern Nevada. Our customers in these states include power marketers, investor-owned utilities, electric cooperatives, municipal utilities and the California

Independent System Operator (Cal ISO) acting on behalf of load-serving entities. We sell power and ancillary services to these customers through a combination of bilateral contracts and sales made in the Cal ISO's day-ahead and hour-ahead ancillary services markets and its real-time energy market. The Cal ISO does not currently maintain a market for capacity; however, a capacity market has recently been proposed by the Cal ISO under its market mitigation plan for the California market.

We have agreed to sell up to 100% of the power generated by our Arizona facility to the Salt River Project Agricultural Improvement and Power District of the State of Arizona under a long-term power purchase agreement. Bilateral contracts, in addition to other physical and financial transactions, enable us to hedge a portion of our generation portfolio. For a more complete description of our hedging strategy and a summary of the consolidated hedge position of our United States generating assets, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Risks Associated with Our Hedging and Risk Management Activities" in Item 7 of this Form 10-K. In addition, although we do not own generation facilities in the states of Oregon, New Mexico, Utah and Washington, our trading and marketing operations purchase and deliver energy commodities in these states.

Our operations in the California market are subject to numerous environmental and other regulatory restrictions. Permits issued by local air districts restrict the output of some of our generating facilities. In addition, certain air districts require us to purchase emission credits to offset NOx emissions from our facilities.

In response to California's electricity market restructuring initiative, the FERC issued a series of orders in 1996 and 1997 approving a wholesale market structure administered by two independent non-profit corporations: the Cal ISO, responsible for operational control of the transmission system and the purchase or sale of electricity in "real-time" to balance actual supply and demand, and the California Power Exchange (Cal PX), responsible for conducting auctions for the purchase or sale of electricity on a day-ahead or day-of basis. As part of this market restructuring, California's distribution utilities sold essentially all of their gas-fired plants to third-party generators. The utilities were required to sell their remaining generation into the Cal PX markets and purchase all of their power requirements from the Cal PX markets at market-based rates approved by the FERC. California's regulatory system initially prohibited the utilities from entering into forward contracts to cover the bulk of their customers' requirements. Retail electricity rates were initially frozen at levels in effect on June 10, 1996, with a 10% rate reduction for residential and smaller commercial customers. When wholesale power costs began to rise dramatically in 2000, driven by a combination of factors, including higher natural gas prices and emission allowance costs, reduction in available hydroelectric generation resources, increased demand and decreases in net imports, some of the California utilities were unable to recover their purchased power costs through the retail rates they were allowed to charge. As a result, the utilities accumulated huge debts to wholesale power suppliers, including us. The Cal ISO currently is conducting a major market redesign process that, if approved by the FERC, could change the structure of the markets operated by the Cal ISO, including changes to market monitoring and mitigation, congestion management and capacity obligations. For a discussion of litigation and other legal proceedings related to energy sales in California, the impact of current regulations on our West region and related uncertainty associated with the California wholesale market, please read "-- Regulation -- Federal Energy Regulatory Commission" in Item 1 of this Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Uncertainty in the California Market" in Item 7 of this Form 10-K and Notes 14(f) and 14(g) to our consolidated financial statements.

In Nevada and Arizona, there is presently no RTO in place to manage the transmission systems or to operate energy markets, although one RTO working group is evaluating the establishment of an organization that would assume control, subject to FERC approval, over the transmission systems of the utilities operating in this region. The FERC has recently expressed its intention to pursue the establishment of an RTO in the West region.

Additionally, in Nevada and Arizona, state-level regulatory initiatives may impact competition in the electric sector. In Nevada, the state legislature has passed legislation prohibiting the state's investor-owned utilities from divesting generation. Similarly, in Arizona, proceedings are pending before the Arizona Corporation Commission that would allow the Arizona Public Service Company to avoid a requirement to seek competitive bids for 50% of the Arizona Public Service Company's generation needs.

ERCOT REGION

Facilities. Through Reliant Resources, we currently own a partially operational 781 MW gas-fired, combined cycle, cogeneration facility in Channelview, Texas. 170 MW of this facility's capacity is currently operational and 611 MW are under construction. We expect the remaining generating units for this facility will begin commercial operations in the third quarter of 2002. This facility is not part of our Electric Operations business segment. For more information on that segment and the facilities that are part of our Texas generation business, please read "Electric Operations" in Item 1 of this Form 10-K.

Market Framework. For information regarding the market framework of the ERCOT region, please read "Electric Operations -- ERCOT Market Framework" in Item 1 of this Form 10-K.

LONG-TERM PURCHASE AND SALE AGREEMENTS

In the ordinary course of business, and as part of our hedging strategy, we enter into long-term sales arrangements for power, as well as long-term purchase arrangements. For information regarding our long-term fuel supply contracts, purchase power and electric capacity contracts and commitments, electric energy and electric sale contracts and tolling arrangements, please read Notes 5, 14(a) and 14(b) to our consolidated financial statements. For information regarding our hedging strategy relating to such long-term commitments, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Risks Associated with Our Hedging and Risk Management Activities" in Item 7 of this Form 10-K.

DEVELOPMENT ACTIVITIES

As of December 31, 2001, we had 3,587 MW (3,391 MW, net of 196 MW to be retired upon completion of one facility) of additional net generating capacity under construction, including 2,120 MW of facilities owned by off-balance sheet special purpose entities, that are being constructed under construction agency agreements pursuant to synthetic leasing arrangements. Upon the completion of the construction of these facilities, we expect that we will lease these facilities from their owners. For additional information regarding the construction agency agreements, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources -- Future Sources and Uses of Cash -- Reliant Resources-unregulated businesses -- Consolidated Sources of Cash -- Off-Balance Sheet Transactions -- Construction Agency Agreements" in Item 7 of this Form 10-K and Note 14(1) to our consolidated financial statements.

In addition, Orion Power had three projects totaling 1,054 MW under construction as of December 31, 2001. However, at this time, we have decided to postpone a 250 MW project in Florida because of capital market and economic considerations. With improved capital market conditions and required approvals from Florida authorities on a newly configured 500 MW design, we would plan to proceed with construction in the future. Also, Orion Power had two projects under advanced development as of December 31, 2001, which have been deferred. A 1,088 MW project in Maryland has been postponed due to capital market considerations and because we believe that the PJM market will be sufficiently supplied for the next few years. A repowering project in New York City with a total capacity of 1,608 MW has been postponed until we see an improvement in the capital markets.

As a result of several recent events, including the United States economic recession, the price decline of our industry sector in the equity capital markets and the downgrading of the credit ratings of several of our significant competitors, the availability and cost of capital for our business and the businesses of our

competitors has been adversely affected. In response to these events and the intensified scrutiny of companies in our industry sector by the rating agencies, we have reduced our planned capital expenditures by \$2.7 billion over the 2002 -- 2006 time frame.

DOMESTIC TRADING, MARKETING, POWER ORIGINATION AND RISK MANAGEMENT SERVICES OPERATIONS

In addition to our power generation operations, we trade and market power, natural gas and other energy-related commodities and provide related risk management services to our customers. According to Platt's Power Markets Week and Natural Gas Intelligence Group, we were the third largest power trader and ninth largest natural gas trader in the United States in 2001. Our domestic trading, marketing, power origination and risk management operations complement our domestic power generation operations by providing a full range of energy management services. These services include management of the sales and marketing of energy, capacity and ancillary services from these facilities, and also management of the purchase and sale of fuels and emission allowances needed to operate these facilities. Generally, we seek to sell a portion of the capacity of our domestic facilities under fixed-price sale contracts, fixed-capacity payments or contracts to sell power at a predetermined multiple of either gas or oil prices. This provides us with certainty as to a portion of our margins while allowing us to maintain flexibility with respect to the remainder of our generation output. We evaluate the regional forward power market versus our own fundamental analysis of projected future prices in the region to determine the amount of our capacity we would like to sell and the terms of sale pursuant to longer-term contracts. We also take operational constraints and operating risk into consideration in making these determinations. Generally, we seek to hedge a portion of our fuel costs, which are usually linked to a percentage of our power sales. We also market energy-related commodities and offer physical and financial wholesale energy marketing and price risk management products and services to a variety of customers. These customers include natural gas distribution companies, electric utilities, municipalities, cooperatives, power generators, marketers or other retail energy providers, aggregators and large volume industrial customers.

The following table illustrates the growth of our physical power and gas trading volumes since 1999.

TRADING VOLUMES

FOR THE YEAR ENDED DECEMBER 31	1999	2000	2001
(1) Total Power (MMWh)	112	202	380
(2) Total Gas (Bcf)	1,746	2,423	3,695

- (1) Million megawatt hours.
- (2) Billion cubic feet.

Electric Power Trading and Marketing. We purchase electric power from other generators and marketers and sell power primarily to electric utilities, municipalities and cooperatives and other marketing companies. Our trading and marketing group is also responsible for the marketing of power produced from the power plants we own. We also provide risk management, physical and financial fuel purchase and power sales and optimization services to our customers.

Power Origination. Some of our employees focus on developing and providing customers with long-term customized products (power origination products). These products are designed and negotiated on a case-by-case basis to meet the specific energy requirements of our customers. Our power origination teams work closely with our trading and marketing group and our power generation group to sell long-term products from our power generation assets. They also work to leverage our market knowledge to capture attractive opportunities available through selling products that combine or repackage energy products purchased from third parties with other third-party products or with products from our power generation assets. Our efforts to sell power origination products from our power generation assets have been focused on longer-term forward sales to municipalities, cooperatives and other companies that serve end users, as well as sales of near-term products that are not widely traded. Our power origination products that combine or repackage third-party

products are generally highly structured and therefore require the application of our commercial capabilities (e.g., power trading and asset positions).

Natural Gas Trading and Marketing. We purchase natural gas from a variety of suppliers under daily, monthly and term, variable-load and base-load contracts that include either market sensitive or fixed pricing provisions. We sell natural gas under sales agreements that have varying terms and conditions, most of which are intended to match seasonal and other changes in demand. We sold an average of 10.1 Bcf per day of natural gas in 2001, an average of 6.6 Bcf per day in 2000 and an average of 4.8 Bcf per day in 1999, some of which was sold to the natural gas distribution company subsidiaries of Reliant Energy. We plan to continue to purchase natural gas to supply to our power plants.

Our natural gas marketing activities include contracting to buy natural gas from suppliers at various points of receipt, aggregating natural gas supplies and arranging for their transportation, negotiating the sale of natural gas and matching natural gas receipts and deliveries based on volumes required by customers.

We arrange for, schedule and balance the transportation of the natural gas we market from the supply receipt point to the purchaser's delivery point. We generally obtain pipeline transportation to serve our customers. Accordingly, we use a variety of transportation arrangements for our customers, including short-term and long-term firm and interruptible agreements with intrastate and interstate pipelines. We also utilize brokered firm transportation agreements when dealing on the interstate pipeline system. As of December 31, 2001, we held over two bcf per day of firm transportation in the United States. In the normal course of business it is common for us to hedge the risk of pipeline transportation expenses through "basis swaps." To the extent we have contractually secured pipeline transportation rights in order to fulfill our obligations to sell gas at specific delivery points, or to acquire gas for our own requirements at generation facilities as part of our hedging strategy for power sales, and a pipeline experiences a force majeure event, our ability to transport gas on a contracted capacity basis could become impaired, which could affect the integrity of our hedged position.

We also enter into various short-term and long-term firm and interruptible agreements for natural gas storage in order to offer peak delivery services to satisfy winter heating and summer electric generating demands. Natural gas storage capacity allows us to better manage the unpredictable daily or seasonal imbalances between supply volumes and demand levels. In addition to entering into contracts of natural gas storage capacity in strategic locations throughout the country, we are actively pursuing a natural gas storage development plan. These services are also intended to provide an additional level of performance security and backup services to our customers.

Other Commodities and Derivatives. We trade and market other energy-related commodities. We use derivative instruments to manage and hedge our fixed-price purchase and sale commitments and to provide fixed-price or floating-price commitments as a service to our customers and suppliers. We also use derivative instruments to reduce our exposure relative to the volatility of the cash and forward market prices and to protect our investment in storage inventories. For additional information regarding our financial exposure to derivative instruments, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Risks Associated with Our Hedging and Risk Management Activities" in Item 7 of this Form 10-K and "Quantitative and Qualitative Disclosures About Market Risk" in Item 7A of this Form 10-K.

Intercontinental-Exchange. In July 2000, we, along with five other natural gas and power companies, American Electric Power, Aquila Energy, Duke Energy, El Paso Corporation and Mirant Corporation, made an investment in Intercontinental-Exchange, a new, web-based, on-line trading platform (www.intcx.com) for trading various commodities including precious metals, crude oil and refined products, natural gas and electricity. The other five natural gas and power companies, along with us, own less than 50% of Intercontinental -- Exchange. In June 2001, Intercontinental-Exchange acquired the International Petroleum Exchange. With this acquisition, Intercontinental-Exchange became the first company to offer both an exchange trading over-the-counter commodity contracts and an exchange trading commodity futures contracts. At the same time, Intercontinental-Exchange announced plans to integrate the two types of exchanges into a single electronic trading platform. Our decision to invest, as one of a group of natural gas and power

companies, in Intercontinental-Exchange was based on a desire to support the development of a neutral, anonymous, electronic trading platform for bilateral energy transactions. We believe the commercial success of such an exchange model will benefit us by contributing to improved price transparency and transaction liquidity in the wholesale energy markets. The principal online competitors of Intercontinental-Exchange are currently TradeSpark.com and the NYMEX, a traditional futures exchange that has announced an online initiative.

Risk Management Controls. For information regarding our risk management structure and accounting policies, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Trading and Marketing Operations" in Item 7 of this Form 10-K and "Quantitative and Qualitative Disclosures About Market Risk" in Item 7A of this Form 10-K.

COMPETITION

For a discussion of competitive factors affecting our Wholesale Energy business segment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Wholesale Energy Operations -- Increasing Competition in Our Industry" in Item 7 of this Form 10-K, which section is incorporated herein by reference.

EUROPEAN ENERGY

Our European Energy business segment, which is conducted through Reliant Resources, includes 3,476 MW of power generation assets located in the Netherlands and a related trading and power origination operation. This business segment includes the operations of Reliant Energy Power Generation Benelux N.V. (formerly UNA N.V.) (REPGB) and Reliant Energy Trading & Marketing B.V. and its affiliates.

In 2001, we evaluated strategic alternatives for our European Energy business segment, including a possible sale. We completed our evaluation and have determined that given current market conditions and prices, it is not advisable to sell our European Energy operations. Consequently, we decided to continue to own and operate our European Energy business segment and expand our trading and origination activities in Northwest Europe. Our European Energy business segment will remain with Reliant Resources in the Separation and will not be part of our business after the Distribution.

EUROPEAN POWER GENERATION OPERATIONS

Facilities. As of December 31, 2001 we owned five electric power generation facilities in the Netherlands with an aggregate net generating capacity of 3,476 MW and include approximately 39% of base-load, 36% of intermediate and 25% of peaking capacity. Our facilities are grouped in three clusters adjacent to the cities of Amsterdam, Utrecht and Velsen. In 2001, our generation facilities produced 14 million MWh, an amount which represented approximately 13% of the electricity production of the Netherlands (excluding electricity generated by cogeneration or other industrial processes). In addition to electricity, our generating stations sell heated water produced as a byproduct of the generation process for use in providing heating (district heating) to the cities of Amsterdam, Nieuwegein, Utrecht and Purmerend.

In 2001, approximately 51% of our European Energy business segment's generation output was natural gas-fired, 30% was coal-fired, 18% was blast furnace gas-fired and less than 1% was oil-fired. Our European Energy business segment purchases substantially all of its gas fuel requirements under medium to long-term gas purchase contracts with N.V. Nederlandse Gasunie, the primary supplier and transporter of natural gas in the Netherlands. The purchase price and transportation costs for natural gas under these contracts are calculated on the basis of regulated tariffs.

Our European Energy business segment historically purchased all of its coal requirements under short-term contracts with a coal trading and supply company now owned by two of the Dutch generation companies. In December 2001, REPGB and the other shareholder of the coal trading and supply company agreed to terminate future coal purchases through this entity effective in mid-2002. Our European Energy business

segment intends to obtain its future coal requirements through short to medium-term forward purchase contracts on the open market through a variety of suppliers and brokers.

One of our European Energy generation stations, which has a production capacity of 144 MW, uses blast furnace gas, an industrial waste gas generated by a steel plant adjacent to the generation station, as its fuel. Two of our other European Energy business segment's generation plants have the flexibility to operate using blast furnace gas. We purchase the blast furnace gas from the adjacent steel plant under a medium-term and a long-term contract. We purchase our fuel oil requirements on the open market.

We acquired REPGb in October 1999 for approximately \$1.9 billion (based on the then applicable exchange rate of 2.06 Dutch Guilders (NLG) per U.S. dollar). For information regarding the acquisition, please read Note 3(b) to our consolidated financial statements.

Market Framework. Our European Energy business segment produces, buys and sells electricity, gas and other energy-related commodities in the Northern European wholesale market. Its generation production activities are centered in the Netherlands, where it is one of the four large-scale generation companies. It operates five generation facilities with an installed capacity of 3,476 MW. Its energy trading and origination operations concentrate their activities primarily in the Netherlands, Germany and the Scandinavian regions. In the fourth quarter of 2001, our European Energy business segment expanded its electricity trading operations to the United Kingdom.

The primary customers of our European Energy business segment are electric distribution companies, large industrial consumers and energy trading companies. We sell electricity and other energy-related commodities primarily in the form of forward purchase contracts transacted in the over the counter markets, on various European energy exchanges and in individually negotiated transactions with individual counterparties. To a lesser extent, we also engage in transactions involving financial energy-related derivative products.

The most significant factor affecting the markets in which our European Energy business segment operates has been the recent deregulation of the Dutch and certain other European wholesale energy markets, including access on a non-discriminatory basis to high voltage transmission grid systems, the establishment of new energy exchanges and other events. Notwithstanding these factors, the scope and pace of the future liberalization of the European energy markets is uncertain. For example, access to some European markets continues to be subject to transmission and other constraints. In some cases, fuel suppliers continue to operate in largely regulated markets not yet open to full competition.

EUROPEAN TRADING AND POWER ORIGINATION OPERATIONS

Our European Energy business segment's trading and power origination operations are centered in Amsterdam, Netherlands, with additional offices in London and Frankfurt. Our European Energy business segment trades electricity and fuel products in the Netherlands, Germany, Austria, Switzerland, the United Kingdom and the Scandinavian countries. Our marketing operations focus on distribution companies and large industrial and commercial customers in the Benelux and German markets. As of December 31, 2001, our European Energy business segment had entered into forward purchase and sale contracts, and associated hedging transactions, covering approximately 18.6 million MWh for delivery in 2002.

Our European Energy business segment's trading and power origination operations seek to utilize a business model, including risk management and related control policies, similar to that utilized in our Wholesale Energy operations in the United States. There are, however, significant differences in the United States and European markets. Among other things, European energy markets involve increased currency hedging requirements (the Euro and non-Euro currencies), and more complicated cross-border tax and transmission tariff systems than in the United States. In addition, European energy markets are significantly less mature than United States energy markets in terms of liquidity, the scope and complexity of trading and marketing products, the use of standardized market-based trading contracts and other aspects.

In addition, there exist greater uncertainties in some European jurisdictions as to the enforceability of certain contract-based mechanisms to hedge risks, such as the enforceability of automatic termination rights and rights of set-off upon bankruptcy, limitations on liquidated damages and the rules by which European

courts construct contracts. In many civil law jurisdictions, courts reserve the right to interpret contracts based upon principles of good faith and fairness as opposed to a literal construction of the contract.

As of December 31, 2001, we had provided an aggregate of \$831 million in guarantees with respect to contract obligations of our European Energy business segment.

COMPETITION

For a discussion of competitive factors affecting our European Energy business segment, please read "Management's Discussion and Analysis of Financial Condition and Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our European Energy Operations -- Competition in the European Market" in Item 7 of this Form 10-K, which section is incorporated herein by reference.

RETAIL ENERGY

Our Retail Energy business segment provides electricity and related services to retail customers primarily in Texas through Reliant Energy Retail Services, LLC (Residential Services), Reliant Energy Solutions, LLC (Solutions) and StarEn Power, LLC (StarEn Power), all of which are wholly owned subsidiaries of Reliant Resources. Our Retail Energy business segment will remain with Reliant Resources in the Separation and will not be part of our business after the Distribution. As a retail electric provider, generally our Retail Energy business segment procures or buys electricity from wholesale generators at unregulated rates, sells electricity at generally unregulated rates to its retail customers and pays the local transmission and distribution regulated utilities a regulated tariff rate for delivering the electricity to its customers. Our Retail Energy business segment became a provider of retail electricity in Texas when that market began opening to retail competition in late 2001 and fully opened to retail competition in January 2002. In January 2002, our Retail Energy business segment began to provide retail electricity services to all of the approximately 1.7 million customers of Reliant Energy HL&P's electric utility located in its service area who did not take action to select another retail electric provider. Our Retail Energy business segment provides electricity and related products and services to residential and small commercial (i.e., small and medium-sized business customers with a peak demand for power at or below one MW) customers through Residential Services, and offers customized, integrated electric commodity and energy management services to large commercial, industrial and institutional (e.g., hospitals, universities, school systems and government agencies) customers through Solutions for customers with a peak demand for power of greater than one MW. Residential Services, Solutions and StarEn Power have been certified as retail electric providers by the Texas Utility Commission. StarEn Power has been appointed by the Texas Utility Commission to be the provider of last resort (POLR) in certain areas of the State of Texas. Under the Texas Electric Restructuring Law, a POLR is required to offer a standard retail electric service package to requesting customers of a class designated by the Texas Utility Commission within the POLR's territory at a fixed, nondiscountable rate.

In preparation for retail electric competition in Texas, Reliant Resources expanded its infrastructure of information technology systems, business processes and staffing levels to meet the needs of its retail businesses. These include a customer care system module and wholesale/retail energy supply, risk management, e-commerce, scheduling/settlement, customer relationship management and sales force automation systems. As of December 31, 2001, Reliant Resources had invested \$153 million in retail infrastructure development. For additional information regarding the Texas retail electric market, please read "-- Market Framework," "-- Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" in Item 1 of this Form 10-K and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Retail Energy Operations -- Competition in the Texas Market" in Item 7 of this Form 10-K.

RESIDENTIAL SERVICES

Residential Services provides electricity to residential retail and small commercial customers in Texas. As of January 1, 2002, Residential Services was the retail electric provider for approximately 1.5 million

residential customers located in the Houston metropolitan area, making us the second largest retail electric provider in Texas as of that date. Residential Services' marketing strategy for residential customers emphasizes reliability and trust with our customers, and focuses on savings, value and customer service. Reliant Resources launched an advertising campaign to reposition its brand in the Houston and Dallas/ Fort Worth metropolitan areas in the second half of 2001.

As the affiliated retail electric provider, or successor in interest, to Reliant Energy HL&P, Residential Services was also the retail electric provider for approximately 200,000 small commercial customers in the Houston metropolitan area as of January 1, 2002. Residential Services' marketing strategy for small commercial customers uses a combination of direct marketing and individual sales calls to establish its brand and to attract additional customers.

As the affiliated retail electric provider, Residential Services will not be permitted to sell electricity to residential and small commercial customers in Reliant Energy HL&P's service territory at a price other than the price to beat until January 1, 2005, unless before that date the Texas Utility Commission determines that 40% or more of the amount of electric power that was consumed in 2000 by the relevant class of customers in the service territory is committed to be served by other retail electric providers. In addition, the Texas Electric Restructuring Law requires Reliant Resources, as the affiliated retail electric provider, to make the price to beat available to residential and small commercial customers in Reliant Energy HL&P's service territory through January 1, 2007, if requested by such customers. For more information about the price to beat, please read "-- Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" in Item 1 of this Form 10-K.

SOLUTIONS

Solutions provides electricity and energy services to the large commercial, industrial and institutional customers with whom it has signed contracts. In addition, it provides electricity at previously established default rates to those large commercial, industrial and institutional customers in the service territory of Reliant Energy HL&P who have not entered into a contract with another retail electric provider. The majority of Solutions' revenues will come from the sale of electricity to its customers. In order to be classified as a large commercial customer, an electricity customer may aggregate the purchase of electricity for its own use at multiple locations such that the total peak demand exceeds one MW.

In addition to providing electricity, Solutions provides customized, integrated energy solutions, including risk management and energy services products, and demand side and energy information services to large commercial, industrial and institutional customers. Since its formation in April 1996, Solutions has completed over 220 energy services projects for large commercial, industrial and institutional clients. The services that Solutions provides its customers include the replacement or upgrade of energy-intensive capital equipment, the financing of energy-intensive equipment, infrastructure optimization, substation development and maintenance and power quality assurance.

Solutions is recognized as the affiliated retail electric provider, or successor in interest, to Reliant Energy HL&P for large commercial, industrial and institutional customers. Solutions targets institutional, manufacturing, industrial and other large commercial customers, including multi-site retailers and restaurants, petroleum refineries, chemical companies, real estate management firms, educational institutions and healthcare providers. As of December 31, 2001, this customer segment in Texas included approximately 1,750 buying organizations consuming an aggregate of approximately 16,000 MW of electricity at peak demand. As of December 31, 2001, Solutions had signed contracts with customers representing a peak demand of approximately 3,700 MW and serving approximately 12,000 meter locations.

STAREN POWER

StarEn Power serves as the POLR in portions of the state of Texas, as designated by the Texas Utility Commission. For 2002, StarEn Power has been appointed to serve as the POLR for residential and small commercial customers in the western portion of the Dallas/Fort Worth metropolitan area formally served by TXU Electric Company. In addition, StarEn Power has been appointed as the POLR in the service territory

of Reliant Energy HL&P for large commercial, industrial and institutional customers. The rates and terms under which StarEn Power provides service are governed by the terms of a settlement agreement between StarEn Power and various interested parties approved by the Texas Utility Commission. For additional information regarding StarEn Power's POLR obligations, rates and terms of service, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Retail Energy Operations -- Obligations as a Provider of Last Resort" in Item 7 of this Form 10-K.

MARKET FRAMEWORK

Generally, under the Texas Electric Restructuring Law, the retail electric provider procures or buys electricity from wholesale generators, sells electricity at retail to its customers and pays the transmission and distribution utility a regulated tariffed rate for delivering electricity to its customers. All retail electric providers in an area pay the same rates and other charges for transmission and distribution, whether or not they are affiliated with the transmission and distribution utility for that area. The transmission and distribution rates in effect as of January 1, 2002 for each utility were set through rate cases before the Texas Utility Commission. For more information regarding the retail market framework in Texas, please read "-- Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" in Item 1 of this Form 10-K and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Retail Energy Operations" in Item 7 of this Form 10-K.

RETAIL ENERGY SUPPLY

In Texas, our Wholesale Energy group and our Retail Energy group work together in order to determine the price, demand and supply of energy required to meet the needs of our Retail Energy business segment's customers. Our Wholesale Energy trading and marketing operations are responsible for commodity pricing, risk assessment and supply procurement for our Retail Energy business segment. Our Retail Energy business segment manages retail pricing decisions and forecasts the demand for the procurement of electricity by the Wholesale Energy business segment. The costs of our trading, marketing and risk management services associated with obtaining the electricity supply for our retail customers in Texas are borne by our Retail Energy business segment. Our Wholesale Energy group acquires supply for our Retail Energy business segment by several means. Wholesale Energy may purchase capacity from non-affiliated parties in the state mandated auctions. Please read "Electric Operations -- Generation -- State Mandated Capacity Auctions" and "-- Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" in Item 1 of this Form 10-K for more information about these auctions. Under the terms of the master separation agreement between Reliant Resources and Reliant Energy, Reliant Resources is entitled to purchase, prior to our submission of capacity to auction, 50% (but not less than 50%) of the capacity we have available to auction in the contractually mandated auctions at the prices bid by third parties in these auctions. Please read "Electric Operations -- Generation -- Contractually Mandated Capacity Auctions" in Item 1 of this Form 10-K for more information about these auctions. Whether or not Reliant Resources exercises the foregoing right, it may submit bids to purchase in the contractually mandated auctions, but cannot participate in state mandated auctions conducted by our Texas generation business. Wholesale Energy entered into bilateral contracts with third parties for capacity, energy and ancillary services. Wholesale Energy continuously monitors and updates these positions based on retail sales forecasts and market conditions.

COMPETITION

For a discussion of competitive factors affecting our Retail Energy business segment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Retail Energy Operations -- Competition in the Texas Market" in Item 7 of this Form 10-K, which section is incorporated herein by reference.

LATIN AMERICA

Effective December 1, 2000 (Measurement Date), our board of directors approved a plan to dispose of our Latin America business segment through sales of its assets. At the time, our major Latin America investments consisted of interests in cogeneration projects, utilities and other power projects in Argentina, Brazil and Colombia. We began disposing of our Latin America assets and reporting the results of our Latin America business segment as "discontinued operations" in our 2000 consolidated financial statements in accordance with Accounting Principles Board (APB) Opinion No. 30 "Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," (APB Opinion No. 30).

By December 2001, we had disposed of all of our Latin America assets except for our Argentine investments, which consisted of a 100% interest in a corporation formed to develop, own and operate a 160 MW cogeneration project (Argener) located at a steel plant near San Nicolas, Argentina and a 90% interest in a utility in north-central Argentina (EDESE). We were in negotiations to dispose of Argener and EDESE, but the negotiations terminated in December 2001 in light of recent adverse economic developments in Argentina. Under applicable accounting rules, because we were not able to dispose of Argener and EDESE within one year of the Measurement Date, our remaining investments in our Latin America business segment are no longer classified as discontinued operations, and the related amounts have been reclassified into continuing operations in our consolidated financial statements. We will continue to evaluate options related to the future disposition of these assets. For more information regarding the accounting treatment of our Latin America business segment, please read Note 19 to our consolidated financial statements.

OTHER OPERATIONS

In 2001, our Other Operations business segment included:

- the operations of Reliant Energy Thermal Systems, Inc. (Thermal Systems);
- the operations of Reliant Energy Power Systems, Inc. (Power Systems);
- the operations of our communications business (Communications);
- the operations of our venture capital division (New Ventures);
- various office buildings and other real estate used in our business operations;
- unallocated corporate costs; and
- intersegment eliminations.

Except for Thermal Systems and Power Systems, we conducted the operations of our Other Operations business segment through Reliant Resources and one or more of its subsidiaries. After the Separation, our Other Operations business segment will consist primarily of Thermal Systems, Power Systems, office buildings and other real estate used in our business operations and unallocated corporate costs.

RELIANT ENERGY THERMAL SYSTEMS

Thermal Systems provides energy management services to commercial and industrial consumers. These services include operations and maintenance services, energy management services, distributed generation services, Internet-based facilities/energy management services, temporary cooling and electrical services, project and construction management services and engineering consulting services. Thermal Systems also owns an interest in the Northwind Houston L.P. (Northwind) district energy system in partnership with a third party. Northwind provides chilled water services to selected buildings in Houston's downtown central business district. Northwind's customers include Astros Field, and various office buildings, hotels and high-rise residential developments. Thermal Systems and the third party have an agreement in principle concerning Thermal System's purchase of the third party's interest in Northwind.

RELIANT ENERGY POWER SYSTEMS

Power Systems is developing a natural-gas-fueled proton exchange membrane fuel cell system targeted at the domestic residential market. Power Systems licenses core technology from Texas A&M University and has developed additional fuel cell technology focused on pursuing its goal of developing and building a low-cost, low-pressure fuel cell using commercially available materials and volume manufacturing design techniques.

NEW VENTURES

Our New Ventures division manages our existing new technology investments and identifies and invests in promising new technologies and businesses that relate to our energy services operations. Focus areas for investment include distributed generation, clean energy and energy industry software and systems.

Generally, we make our investments either directly or indirectly as limited partners in venture capital funds. As of December 31, 2001, we have invested approximately \$35 million in five venture capital funds with an energy and utility focus and have made commitments to invest an additional \$11 million in these funds. As of December 31, 2001, these funds held investments in 43 companies. Excluding our investment in Grande Communications, Inc. discussed below, New Ventures' direct investment portfolio consists of eight companies with a total of \$7 million invested as of December 31, 2001.

In September 2000, we committed to make a \$25 million investment in Grande Communications, Inc., which was completed in August 2001. Grande Communications is a Texas-based communications company building a deep fiber broadband network that will offer bundled services, including high-speed Internet, all-distance telephone and advanced cable entertainment to homes and businesses. We invested a further \$1 million in Grande Communications in October 2001 as part of a larger debt and equity financing for the company. Grande Communications has announced its intention to build a broadband network in the Houston area and has secured a cable franchise from the City of Houston. The Houston build out will be in addition to the Central Texas cities of Austin, San Marcos, and San Antonio which are already under development.

COMMUNICATIONS

During the third quarter of 2001, we decided to exit our Communications business. The business served as a facility-based competitive local exchange carrier and Internet services provider and owned network operations centers and managed data centers in Houston and Austin. Our exit plan was substantially completed in the first quarter of 2002. For more information regarding the exiting of our Communications business, please read Note 20 to our consolidated financial statements.

OUR BUSINESS GOING FORWARD

Our business and operations are changing significantly as a result of the Texas Electric Restructuring Law and the Separation. Below is a summary of the principal changes to our business and operations that have occurred and that we anticipate will occur due to the Texas Electric Restructuring Law and the Separation.

Separation of Reliant Energy HL&P's Operations. Because the Texas Electric Restructuring Law requires the separation of generation, transmission and distribution and retail electric sales operations of electric utilities in Texas, Reliant Energy HL&P no longer operates as a traditional, vertically-integrated utility. The retail electric sales operations of Reliant Energy HL&P were transferred to, and have been operated by, subsidiaries of Reliant Resources. Since January 1, 2002, retail customers of Reliant Energy HL&P and other investor-owned electric utilities in Texas have been entitled to purchase their electricity from any of a number of certified retail electric providers, including Reliant Resources, at generally unregulated rates. Reliant Energy (of which Reliant Energy HL&P is an unincorporated division) no longer provides retail electric services to customers, except through Reliant Resources, and, upon completion of the Distribution, such services will be provided at rates separately and independently of CenterPoint Energy by Reliant Resources and its subsidiaries and by other retail electric providers.

Since January 1, 2002, we have been selling electric energy from our Texas generation business to wholesale purchasers, including retail electric providers, at unregulated rates pursuant to the state mandated auctions and the contractually mandated auctions. We plan to transfer our Texas generation business to Texas Genco in connection with the Restructuring. Pursuant to the Texas Genco Option, Reliant Resources has the option to acquire our interest in Texas Genco in 2004. As a result of these changes, our Texas generation operations are no longer conducted as part of an integrated utility and will comprise a new business segment in 2002, Electric Generation.

Distribution of Reliant Resources' Stock and New Business Segment. We have transferred substantially all of our unregulated businesses to Reliant Resources and its subsidiaries. When we complete the Separation, CenterPoint Energy's business will consist principally of regulated operations. We anticipate that upon completion of the Separation described above, CenterPoint Energy's business segments will consist of the following:

- Electric Transmission and Distribution;
- Electric Generation;
- Natural Gas Distribution;
- Pipelines and Gathering; and
- Other Operations.

The Wholesale Energy, European Energy, Retail Energy and unregulated portions of our Other Operations business segments will be conducted by Reliant Resources as a separate publicly traded company.

For information regarding the effect of the changes in our business and operations on our future earnings, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Associated with the Business Separation, Restructuring and Distribution" in Item 7 of this Form 10-K.

REGULATION

We are subject to regulation by various federal, state, local and foreign governmental agencies, including the regulations described below.

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Current Status. Reliant Energy is both a public utility holding company and an electric utility company as defined in the 1935 Act; however, it is exempt from regulation as a registered holding company pursuant to Section 3(a)(2) of the 1935 Act. Although RERC Corp. is a gas utility company as defined under the 1935 Act, it is not a holding company within the meaning of the 1935 Act. Reliant Energy and RERC Corp. are currently subject to regulation under the 1935 Act with respect to certain acquisitions of voting securities of other domestic public utility companies and utility holding companies.

Section 33(a)(1) of the 1935 Act exempts foreign utility company affiliates of Reliant Energy and RERC Corp. from regulation as "public utility companies," thereby permitting Reliant Energy and RERC Corp. to invest in foreign utility companies without becoming subject to registration under the 1935 Act as a registered holding company and without approval by the SEC. The exemption, however, is subject to the SEC having received certification from each state commission having jurisdiction over the retail rates of any electric or gas utility company affiliated with Reliant Energy or RERC Corp. that such commission has the authority and resources to protect ratepayers subject to its jurisdiction and that it intends to exercise its authority. The Texas Utility Commission and the state regulatory commissions exercising jurisdiction over RERC Corp. (Arkansas, Louisiana, Minnesota, Mississippi, Oklahoma and Texas) have provided a certification to the SEC subject, however, to the right of such commissions to revise or withdraw their certifications as to any future acquisitions of a foreign utility company. The Texas Utility Commission and the state regulatory commissions of Arkansas and Minnesota have imposed limitations on the amount of investments that can be made by

utility companies (including Reliant Energy and RERC Corp.) in foreign utility companies and, in some cases, foreign electric wholesale generating companies. These limitations are based upon a utility company's consolidated net worth, retained earnings, and debt and stockholders' equity. We currently do not plan to make any incremental investments in foreign utility companies.

Subject to some limited exceptions, Section 33(f)(1) of the 1935 Act prohibits us, as a public utility company, from issuing any security for the purpose of financing the acquisition, ownership or operation of a foreign utility company, or assuming any obligation or liability in respect of any security of a foreign utility company.

Under the Energy Policy Act of 1992, a company engaged exclusively in the business of owning and/or operating facilities used for the generation of electric energy exclusively for sale at wholesale and selling electric energy at wholesale may be exempted from regulation under the 1935 Act as an exempt wholesale generator (EWG). All but two of our electric generation facilities owned by Reliant Resources have received determinations of EWG status from the FERC. If any of these subsidiaries loses its EWG status, we would have to restructure our organization or risk being subjected to regulation under the 1935 Act. The two electric generation facilities in which Reliant Resources owns interests that are not EWGs are "qualifying facilities" under PURPA. As such, these facilities, and the subsidiaries who own them, also are exempted from regulation under the 1935 Act.

Impact on the Restructuring. SEC approval is required for CenterPoint Energy to acquire Reliant Energy and its subsidiary companies. As a result of the Restructuring, CenterPoint Energy will be a holding company within the meaning of the 1935 Act and, as such, required to register under the 1935 Act unless it is able to qualify for exemption. Section 3(a)(1) of the 1935 Act provides an exemption for a holding company if it and each of its material public utility subsidiary companies carry on their utility operations substantially and predominantly in a single state in which they are all organized. While we believe that CenterPoint Energy will ultimately be in compliance with the requirements for exemption under Section 3(a)(1), RERC Corp. initially will be a material subsidiary with significant out-of-state utility operations. As described in our application to the SEC, we plan to bring CenterPoint Energy into full compliance with the standards of Section 3(a)(1) by separating the Entex, Arkla and Minnegasco operations of RERC Corp. into separate business entities. We are in the process of obtaining the necessary state approvals for the RERC Corp. separation.

In the interim, CenterPoint Energy must either obtain a temporary exemption from registration or else register under the 1935 Act until the separation of RERC Corp. is completed. We have previously submitted a request for a temporary exemption for CenterPoint Energy but believe that the new holding company could also register and obtain the necessary authority under the 1935 Act to operate during this interim period consistent with our business plan.

Following the Distribution, Reliant Resources and its subsidiaries would not be subject to the provisions of the 1935 Act either as subsidiaries or affiliates of CenterPoint Energy.

Proposals to Repeal the 1935 Act. In recent years, several bills have been introduced in Congress that would repeal the 1935 Act. Repeal or significant modification to the 1935 Act could have a significant impact on us and the electric utility industry. At this time, however, we are not able to predict the outcome of any bills to repeal the 1935 Act or the outlook for additional legislation in 2002.

FEDERAL ENERGY REGULATORY COMMISSION

Natural Gas. The transportation and sale for resale of natural gas in interstate commerce is subject to regulation by the FERC under the Natural Gas Act and the Natural Gas Policy Act of 1978, as amended. The FERC has jurisdiction over, among other things, the construction of pipeline and related facilities used in the transportation and storage of natural gas in interstate commerce, including the extension, expansion or abandonment of these facilities. The rates charged by interstate pipelines for interstate transportation and storage services are also regulated by the FERC.

REGT and MRT periodically file applications with the FERC for changes in their generally available maximum rates and charges designed to allow them to recover their costs of providing service to customers (to the extent allowed by prevailing market conditions), including a reasonable rate of return. These rates are normally allowed to become effective after a suspension period, and in some cases are subject to refund under applicable law, until such time as the FERC issues an order on the allowable level of rates. REGT currently is operating under such rates approved by the FERC that took effect in February 1995. MRT currently is operating under such rates that took effect in October 2001, pursuant to a rate case settlement approved by the FERC on January 16, 2002.

On February 9, 2000, the FERC issued Order No. 637, which introduces several measures to increase competition for interstate pipeline transportation services. Order No. 637 authorizes interstate pipelines to propose term-differentiated and peak/off-peak rates, and requires pipelines, including MRT and REGT, to make tariff filings to expand pipeline service options for customers. REGT and MRT made Order No. 637 compliance filings in 2000. On March 29, 2002, the FERC issued an order accepting, subject to certain modifications, a settlement agreement that would resolve REGT's Order No. 637 proceeding. On November 21, 2001, MRT filed with the FERC for approval of a settlement intended to resolve the MRT Order No. 637 compliance proceeding. The settlement was uncontested. No action on the settlement has yet been taken by the FERC.

On May 31, 2001, the FERC issued an order on rehearing establishing hearing procedures to evaluate MRT's request for authority to recover four Bcf of undercollected lost and unaccounted for gas over a three-year period. A settlement resolving all issues in this case, among other things, was filed with the FERC on November 5, 2001. The FERC approved the settlement on January 16, 2002.

Electricity. Under the Federal Power Act, the FERC has exclusive ratemaking jurisdiction over wholesale sales of electricity and the transmission of electricity in interstate commerce by "public utilities." Public utilities that are subject to the FERC's jurisdiction must file rates with the FERC applicable to their wholesale sales or transmission of electricity in interstate commerce. All of Reliant Resources' generation subsidiaries sell power at wholesale and are public utilities under the Federal Power Act with the exception of two facilities in Texas, which are qualifying facilities and not regulated as public utilities. The facilities in our Texas generation business are located in ERCOT and therefore are not public utilities subject to the FERC's jurisdiction under the Federal Act. The FERC has authorized our public utility subsidiaries to sell electricity and related services at wholesale at market-based rates. In its orders authorizing market-based rates, the FERC also has granted these subsidiaries waivers of many of the accounting, record keeping and reporting requirements that are imposed on public utilities with cost-based rate schedules.

The FERC's orders accepting the market-based rate schedules filed by our subsidiaries or their predecessors, as is customary with such orders, reserve the right to revoke or limit our market-based rate authority if the FERC subsequently determines that any of our affiliates possess excessive market power. If the FERC were to revoke or limit our market-based rate authority, we would have to file, and obtain the FERC's acceptance of, cost-based rate schedules for all or some of our sales. In addition, the loss of market-based rate authority could subject us to the accounting, record keeping and reporting requirements that the FERC imposes on public utilities with cost-based rate schedules. Sales from our Electric Operations business segment are not subject to FERC jurisdiction because ERCOT is not connected to a national grid.

The FERC issued Order No. 2000 in December 1999. Order No. 2000, which applies to all FERC jurisdictional transmission providers, describes the FERC's intention to promote the establishment of large RTOs and sets forth the minimum characteristics and functions of RTOs. Among the basic minimum characteristics are that the RTOs must be independent of market participants and must be of sufficient scope and geographical configuration. Order No. 2000 also encourages RTOs to work with each other to minimize or eliminate "seams" issues between RTOs that operate as barriers to inter-regional transactions. The FERC's goal is to encourage the growth of a robust competitive wholesale market for electricity. Although jurisdictional transmission providers are not required to join RTOs, they are encouraged to do so. Under Order No. 2000, RTOs were to be operational by December 15, 2001. However, because RTO development was in different stages in different regions of the country, the FERC issued an order on November 7, 2001 extending

the deadline until it resolves issues relating to geographic scope and governance of qualifying RTOs across the country and issues relating to business and procedural needs. For organizations to accomplish the functions of Order No. 2000, the FERC is taking steps to create business standards and protocols to facilitate RTO formation. However, there can be no assurance that the FERC's goals will be achieved. Also there is considerable state-level resistance in some regions, including regions in which we operate, to the formation of RTOs. At least 14 separate organizations, covering the substantial majority of all the FERC jurisdictional transmission providers, are in various stages of organization and have made at least preliminary filings with the FERC. Our T&D Utility is not subject to the FERC's jurisdiction, except with respect to certain high voltage, direct current ties linking ERCOT to the Southwest Power Pool, and therefore does not have to join an RTO.

Trading and Marketing. Our domestic electric trading and marketing operations outside of ERCOT are also subject to the FERC's jurisdiction under the Federal Power Act. As a gas marketer, we make sales of natural gas in interstate commerce at wholesale pursuant to a blanket certificate issued by the FERC, but the FERC does not otherwise regulate the rates, terms or conditions of these gas sales. We also have subsidiaries that are "public utilities" under the Federal Power Act, and their wholesale sales of electricity in interstate commerce are subject to FERC-filed rate schedules that authorize them to make sales at negotiated, market-based rates.

In authorizing market-based rates for various of our subsidiaries, the FERC has imposed some restrictions on these entities' transactions with Reliant Energy HL&P, including a prohibition on the receipt of goods or services on a preferential basis. The FERC also has imposed restrictions on natural gas transactions between Reliant Resources' public utility subsidiaries and Reliant Energy's natural gas pipeline subsidiaries to preclude any preferential treatment. Similar restrictions apply to transactions between Reliant Resources and Reliant Energy HL&P under Texas utility regulatory laws.

Hydroelectric Facilities. The majority of our generating facilities located in the state of New York are hydroelectric facilities, many of which are subject to the FERC's exclusive authority under the Federal Power Act to license non-federal hydroelectric projects located on navigable waterways and federal lands. These FERC licenses must be renewed periodically and can include conditions on operation of the project at issue.

STATE AND LOCAL REGULATIONS

TEXAS

Electric Operations -- The Texas Electric Restructuring Law. In June 1999, the Texas legislature adopted the Texas Electric Restructuring Law, which substantially amended the regulatory structure governing electric utilities in Texas in order to allow and encourage retail competition. Retail pilot projects allowing competition for up to 5% of each utility's load in all customer classes began in August 2001, and retail electric competition for all other customers began in January 2002.

The Texas Electric Restructuring Law required electric utilities in Texas to restructure their businesses in order to separate power generation, transmission and distribution, and retail electric sales activities into three different units, whether commonly or separately owned. As a result of the Texas Electric Restructuring Law, retail sales of electricity to residential, commercial and industrial customers must now be made by "retail electric providers." Generally, the retail electric providers that have been certified by the Texas Utility Commission obtain electricity from power generation companies, exempt wholesale generators and other generating entities at unregulated rates, sell electricity at generally unregulated rates to their retail customers and pay the transmission and distribution utility a regulated tariff rate for delivering the electricity to their customers. For additional information regarding these transmission and distribution utility tariff rates, please read "-- Electric Operations -- Rate Case" in Item 1 of this Form 10-K. Retail electric providers are not permitted to own or operate generation assets and, as a general rule, their prices are not subject to traditional cost-of-service rate regulation. Retail electric providers that are affiliates of, or successors in interest to, electric utilities may compete substantially statewide for these sales, but prices they may charge to residential and small commercial customers within the affiliated electric utility's certificated service territory are subject to a fixed, specified price set by the Texas Utility Commission at the outset of retail competition (price to beat) that is subject to potential adjustments up to two times per year. All of our retail activities, including

activities conducted by retail electric providers in Texas, are now conducted by Reliant Resources and its subsidiaries.

Wholesale power generators will continue to sell electric energy to purchasers, including retail electric providers, at unregulated rates. To facilitate a competitive market, each power generator affiliated with a transmission and distribution utility is required to sell at auction 15% of the output of its installed generating capacity. This auction obligation continues until January 1, 2007, unless the Texas Utility Commission determines before that date that at least 40% of the quantity of electric power consumed in 2000 by residential and small commercial customers in the affiliated transmission and distribution utility's service area is being served by retail electric providers not affiliated with the incumbent utility. An affiliated retail electric provider may not purchase capacity sold by its affiliated power generation company in the state mandated capacity auction. For additional information regarding the state mandated auctions, please read "Electric Operations -- Generation -- State Mandated Capacity Auctions" in Item 1 of this Form 10-K and Note 4(a) to our consolidated financial statements.

Municipally-owned utilities and electric cooperatives have the option to open their markets to retail competition any time after January 1, 2002. However, until a municipally-owned utility or electric cooperative adopts a resolution opting to open its market to retail competition, it may not offer electric energy at unregulated prices to retail customers outside its service area. In November 2001, Nueces Electric Cooperative and San Patricio Electric Cooperative received Texas Utility Commission approval of required filings necessary to open their markets to retail competition. Some large Texas cities, including San Antonio and Austin, are served by municipally-owned utilities that have not announced when or if they will open their markets to competition.

In December 2001, the Texas Utility Commission established the price to beat which the retail electric providers operated under Reliant Resources are required to charge their residential and small commercial customers for electricity sales in Reliant Energy HL&P's service territory. The price to beat was set at a level resulting in an estimated 17% reduction to pre-existing rates for residential customers and an estimated 22% reduction to pre-existing rates for small commercial customers.

New, unaffiliated retail electric providers that enter a particular market may sell electricity to residential and small commercial customers at any price, including a price below the price to beat. By allowing non-affiliated retail electric providers to provide retail electric service to customers in an electric utility's traditional service territory at any price, including a price below the price to beat, the Texas Electric Restructuring Law is designed to encourage competition among retail electric providers. Affiliated retail electric providers will not be permitted to sell electricity to residential and small commercial customers in the transmission and distribution utility's traditional service territory at a price other than the price to beat until January 1, 2005, unless before that date the Texas Utility Commission determines that 40% or more of the amount of electric power that was consumed in 2000 by the relevant class of customers in the certificated service area of the affiliated transmission and distribution utility is committed to be served by other retail electric providers. In addition, the Texas Electric Restructuring Law requires the affiliated retail electric provider to make the price to beat available to residential and small commercial customers in the traditional service area of the related incumbent utility through January 1, 2007. The price to beat only applies to electric services provided to residential and small commercial customers (i.e. customers with an aggregate peak demand at or below one MW). Electric services provided to large commercial, industrial and institutional customers (i.e. customers with an aggregate peak demand of greater than one MW), whether by the affiliated retail electric provider or a non-affiliated retail electric provider, may be provided at any negotiated price.

The Texas Utility Commission's regulations allow an affiliated retail electric provider to adjust the wholesale energy supply cost component or "fuel factor" included in its price to beat based on a percentage change in the price of natural gas. The fuel factor included in our price to beat was initially set by the Texas Utility Commission at the then average forward 12 month gas price strip of approximately \$3.11/MMBtu. In addition, the affiliated retail electric provider may also request an adjustment as a result of changes in its price of purchased energy. In such a request, the affiliated retail electric provider may adjust the fuel factor to the extent necessary to restore the amount of headroom that existed at the time the initial price to beat fuel factor

was set by the Texas Utility Commission. An affiliated retail electric provider may request that its price to beat be adjusted twice a year. Currently, we cannot estimate with any certainty the magnitude and timing of the adjustments required, if any, and the eventual impact of such adjustments on headroom. To the extent that the adjustments are not received on a timely basis, our Retail Energy business segment's results of operations may be adversely affected. Based on forward gas prices at the end of March 2002, the retail electric providers operated under Reliant Resources estimate they would be able to increase their price to beat by between approximately 4-5%.

The Texas Electric Restructuring Law requires the affiliated retail electric provider to reconcile and credit to the affiliated transmission and distribution utility in early 2004 any positive difference between the price to beat, reduced by a specified delivery charge, and the prevailing market price of electricity unless the Texas Utility Commission determines that, on or prior to January 1, 2004, 40% or more of the amount of electric power that was consumed in 2000 by residential or small commercial customers, as applicable, within the affiliated transmission and distribution utility's traditional service territory is committed to be served by other non-affiliated retail electric providers. If the 40% test is not met, the reconciliation and credit will be in the form of a payment from Reliant Resources to CenterPoint Energy, not to exceed \$150 per customer. For additional information regarding this payment, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources -- Reliant Resources-unregulated businesses -- "Clawback" Payment to Reliant Energy" in Item 7 of this Form 10-K.

The Texas Electric Restructuring Law requires the Texas Utility Commission to designate retail electric providers as POLRs in areas of the state in which retail competition is in effect. A POLR is required to offer a standard retail electric service package for each class of customers designated by the Texas Utility Commission at a fixed, nondiscountable rate approved by the Texas Utility Commission, and is required to provide the service package to any requesting retail customer in the territory for which it is the POLR. In the event that another retail electric provider fails to serve any or all of its customers, the POLR is required to offer that customer the standard retail service package for that customer class with no interruption of service. For additional information regarding the obligations of StarEn Power, a subsidiary of Reliant Resources, as a POLR, and regarding the Texas retail market framework in general, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Retail Energy Operations" in Item 7 of this Form 10-K.

Electric Operations -- Rate Case. On October 3, 2001, the Texas Utility Commission issued an order setting the rates to be charged by the T&D Utility for delivery of electricity beginning in January 2002. The order resulted from a March 31, 2000 filing (Wires Case) with the Texas Utility Commission as required by the Texas Electric Restructuring Law. The Wires Case set the regulated rates for the T&D Utility to be effective when electric competition began. This regulated wires rate, or non-bypassable delivery charge, includes the transmission and distribution rate, a system benefit fund fee, a nuclear decommissioning fund charge, a municipal franchise fee and a transition charge associated with securitization of regulatory assets. In addition, we are required to make a final fuel reconciliation filing under the terms of the Texas Electric Restructuring Law on or before July 1, 2002. For additional information regarding the effects of the Texas Utility Commission's October 3, 2001 order, please read Note 4 to our consolidated financial statements.

Electric Operations -- Fuel Filings. For additional information regarding the fuel filings of our Texas generation business for the recovery of under-recovered fuel costs, please read Note 4(c) to our consolidated financial statements.

Electric Operations -- Stranded Costs and Regulatory Assets. The Texas Electric Restructuring Law provides for the recovery of stranded costs and regulatory assets resulting from the unbundling of generation facilities and the related onset of retail competition. Stranded costs include the positive excess of the regulatory net book value of generation assets over the market value of the assets, taking into account a utility's generation assets, any above-market purchased power costs and any deferred debits relating to a utility's mandatory discontinuance of the application of certain accounting standards for generation-related assets. The Texas Electric Restructuring Law provides several alternatives for the determination of stranded costs, and pursuant to the master separation agreement we have agreed to use the "partial stock valuation"

methodology under which we plan to cause Texas Genco to either issue and sell in an initial public offering or to distribute to our shareholders no more than 20% of Texas Genco's common stock. Under this methodology, the Texas Utility Commission will employ the trading price of the stock on a national exchange over a defined period to arrive at the market value of Texas Genco in order to assess our stranded costs in a proceeding that we will file in 2004. In accordance with the Texas Electric Restructuring Law, beginning on January 1, 2002, and ending when the true-up proceeding is completed in January 2004, any difference between market power prices received in the generation capacity auction and the Texas Utility Commission's earlier estimates of those market prices will be included in the 2004 stranded cost true-up. This component of the true-up is intended to ensure that neither the customers nor Reliant Energy is disadvantaged economically as a result of the two-year transition period by providing this pricing structure. For more information about stranded costs, please read "Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our Electric Operations -- Generation" in Item 7 of this Form 10-K and Note 4(a) to our consolidated financial statements.

Our regulatory assets include the Texas generation business-related portion of the amount reported by us in our 1998 Form 10-K as "regulatory assets and liabilities," offset by the applicable portion of generation-related investment tax credits permitted under the Internal Revenue Code. Pursuant to a financing order issued by the Texas Utility Commission, we issued, through an indirect wholly owned subsidiary, \$749 million aggregate principal amount of transition bonds in October 2001 and used the proceeds to reduce our recoverable regulatory assets by repaying other indebtedness. For more information about the transition bonds and recovery of regulatory assets, please read Note 4(a) to our consolidated financial statements.

We will make a filing in January 2004 in a true-up proceeding provided for by the Texas Electric Restructuring Law. The purpose of this proceeding will be to quantify and reconcile the amount of stranded costs, differences in the capacity auction prices and Texas Utility Commission estimates, unreconciled fuel costs and other regulatory assets associated with our Texas generation business not previously securitized by the transition bonds. We will be required to establish and support the amounts of these costs in order to recover them. For more information about the true-up proceeding, please read Note 4(a) to our consolidated financial statements.

Electric Operations -- Other. Currently, the T&D Utility conducts its electric utility operations under a certificate of convenience and necessity granted by the Texas Utility Commission. The certificate of convenience and necessity covers the present service area and facilities of our Electric Operations business segment. In addition, the T&D Utility holds non-exclusive franchises from the incorporated municipalities in the service territory of our Electric Operations business segment. These franchises give the T&D Utility the right to operate its transmission and distribution system within the streets and public ways of these municipalities for the purpose of delivering electric service to the municipality, its residents and businesses. None of these franchises expires before 2007.

OTHER STATES

Natural Gas Distribution. In almost all communities in which our Natural Gas Distribution business segment provides service, RERC operates under franchises, certificates or licenses obtained from state and local authorities. The terms of the franchises, with various expiration dates, typically range from 10 to 30 years. None of our Natural Gas Distribution business segment's material franchises expire before 2005. We expect to be able to renew expiring franchises. In most cases, franchises to provide natural gas utility services are not exclusive.

Substantially all of our Natural Gas Distribution business segment's retail sales are subject to traditional cost-of-service regulation at rates regulated by the relevant state public service commissions and, in Texas, by the Texas Railroad Commission and municipalities we serve. For additional information regarding our ability to recover increased costs of natural gas from our customers, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Competitive and Other Factors Affecting RERC Operations -- Natural Gas Distribution" in Item 7 of this Form 10-K.

On November 21, 2001, Arkla filed a rate case (Docket 01-243-U) with the Arkansas Public Service Commission seeking an increase in rates for its Arkansas customers of approximately \$47 million on an annual basis. Arkla's last rate increase was authorized in 1995. In the rate filing, Arkla maintains that its rate base has grown by \$183 million, and its operating expenses have increased from \$93 million to \$106 million on an annual basis and, therefore, Arkla's current rates for service to Arkansas customers do not provide a reasonable opportunity for Arkla to cover its operating costs and earn a fair return on its investment. A decision in the case is expected by the fourth quarter of 2002.

NUCLEAR REGULATORY COMMISSION

We are required by NRC regulations to estimate from time to time the amounts required to decommission our ownership share of the South Texas Project and are required to maintain funds to satisfy that obligation when the plant ultimately is decommissioned. We currently collect through our electric rates amounts calculated to provide sufficient funds at the time of decommissioning to discharge these obligations. Those funds are maintained in a nuclear decommissioning trust (Nuclear Decommissioning Trust). Under the Texas Electric Restructuring Law, funds for decommissioning nuclear facilities like the South Texas Project continue to be subject to cost of service rate regulation and are collected by the T&D Utility through a non-bypassable charge from transmission and distribution customers. Funds collected will be deposited into the Nuclear Decommissioning Trust.

When our Texas generation business is transferred to Texas Genco, we will transfer beneficial ownership in the Nuclear Decommissioning Trust to Texas Genco, as the licensee of the facility. In connection with that transfer, we have obtained a private letter ruling from the IRS to confirm that such funds will continue to receive tax treatment they currently hold following the transfer so long as Reliant Energy and its successor continue to own the controlling interest in Texas Genco. After the Restructuring, the T&D Utility will continue to collect amounts authorized under its rates for nuclear decommissioning and will pay the amounts collected to Texas Genco for deposit into the Nuclear Decommissioning Trust. Texas Genco will be responsible for complying with NRC requirements for decommissioning. Under the master separation agreement, however, the T&D Utility is obligated to collect from its customers amounts required to decommission the South Texas Project in the event the funds in the Nuclear Decommissioning Trust prove to be inadequate to satisfy the licensee's obligations, and the T&D Utility has agreed to indemnify Texas Genco from responsibility for additional amounts required even if they are not collected from customers.

While our current funding levels exceed NRC minimum requirements, no assurance can be given that the amounts held in trust will be adequate to cover the actual decommissioning costs of the South Texas Project. Such costs may vary because of changes in the assumed date of decommissioning and changes in regulatory requirements, technology and costs of labor, materials and waste burial. Nor can assurance be given that the current tax treatment accorded funds maintained in the Nuclear Decommissioning Trust or additional amounts deposited can be maintained if Reliant Resources exercises the Texas Genco Option.

For information regarding the NRC's regulation of nuclear decommissioning trust funds, please read Note 14(k) to our consolidated financial statements.

THE NETHERLANDS

Prior to the deregulation of the Dutch wholesale market in 2001, our European Energy business segment sold its generating output to a national production pool and, in return, received a standardized remuneration. The remuneration included fuel cost, return of and on capital and operation and maintenance expenses. Under a transitional agreement which expired in 2000, the non-fuel portion of this amount was fixed during the period 1997 through 2000. For additional information, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of Our European Energy Operations -- Competition in the European Market" and "-- Deregulation of the Dutch Market" in Item 7 of this Form 10-K.

In 2001, the wholesale energy market of our European Energy business segment's primary market in the Netherlands was opened to competition. Our European Energy business segment continues to be subject to

regulation by a number of national and European regulatory agencies and regulations relating to the environment, labor, tax and other matters. For example, our European Energy business segment's operations are subject to the regulation of Dutch and European Community anti-trust authorities, who have extensive authority to investigate and prosecute violations by energy companies of anti-monopolistic and price-fixing regulations. In addition, our European Energy business segment must also comply with various national and regional grid codes and other regulations establishing access to transmission systems. Many of the significant suppliers and customers of our European Energy business segment are subject to continued regulation by various energy regulatory bodies that have the authority to establish tariffs for such entities. The impact of regulations on these entities has an indirect impact on our European Energy business segment.

In some European countries, it is uncertain to what extent companies trading in energy, fuel and other commodities (physical and financial) might be deemed subject to regulation as brokers and dealers under local securities laws. To the extent that its operations are deemed subject to these laws, our European Energy business segment could become subject to minimum capitalization, licensing and reporting requirements similar to those which exist for securities broker and dealer firms. Although our European Energy business segment believes that its operations are currently outside the scope of such regulations, no assurance can be given as to the future positions of these regulatory agencies regarding the applicability of these regulations to our European Energy business segment's operations.

ENVIRONMENTAL MATTERS

GENERAL ENVIRONMENTAL ISSUES

We are subject to numerous federal, state and local requirements relating to the protection of the environment and the safety and health of personnel and the public. These requirements relate to a broad range of our activities, including the discharge of pollutants into air, water, and soil, the proper handling of solid, hazardous, and toxic materials and waste, noise, and safety and health standards applicable to the workplace. In order to comply with these requirements, we will spend substantial amounts from time to time to construct, modify and retrofit equipment, acquire air emission allowances for operation of our facilities, and to clean up or decommission disposal or fuel storage areas and other locations as necessary.

If we do not comply with environmental requirements that apply to our operations, regulatory agencies could seek to impose on us civil, administrative and/or criminal liabilities as well as seek to curtail our operations. Under some statutes, private parties could also seek to impose upon us civil fines or liabilities for property damage, personal injury and possibly other costs.

We anticipate investing up to \$532 million in capital and other special project expenditures between 2002 and 2006 for environmental compliance, \$397 million of which is comprised of projected expenditures for CenterPoint Energy and its subsidiaries after the Distribution and \$135 million of which is comprised of projected expenditures for Reliant Resources and its subsidiaries after the Distribution. In addition, environmental capital expenditures for the recently acquired Orion Power assets over this period are estimated to be \$241 million. We are currently reviewing these estimates. For additional information regarding environmental expenditures, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Environmental Expenditures" in Item 7 of this Form 10-K and Note 14(f) to our consolidated financial statements.

AIR EMISSIONS

As part of the 1990 amendments to the Federal Clean Air Act, requirements and schedules for compliance were developed for attainment of health-based standards. As part of this process, standards for the emission of NOx, a product of the combustion process associated with power generation and natural gas compression, are being developed or have been finalized. The standards require reduction of emissions from our power generating units in the United States and some of our natural gas compression facilities. We believe the reductions will require substantial expenditures in the years 2002 through 2004, with possible additional expenditures after that for our facilities in Texas. The Texas Electric Restructuring Law provides for stranded cost recovery of costs incurred before May 1, 2003 to achieve the NOx reduction requirements. The post-2004

requirements in Texas are currently being litigated, and the outcome of the litigation cannot be predicted at this time. Our facilities in the Netherlands were in compliance with applicable Dutch NOx emission standards through the year 2001. New NOx reduction targets have recently been adopted in the Netherlands which will require a 50% reduction in NOx emissions from 2000 levels by 2010. The reductions may be achieved through the installation of emission control equipment or through the participation in a planned market-based emission trading system. We currently believe that our Dutch facilities will not be required to install NOx controls or purchase emission credits until the 2005 through 2006 time period. Projected emission control costs are estimated to be approximately \$30 million, although this investment may be offset to some extent or delayed if a market-based trading program develops.

The Environmental Protection Agency (EPA) has announced its determination to regulate hazardous air pollutants (HAPs), including mercury, from coal-fired and oil-fired steam electric generating units under Section 112 of the Clean Air Act. The EPA plans to develop maximum achievable control technology (MACT) standards for these types of units. The rulemaking for coal and oil-fired steam electric generating units must be completed by December 2004. Compliance with the rules will be required within three years thereafter. The MACT standards that will be applicable to the units cannot be predicted at this time and may adversely impact our results of operations. In addition, a request for reconsideration of the EPA's decision to impose MACT standards has been filed with the EPA. We cannot predict the outcome of the request.

In 1998, the United States became a signatory to the United Nations Framework Convention on Climate Change (Kyoto Protocol). The Kyoto Protocol calls for developed nations to reduce their emissions of greenhouse gases. Carbon dioxide, which is a major byproduct of the combustion of fossil fuel, is considered to be a greenhouse gas. If the United States Senate ultimately ratifies the Kyoto Protocol, any resulting limitations on power plant carbon dioxide emissions could have a material adverse impact on all fossil fuel fired facilities, including those belonging to us. The European Union, of which the Netherlands is a member, has adopted the Kyoto Protocol as the goal for greenhouse gas emission targets. We expect REPG, our Dutch subsidiary, through use of "green fuels" and efficiency improvements, will be able to meet its portion of the target reductions.

The EPA is conducting a nationwide investigation regarding the historical compliance of coal-fueled electric generating stations with various permitting requirements of the Clean Air Act. Specifically, the EPA and the United States Department of Justice have initiated formal enforcement actions and litigation against several other utility companies that operate these stations, alleging that these companies modified their facilities without proper pre-construction permit authority. Since June 1998, six of our coal-fired facilities operated through Reliant Resources have received requests for information related to work activities conducted at those sites, as have two of our recently acquired Orion Power facilities. The EPA has not filed an enforcement action or initiated litigation in connection with these facilities at this time. Nevertheless, any litigation, if pursued successfully by the EPA, could accelerate the timing of emission reductions currently contemplated for the facilities and result in the imposition of penalties.

In February 2001, the United States Supreme Court upheld a previously adopted EPA ambient air quality standards for fine particulate matter and ozone. While attaining these new standards may ultimately require expenditures for air quality control system upgrades for our facilities, regulations addressing affected sources and required controls are not expected until after 2005. Consequently, it is not possible to determine the impact on our operations at this time.

Multi-pollutant air emission initiative. On February 14, 2002, the White House announced its "Clear Skies Initiative." The proposal is aimed at long term reductions of multiple pollutants produced from fossil fuel-fired power plants. Reductions averaging 70% are targeted for sulfur dioxide (SO₂), NO_x, and mercury. In addition, a voluntary program for greenhouse gas emissions is proposed as an alternative to the Kyoto Protocol discussed above. The implementation of the initiative, if approved by the United States Congress, would be a market-based program beginning in 2008 and phased full compliance by 2018. Fossil fuel-fired power plants in the United States would be affected by the adoption of this program, or other legislation currently pending in the United States Congress addressing similar issues. Such programs would require

compliance to be achieved by the installation of pollution controls, the purchase of emission allowances or curtailment of operations.

WATER ISSUES

In July 2000, the EPA issued final rules for the implementation of the Total Maximum Daily Load program of the Clean Water Act (TMDL). The goal of the TMDL rules is to establish, over the next 15 years, the maximum amounts of various pollutants that can be discharged into waterways while keeping those waterways in compliance with water quality standards. The establishment of TMDL values may eventually result in more stringent discharge limits in each facility's discharge permit. Such limits may require our facilities to install additional water treatment, modify operational practices or implement other wastewater control measures. Certain members of the United States Congress have expressed concern to the EPA about the TMDL program and the EPA, in October 2001, extended the effective date of the regulation until April 2003.

In November 2001, the EPA promulgated rules that impose additional technology based requirements on new cooling water intake structures. Proposed rules for existing intake structures have also been issued. It is not known at this time what requirements the final rules for existing intake structures will impose and whether our existing intake structures will require modification as a result of such requirements. The process by which the intake structure rules were written was contentious and litigation is expected. Court action in response to this expected litigation could result in unforeseen changes in the requirements.

A number of efforts are under way within the EPA to evaluate water quality criteria for parameters associated with the by-products of fossil fuel combustion. These parameters include arsenic, mercury and selenium. Significant changes in these criteria could impact station discharge limits and could require our facilities to install additional water treatment equipment. The impact on us as a result of these initiatives is unknown at this time.

LIABILITY FOR PREEXISTING CONDITIONS AND REMEDIATION

Under the purchase agreements between Sithe Energies and Reliant Energy Power Generation, Inc. (REPG), a subsidiary of Reliant Resources, relating to some of our Northeast regional facilities, and in the transaction with Orion Power, Reliant Resources, with a few exceptions, assumed liability for preexisting conditions, including some ongoing remediations at the electric generating stations. Funds for carrying out any identified actions have been included in our planning for future requirements, and we are not currently aware of any environmental condition at any of our facilities that we expect to have a material adverse effect on our financial position, results of operation or cash flows.

A prior owner of one of our Northeast facilities entered into a Consent Order Agreement with the Pennsylvania Department of Environmental Protection (PaDEP) to remediate a coal refuse pile on the property of the facility. We expect the remediation will cost between \$10 million and \$15 million. Under the acquisition agreements between Sithe Energies and GPU, Inc. (GPU) relating to some of our Northeast regional facilities, GPU has agreed to retain responsibility for up to \$6 million of environmental liabilities associated with the coal refuse site at this facility. We will be responsible for any amounts in excess of that \$6 million. In August 2000 we signed a modified consent order that committed us to complete the remediation work no later than November 2004. In addition to the coal refuse site at this facility, we had liabilities associated with six future ash disposal site closures and six current site investigations and environmental remediations. We expect to pay approximately \$16 million over the next five years to monitor and remediate these sites.

Under the New Jersey Industrial Site Recovery Act (ISRA), owners and operators of industrial properties are responsible for performing all necessary remediation at the facility prior to the closing of a facility and the termination of operations, or undertaking actions that ensure that the property will be remediated after the closing of a facility and the termination of operations. In connection with the acquisition of facilities from Sithe Energies, Reliant Resources has agreed to take responsibility for any costs under ISRA relating to the four New Jersey properties they purchased. They estimate that the costs to fulfill their

obligations under ISRA will be approximately \$10 million. However, these remedial activities are still in the early stages. Following further investigation the scope of the necessary remedial work could increase, and we could, as a result, incur greater costs.

One of our Florida generation facilities operated through Reliant Resources discharges wastewater to percolation ponds which in turn, percolate into the groundwater. Elevated levels of vanadium and sodium have been detected in groundwater monitoring wells. A noncompliance letter has been received from the Florida Department of Environmental Protection. A study to evaluate the cause of the elevated constituents has been undertaken. At this time, if remediation is required, the cost, if any, is not anticipated to be material.

As a result of their age, many of our facilities contain significant amounts of asbestos insulation, other asbestos containing materials, as well as lead-based paint. Existing state and federal rules require the proper management and disposal of these potentially toxic materials. We have developed a management plan that includes proper maintenance of existing non-friable asbestos installations, and removal and abatement of asbestos containing materials where necessary because of maintenance, repairs, replacement or damage to the asbestos itself. We have planned for the proper management, abatement and disposal of asbestos and lead-based paint at our facilities in our financial planning.

Manufactured Gas Plant Sites. RERC and its predecessors operated a manufactured gas plant until 1960 adjacent to the Mississippi River in Minnesota formerly known as Minneapolis Gas Works. RERC has substantially completed remediation of the main site other than ongoing water monitoring and treatment. The manufactured gas was stored in separate holders. RERC is negotiating cleanup of one such holder. There are six other former manufactured gas plant sites in the Minnesota service territory. Remediation has been completed on one site. Of the remaining five sites, RERC believes that two were neither owned nor operated by RERC. RERC believes it has no liability with respect to the sites we neither owned nor operated.

At December 31, 2000 and 2001, RERC had accrued \$18 million and \$23 million, respectively, for remediation of the Minnesota sites. At December 31, 2001, the estimated range of possible remediation costs was \$11 million to \$49 million. The cost estimates of the Minneapolis Gas Works site are based on studies of that site. The remediation costs for the other sites are based on industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites remediated, the participation of other potentially responsible parties, if any, and the remediation methods used.

Issues relating to the identification and remediation of manufactured gas plants are common in the natural gas distribution industry. RERC has received notices from the United States Environmental Protection Agency and others regarding its status as a potentially responsible party for other sites. Based on current information, RERC has not been able to quantify a range of environmental expenditures for potential remediation expenditures with respect to other manufactured gas plant sites.

Hydrocarbon Contamination. In August 2001, a number of Louisiana residents who live near the Wilcox Aquifer filed suit against RERC Corp., Reliant Energy Pipeline Services, Inc., other Reliant Energy entities and third parties (Docket No. 460, 916-Div. "B"), in the 1st Judicial District Court, Caddo Parish, Louisiana. The suit alleges that we and the other defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer, which lies beneath property owned or leased by the defendants and is the sole or primary drinking water aquifer in the area. The quantity of monetary damages sought is unspecified. For additional information regarding this suit and the remediation of the site, please read note 14(f) to our consolidated financial statements.

Other Minnesota Matters. At December 31, 2000 and 2001, RERC had recorded accruals of \$4 million and \$5 million, respectively, for other environmental matters in Minnesota for which remediation may be required. At December 31, 2001, the estimated range of possible remediation costs was \$4 million to \$8 million.

MERCURY CONTAMINATION

Like similar companies, our pipeline and natural gas distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may

have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area around the meters with elemental mercury. We have found this type of contamination in the past, and we have conducted remediation at sites found to be contaminated. Although we are not aware of additional specific sites, it is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total amount of these costs cannot be known at this time, based on our experience and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, we believe that the cost of any remediation of these sites will not be material to our financial position, results of operations or cash flows. For additional information regarding environmental expenditures associated with mercury contamination, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting our Future Earnings -- Environmental Expenditures -- Water, Mercury and Other Expenditures" in Item 7 of this Form 10-K.

Under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, or CERCLA, owners and operators of facilities from which there has been a release or threatened release of hazardous substances, together with those who have transported or arranged for the disposal of those substances, are liable for:

- The costs of responding to that release or threatened release; and
- The restoration of natural resources damaged by any such release.

We are not aware of any liabilities under CERCLA that would have a material adverse effect on us, our financial position, results of operations or cash flows.

EUROPEAN ENERGY

European and Dutch environmental laws are among the most stringent in the industrial world. Under Dutch environmental laws, an environmental permit is required to be maintained for each generation facility. As is customary in Dutch practice, our European Energy business segment has, together with other industry participants, entered into various contractual agreements with the national government on specific environmental matters, including the reduction of the use of coal and other fossil fuel. The environmental laws also address public safety. We believe our European Energy business segment holds all necessary authorizations and approvals for its current operations.

The European Union, of which the Netherlands is a member, adopted the Kyoto Protocol as the goal for greenhouse gas emission targets. For further discussion of the protocol, please read "-- Air Emissions." We believe our European Energy business segment will meet its current portion of target reductions because of its use of "green fuels" and efficiency improvements to its facilities.

NOx reduction targets will require a 50% reduction in NOx emissions from 2000 levels by 2010. The reductions may be achieved through the installation of emission control equipment or through the participation in a planned market-based emission trading system. Our European facilities are in compliance with current and applicable Dutch NOx emission standards. Based on current factors, we believe that our European facilities will not be required to install NOx controls or purchase emission credits until the 2005-2006 time period.

We estimate that we will spend approximately \$30 million in emission control and other environmental costs associated with our European Energy business segment for the period 2002 through 2006. In addition, we expect to spend approximately \$18 million in asbestos and other environmental remediation programs during this period.

OTHER

We have been named, along with numerous others, as a defendant in a number of lawsuits filed by a large number of individuals who claim injury due to exposure to asbestos while working at sites along the Texas Gulf Coast. Most of these claimants have been workers who participated in construction of various industrial

facilities, including power plants, and some of the claimants have worked at locations owned by us. We anticipate that additional claims like those received may be asserted in the future, and we intend to continue our practice of vigorously contesting claims that we do not consider to have merit. Although their ultimate outcome cannot be predicted at this time, we do not believe, based on our experience to date, that these matters, either individually or in the aggregate, will have a material adverse effect on our financial position, results of operations or cash flows.

EMPLOYEES

As of December 31, 2001, we had 16,563 full-time employees. The following table sets forth the number of our employees by business segment as of December 31, 2001:

BUSINESS SEGMENT NUMBER - -----	
Electric	
Operations.....	
5,741 Natural Gas	
Distribution.....	4,943
Pipelines and	
Gathering.....	614
Wholesale	
Energy.....	
2,395 European	
Energy.....	
916 Retail	
Energy.....	
1,202 Latin	
America.....	
398 Other	
Operations.....	
749 -----	
Total.....	16,958 =====

The number of our employees who were represented by unions or other collective bargaining groups as of December 31, 2001 include (i) Electric Operations, 2,735; (ii) Natural Gas Distribution, 1,542; (iii) Wholesale Energy, 810; and (iv) European Energy, 745.

EXECUTIVE OFFICERS OF RELIANT ENERGY
(AS OF MARCH 1, 2002)

OFFICER NAME AGE SINCE	
PRESENT POSITION - -----	
----- R.	
Steve	
Letbetter(1).....	
53 1978 Chairman, President,	
Chief Executive Officer and	
Director Robert W.	
Harvey(1).....	
46 1999 Vice Chairman David	
M.	
McClanahan(2).....	
52 1986 Vice Chairman,	
President and Chief	
Operating Officer, Reliant	
Energy Regulated Group	
Stephen W.	
Naeve(1).....	
54 1988 Vice Chairman and	
Chief Financial Officer Joe	
Bob	
Perkins(1).....	
41 1996 President and Chief	
Operating Officer, Reliant	
Energy Wholesale Group Hugh	
Rice	
Kelly(1).....	
59 1984 Executive Vice	
President, General Counsel	
and Corporate Secretary Mary	
P.	
Ricciardello(1).....	
46 1993 Senior Vice	
President and Chief	
Accounting Officer	

(1) Effective as of the Restructuring, these individuals will continue to serve

in the indicated capacities for CenterPoint Energy. Effective as of the Distribution, these individuals will resign their positions with CenterPoint Energy, except that Mr. Letbetter will continue to serve as non-executive Chairman of the CenterPoint Energy Board of Directors.

- (2) Effective as of the Distribution, Mr. McClanahan will become President and Chief Executive Officer of CenterPoint Energy.

Mr. Letbetter has served as Chairman of Reliant Energy since January 2000 and as President and Chief Executive Officer of Reliant Energy since June 1999. He has been a director of Reliant Energy since 1995. He has served in various executive officer capacities with Reliant Energy since 1978.

Mr. Harvey has served as Vice Chairman of Reliant Energy since June 1999. Prior to joining Reliant Energy, he served as a director in the Houston office of McKinsey & Company, Inc.

Mr. Naeve has served as Vice Chairman of Reliant Energy since June 1999 and as Chief Financial Officer of Reliant Energy since 1997. Between 1997 and 1999, he served as Executive Vice President and Chief Financial Officer of Reliant Energy. He has served in various executive officer capacities with Reliant Energy since 1988.

Mr. Perkins has served as President and Chief Operating Officer, Reliant Energy Wholesale Group, and as President and Chief Operating Officer, Reliant Energy Power Generation, Inc. since 1998. In 1998, Mr. Perkins served as President and Chief Operating Officer of the Reliant Energy Power Generation Group. Between 1996 and 1998, Mr. Perkins served as Vice President -- Corporate Planning and Development.

Mr. Kelly has served as Executive Vice President, General Counsel and Corporate Secretary of Reliant Energy since 1997. Between 1984 and 1997, he served as Senior Vice President, General Counsel and Corporate Secretary of Reliant Energy.

Ms. Ricciardello has served as Chief Accounting Officer of Reliant Energy since June 2000 and as Senior Vice President since June 1999. Between 1999 and 2000, she served as Senior Vice President and Comptroller of Reliant Energy. She also served as Vice President and Comptroller of Reliant Energy from 1996 to 1999. She has served in various executive officer capacities with Reliant Energy since 1993.

We currently expect that at the time of the Distribution, David M. McClanahan will become President and Chief Executive Officer of CenterPoint Energy. Mr. McClanahan, who is 52 years old, has served as Vice Chairman of Reliant Energy since October 2000 and as President and Chief Operating Officer of Reliant Energy's Regulated Group since 1999. He served as President and Chief Operating Officer of Reliant Energy HL&P from 1997 to 1999. He has served in various executive officer capacities with Reliant Energy since 1986.

ITEM 3. LEGAL PROCEEDINGS

For a description of certain legal and regulatory proceedings affecting us, see Notes 4, 14(f), 14(g) and 21 to our consolidated financial statements, which notes are incorporated herein by reference.

RESTATEMENT OF SECOND AND THIRD QUARTER 2001 RESULTS OF OPERATIONS

On February 5, 2002, Reliant Energy announced that it was restating its earnings for the second and third quarters of 2001. As more fully described in Reliant Energy's March 15, 2002 Current Report on Form 8-K, the restatement related to a correction in accounting treatment for a series of four structured transactions that were inappropriately accounted for by Reliant Resources as cash flow hedges for the period of May 2001 through September 2001, rather than as derivatives with changes in fair value recognized through the income statement. Each structured transaction involved a series of forward contracts to buy and sell an energy commodity in 2001 and to buy and sell an energy commodity in 2002 or 2003.

At the time of the public announcement of Reliant Energy's intention to restate its reporting of the structured transactions, the Audit Committees of each of the boards of directors of Reliant Energy and Reliant Resources instructed Reliant Resources to conduct an internal audit review to determine whether there were any other transactions included in the asset books as cash flow hedges that failed to meet the cash flow hedge requirements under Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting

for Derivative Instruments and Hedging Activities" (SFAS No. 133). This targeted internal audit review found no other similar transactions.

The Audit Committees also directed an internal investigation by outside legal counsel of the facts and circumstances leading to the restatement, which investigation has been completed. In connection with the restatement and related investigations, the Audit Committees have met eight times to hear and assess reports from the investigative counsel regarding its investigation and contacts with the staff of the SEC. To address the issues identified in the investigation process, the Audit Committees and management have begun analyzing and implementing remedial actions, including, among other things, changes in organizational structure and enhancement of internal controls and procedures.

On April 5, 2002, Reliant Resources was advised that the Staff of the Division of Enforcement of the SEC is conducting an informal inquiry into the facts and circumstances surrounding the restatement. Reliant Resources is cooperating with this inquiry. Before releasing its 2001 earnings, Reliant Energy received concurrence from the SEC's accounting staff on the accounting treatment of the restatement, which increased its earnings for the two quarters by a total of \$107 million. At this time, we cannot predict the outcome of the SEC's inquiry. In addition, we cannot predict what effect the inquiry may have on our pending application to the SEC under the 1935 Act, which is required for our Restructuring. For more information about our Restructuring, please read "Our Business -- Status of Business Separation" and "-- Business Separation" in Item 1 of this Form 10-K.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CERTAIN FACTORS AFFECTING OUR FUTURE EARNINGS

Our past earnings are not necessarily indicative of our future earnings and results of operations. The magnitude of our future earnings and results of our operations will depend on numerous factors including:

- state, federal and international legislative and regulatory developments, including deregulation, re-regulation and restructuring of the electric utility industry, changes in or application of environmental and other laws and regulations to which we are subject and changes in or application of laws or regulations applicable to other aspects of our business, such as commodities trading and hedging activities;
- the timing of the implementation of our Business Separation Plan;
- the effects of competition, including the extent and timing of the entry of additional competitors in our markets;
- liquidity concerns in our markets;

- industrial, commercial and residential growth in our service territories;
- the degree to which Reliant Resources successfully integrates the operations and assets of Orion Power into the Wholesale Energy business segment;
- the determination of the amount of our Texas generation business' stranded costs and the recovery of these costs;
- the availability of adequate supplies of fuel, water, and associated transportation necessary to operate our generation facilities;
- our pursuit of potential business strategies, including acquisitions or dispositions of assets or the development of additional power generation facilities;
- state, federal and other rate regulations in the United States and in foreign countries in which we operate or into which we might expand our operations;
- the timing and extent of changes in interest rates and commodity prices, particularly natural gas prices;
- weather variations and other natural phenomena, which can affect the demand for power from, or our ability to produce power at our generating facilities;
- our ability to cost-effectively finance and refinance;
- the degree to which we successfully integrate the operations and assets of Orion Power into our Wholesale Energy segment;
- the successful and timely completion of our construction programs, as well as the successful start-up of completed projects;
- financial market conditions, our access to and cost of capital and the results of our financing and refinancing efforts, including availability of funds in the debt/capital markets for merchant generation companies;
- the credit worthiness or bankruptcy or other financial distress of our trading, marketing and risk management services counterparties;
- actions by rating agencies with respect to us or our competitors;
- acts of terrorism or war;
- the availability and price of insurance;
- the reliability of the systems, procedures and other infrastructure necessary to operate our retail electric business, including the systems owned and operated by ERCOT;
- political, legal, regulatory and economic conditions and developments in the United States and in foreign countries in which we operate or into which we might expand our operations, including the effects of fluctuations in foreign currency exchange rates;
- the resolution of the refusal by California market participants to pay our receivables balances due to the recent energy crisis in the West region; and
- the successful operation of deregulating power markets.

In order to adapt to the increasingly competitive environment in our industry, we continue to evaluate a wide array of potential business strategies, including business combinations or acquisitions involving other utility or non-utility businesses or properties, dispositions of currently owned businesses, as well as developing new generation projects, products, services and customer strategies.

FACTORS ASSOCIATED WITH THE BUSINESS SEPARATION, RESTRUCTURING AND DISTRIBUTION

As previously discussed, in anticipation of electric deregulation in Texas, and pursuant to the Texas Electric Restructuring Law, we submitted a business separation plan in January 2000 to the Texas Utility Commission. Pursuant to the Business Separation Plan, we are in the process of separating our regulated and our unregulated businesses into two separate publicly traded companies.

After the Restructuring, we plan, subject to further corporate approvals, market and other conditions, to complete the separation of our regulated and unregulated businesses through the Distribution. Our goal is to complete the Restructuring and subsequent Distribution as quickly as possible after all the necessary conditions are fulfilled, including receipt of an order from the SEC granting the required approvals under the Public Utility Holding Company Act of 1935 (1935 Act) and an extension from the IRS for a private letter ruling we have obtained regarding the tax-free treatment of the Distribution. We currently expect to complete the Restructuring and Distribution in the summer of 2002. See "Our Business -- Business Separation" in Item 1 of this Form 10-K.

Regulatory Uncertainty. The Restructuring as currently planned cannot be completed unless and until the SEC issues an order approving the acquisition by CenterPoint Energy of Reliant Energy and its subsidiary companies and either granting CenterPoint Energy an exemption from regulation as a registered public utility holding company under the 1935 Act or the necessary authority to operate as a registered holding company. While we believe such an order will be received, and that both the Restructuring and Distribution will be completed during the summer of 2002, there can be no assurances that such will be the case. The Restructuring has been designed to enable us to meet all of the requirements of the Texas Electric Restructuring Law. We have not formulated an alternative restructuring plan that could be implemented if the SEC fails or refuses to grant an exemption for CenterPoint Energy or the authority for CenterPoint Energy to become a registered holding company on terms consistent with our business plan. For information about an informal inquiry by the staff of the Division of Enforcement of the SEC in connection with an earnings restatement by Reliant Energy that might impact the approval process, please read "Restatement of Second and Third Quarter 2001 Results of Operations" in Item 3 of this Form 10-K.

The tax ruling that we received from the IRS expires at the end of April 2002. We are currently seeking an extension of this ruling from the IRS. There can be no assurance that we will receive the extension quickly or at all. In this event, the Restructuring and Distribution are not likely to be completed within our expected time frame, or, perhaps, at all. In addition, our tax ruling contemplates that the Restructuring will occur prior to the Distribution. If, due to delay or uncertainty regarding receipt of an order under the 1935 Act, we decide to make the Distribution before completing the Restructuring, we would have to seek a new ruling from the IRS that the Distribution would be tax free to us and to our shareholders. This process could take six months or longer.

A significant delay in completing the Restructuring and the Distribution may impact planned financings by each of Reliant Energy and Reliant Resources and make it more difficult and more expensive for us to obtain bank financing. We cannot predict how any such delay might impact our credit ratings or those of Reliant Resources.

Adverse Tax Consequences. If we take actions which cause the Distribution to fail to qualify as a tax-free transaction, we will incur taxable gain equal to the positive difference between the value of the Reliant Resources shares distributed and our tax basis in those shares. Current tax law provides that, depending on the facts and circumstances, the Distribution may be taxable if either CenterPoint Energy or Reliant Resources undergo a 50% or greater change in stock ownership within two years after the Distribution. These costs may be so great that they delay or prevent a strategic acquisition or change in control of our company. If Reliant Resources takes actions which cause the Distribution to fail to qualify as a tax-free transaction, for example, through a change in control of Reliant Resources, we will be responsible for the tax due on the gain but may seek indemnity from Reliant Resources for such payments.

Credit. To the extent that we continue to need access to current amounts of committed credit prior to the Distribution, we expect to extend or replace the credit facilities on a timely basis. The terms of any new

credit facilities are expected to be adversely affected by our leverage, the amount of bank capacity utilized, any delay in the date of Restructuring and Distribution and conditions in the bank market. These same factors are expected to make the syndication of new credit facilities more difficult in the future. Proceeds from any issuance of debt in the capital markets are expected to be used to retire a portion of our short-term debt and reduce our need for committed revolving credit facilities.

FACTORS AFFECTING THE RESULTS OF OUR ELECTRIC OPERATIONS

Deregulation. In June 1999, the Texas legislature adopted the Texas Electric Restructuring Law, which substantially amended the regulatory structure governing electric utilities in Texas in order to allow retail competition. Retail pilot projects for up to 5% of each utility's load in all customer classes began in August 2001 and retail electric competition for all other customers began on January 1, 2002. We have made significant changes in the electric utility operations previously conducted through Reliant Energy HL&P. For additional information regarding these changes, please read "Our Business -- Deregulation," "-- Electric Operations," "-- Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" and "-- Our Business Going Forward" in Item 1 of this Form 10-K and Note 4 to our consolidated financial statements.

Transmission and Distribution. Under the Texas Electric Restructuring Law, our T&D Utility will remain subject to traditional rate regulation by the Texas Utility Commission, and we will collect from retail electric providers the rates approved in the T&D Utility's rate case (Wires Case) to cover the cost of providing transmission and distribution service and any other expenses. Our ability to earn the rate of return built into the T&D Utility's rates may be affected, positively or negatively, to the extent that the T&D Utility's actual expenses or revenues differ from the estimates used to set the T&D Utility's rates.

Generation. As described under "Electric Operations -- Generation," since January 1, 2002, we have been obligated to sell substantially all of the generating capacity and related ancillary services of our Texas generation business through auctions. As a result, we are not guaranteed any rate of return on our investment in these generation facilities through mandated rates, and our revenues and results of operations are likely to depend, in large part, upon prevailing market prices for electricity in the Texas market and the related results of our capacity auctions. These market prices may fluctuate substantially over relatively short periods of time. In addition, ERCOT, the independent system operator for the Texas markets, may impose price limitations, bidding rules and other mechanisms that may impact wholesale power prices in the Texas market and the outcome of our capacity auctions. Our historical financial results represent the results of our Texas generation business as part of an integrated utility in a regulated market and may not be representative of its results as a stand-alone wholesale electric power generation company in an unregulated market. Therefore, the historical financial information included in this report does not necessarily reflect what our financial position, results of operations and cash flows would have been had our generation facilities been operated in an unregulated market.

Under the terms of the auctions pursuant to which we are obligated to sell our capacity, we are obligated to provide specified amounts of capacity to successful bidders. The products we sell in the auctions are only entitlements to capacity dispatched from our units and do not convey the right to have power dispatched from a particular unit. This flexibility exposes us to the risk that, depending on the availability of our units, we could be required to supply energy from a higher cost unit to meet an obligation for lower cost generation or to obtain the energy on the open market. Obtaining such replacement generation could involve significant additional costs. We manage this risk by maintaining appropriate reserves within our generation asset base but these reserves may not cover an entire exposure in the event of a significant outage at one of our facilities. For information about operating risks associated with our Texas generation business, please read "Factors Affecting the Results of Our Wholesale Energy Operations -- Operating Risks" below.

Also, market volatility in the price of fuel for our generation operations, as well as in the price of purchased power, could have an effect on our cost to generate or acquire power. For additional information regarding commodity prices and supplies, please read "-- Factors Affecting the Results of Our Wholesale Energy Operations -- Price Volatility."

Pursuant to the Texas Electric Restructuring Law, we will be entitled to recover our stranded costs (i.e., the excess of regulatory net book value of generation assets, as defined by the Texas Electric Restructuring Law, over the market value of those assets) and our regulatory assets related to generation. The Texas Electric Restructuring Law prescribes specific methods for determining the amount of stranded costs and the details for their recovery, and our recovery of stranded costs is dependent upon the outcome of regulatory proceedings in which we will be required to establish the extent of our stranded costs and related underlying matters. During the base rate freeze period from July 1999 through 2001, earnings above the utility's authorized rate of return formula were applied in a manner to accelerate depreciation of generation related plant assets for regulatory purposes. In addition, depreciation expense for transmission and distribution related assets was redirected to generation assets for regulatory purposes from 1998. The Texas Electric Restructuring Law also provided for us, or a special purpose entity formed by us, to issue securitization bonds for the recovery of generation related regulatory assets and a portion of stranded costs. Reliant Energy Transition Bond Company LLC, our wholly owned subsidiary, issued \$749 million of securitization bonds on October 24, 2001. Any stranded costs not recovered through the sale of securitization bonds may be recovered through a charge to transmission and distribution customers. For additional information regarding these securitization bonds, please read Note 4(a) to our consolidated financial statements. For information regarding recovery of under-collected fuel expenses, please read "Liquidity and Capital Resources -- Future Sources and Uses of Cash -- Fuel Filing in Item 7 of this Form 10-K".

The Texas Utility Commission issued a final order on October 3, 2001 (October 3, 2001 Order) that established the transmission and distribution rates that became effective January 2002. In this Order, the Texas Utility Commission found that we had overmitigated our stranded costs by redirecting transmission and distribution depreciation and by accelerating depreciation of generation assets as provided under the Transition Plan and Texas Electric Restructuring Law. In December 2001, we recorded a regulatory liability of \$1.1 billion to reflect the prospective refund of accelerated depreciation, removed our previously recorded embedded regulatory asset of \$841 million related to redirected depreciation and recorded a regulatory asset of \$2.0 billion based upon current projections of market value of the Reliant Energy HL&P generation assets to be covered by the 2004 true-up proceeding provided for in the Texas Electric Restructuring Law. Recovery of this asset is subject to regulatory risk. We began refunding the excess mitigation credits in January 2002 and will continue over a seven year period. If events occur that make the recovery of all or a portion of the regulatory assets no longer probable, we will write off the corresponding balance of these assets as a charge against earnings. One of the results of discontinuing the application of regulatory accounting for the generation operations is the elimination of the regulatory accounting effects of excess deferred income taxes and investment tax credits related to these operations. We believe it is probable that some parties will seek to return these amounts to ratepayers and, accordingly, we have recorded an offsetting liability.

The Texas Electric Restructuring Law requires us to auction 15% of the output of the installed generating capacity of our Texas generation business until January 1, 2007 unless certain criteria are met (state mandated auctions). In addition, the master separation agreement between Reliant Energy and Reliant Resources requires us to auction to third parties, including Reliant Resources, the capacity available in excess of amounts included in the state mandated auctions (contractually mandated auctions). Beginning January 2002, our Texas generation business began delivering power sold through the state mandated auctions and contractually mandated auctions at market rates. However, the Texas Electric Restructuring Law provides for recovery of any difference between market power prices received in these capacity auctions and the Texas Utility Commission's earlier estimates of those market prices. This capacity auction true-up should provide for revenues earned by our Texas generation business during the two-year period ending December 2003 to approximate a regulated return on the invested capital of our Texas generation business. The Texas Utility Commission's estimate serves as a preliminary identification of stranded costs for recovery through securitization. This component of the true-up is intended to ensure that neither the customers nor we are disadvantaged economically as a result of the two-year transition period by providing this pricing structure. The underlying data for the true-up calculation has not been finalized. Because the capacity true-up process provided for in the Texas Electric Restructuring Law will take into account only the prices we receive in the state mandated auctions, lower prices that we may receive in the contractually mandated auctions will not be considered and

we may therefore not recover all of our stranded costs. We cannot predict the amount, if any, of these costs that would not be recovered.

Retail. For a discussion of factors affecting our retail operations, please read "-- Factors Affecting the Results of Our Retail Operations."

Other. For additional information regarding litigation over franchise fees, please read Note 14(f) to our consolidated financial statements.

FACTORS AFFECTING THE RESULTS OF RERC'S OPERATIONS

Natural Gas Distribution. Our Natural Gas Distribution business segment competes primarily with alternate energy sources such as electricity and other fuel sources. In some areas, intrastate pipelines, other gas distributors and marketers also compete directly with our Natural Gas Distribution business segment for gas sales to end-users. In addition, as a result of federal regulatory changes affecting interstate pipelines, natural gas marketers operating on these pipelines may be able to bypass our Natural Gas Distribution business segment's facilities and market, sell and/or transport natural gas directly to commercial and industrial customers.

Generally, the regulations of the states in which our Natural Gas Distribution business segment operates allow us to pass through changes in the costs of natural gas to our customers through purchased gas adjustment provisions in rates. There is, however, an inherent timing difference between our purchases of natural gas and the ultimate recovery of these costs. Consequently, we may incur additional "carrying" costs as a result of this timing difference and the resulting, temporary under-recovery of our purchased gas costs. To a large extent, these additional carrying costs are not recovered from our customers.

On November 21, 2001, Arkla filed a rate case (Docket 01-243-U) with the Arkansas Public Service Commission seeking an increase in rates for its Arkansas customers of approximately \$47 million on an annual basis. Arkla's last rate increase was authorized in 1995. In the rate filing, Arkla maintains that its rate base has grown by \$183 million, and its operating expenses have increased from \$93 million to \$106 million on an annual basis and, therefore, Arkla's current rates for service to Arkansas customers do not provide a reasonable opportunity for Arkla to cover its operating costs and earn a fair return on its investment. A decision in the case is expected by the fourth quarter of 2002.

Pipelines and Gathering. Our Pipelines and Gathering business segment competes with other interstate and intrastate pipelines in the transportation and storage of natural gas. The principal elements of competition among pipelines are rates, terms of service, and flexibility and reliability of service. Our Pipelines and Gathering business segment competes indirectly with other forms of energy available to its customers, including electricity, coal and fuel oils. The primary competitive factor is price. Changes in the availability of energy and pipeline capacity, the level of business activity, conservation and governmental regulations, the capability to convert to alternative fuels, and other factors, including weather, affect the demand for natural gas in areas we serve and the level of competition for transportation and storage services. Since FERC Order No. 636, REGT's and MRT's commodity sales activity has been minimal. Commodity transactions are usually related to system management activity which we have been able to manage with little exposure. We have not been nor do we anticipate being negatively impacted by higher price levels and the tightening of supply experienced in the fourth quarter of 2000 and the first quarter of 2001. In addition, competition for our gathering operations is impacted by commodity pricing levels in its markets because these prices influence the level of drilling activity in those markets.

Natural Gas Pipeline Company of America has proposed, and is soliciting customers for a 30" pipeline paralleling MRT's East Line in Illinois to a point 17 miles east of St. Louis Metro, with a proposed in-service date of June 2002. This service would represent an alternative to that provided by MRT. MRT has renewed or is engaged in negotiations to renew service agreements under multi-year terms, including service and potential expansion needs along MRT's existing East Line in Illinois. Our Pipelines and Gathering business segment derives approximately 14% of its revenues from Laclede Gas Company, which has an annual evergreen term provision. In February 2002, MRT negotiated an agreement to extend its existing service relationship with Laclede for a five year period subject to acceptance by the FERC. However, the Pipelines and Gathering

business segment's financial results could be materially adversely affected after this five year period if Laclede decides to engage another pipeline for the transportation services currently provided by the Pipelines and Gathering business segment.

FACTORS AFFECTING THE RESULTS OF OUR WHOLESALE ENERGY OPERATIONS

Price Volatility. Our Wholesale Energy business segment, which is conducted through Reliant Resources, sells electricity from its facilities into spot markets under short- and long-term contractual arrangements. We are not guaranteed any rate of return on our capital investments through cost of service rates, and our revenues and results of operations are likely to depend, in large part, upon prevailing market prices for electricity and fuel in our regional markets. In addition to our power generation operations, we trade and market power. Market prices may fluctuate substantially over relatively short periods of time. Demand for electricity can fluctuate dramatically, creating periods of substantial under- or over-supply. During periods of over-supply, prices are depressed. During periods of under-supply, there is frequently regulatory or political pressure to regulate prices to compensate for product scarcity.

In addition, the FERC, which has jurisdiction over wholesale power rates, as well as independent system operators that oversee some of these markets, have imposed price limitations, bidding rules and other mechanisms to attempt to address some of the volatility in these markets and mitigate market prices. For a discussion of the implementation of price limitations and other rules in the California market, please read Note 14(g) to our consolidated financial statements.

Most of our Wholesale Energy business segment's domestic power generation facilities purchase fuel under short-term contracts or on the spot market. Fuel prices may also be volatile, and the price we can obtain for power sales may not change at the same rate as changes in fuel costs. In addition, we trade and market natural gas and other energy-related commodities. These factors could have an adverse impact on our revenues, margins and results of operations.

Volatility in market prices for fuel and electricity may result from:

- weather conditions;
- seasonality;
- forced or unscheduled plant outages;
- addition of generating capacity;
- changes in market liquidity;
- disruption of electricity or gas transmission or transportation, infrastructure or other constraints or inefficiencies;
- availability of competitively priced alternative energy sources;
- demand for energy commodities and general economic conditions;
- availability and levels of storage and inventory for fuel stocks;
- natural gas, crude oil and refined products, and coal production levels;
- natural disasters, wars, embargoes and other catastrophic events; and
- federal, state and foreign governmental regulation and legislation.

Risks Associated with Our Hedging and Risk Management Activities. To lower our financial exposure related to commodity price fluctuations, our trading, marketing and risk management services operations routinely enter into contracts to hedge a portion of our purchase and sale commitments, exposure to weather fluctuations, fuel requirements and inventories of natural gas, coal, crude oil and refined products, and other commodities. As part of this strategy, we routinely utilize fixed-price forward physical purchase and sales contracts, futures, financial swaps and option contracts traded in the over-the-counter markets and on exchanges. However, we do not expect to cover the entire exposure of our assets or our positions to market price volatility, and the coverage will vary over time. This hedging activity fluctuates according to strategic objectives, taking into account the desire for cash flow or earnings certainty and our view on market prices. To the extent we have unhedged positions, fluctuating commodity prices could negatively impact our financial

results and financial position. For additional information regarding the accounting treatment for our hedging, trading and marketing and risk management activities, please read Notes 2(d) and 5 to our consolidated financial statements. For additional information regarding the types of contracts and activities of our trading and marketing operations, please read "-- Trading and Marketing Operations" and "Qualitative and Quantitative Disclosures about Market Risk" in Item 7A of this Form 10-K.

We manage our power generation hedge objectives in the context of market conditions while targeting certain hedge percentages of future earnings through hedge actions in the current year. As of December 31, 2001, we had hedged 39% and 29% of our planned Wholesale Energy margins for 2002 and 2003, respectively, excluding margins related to Orion Power. Margins for 2002 and 2003 are expected to be positively impacted by the acquisition of Orion Power and negatively affected by lower forward electric power prices as they relate to unhedged positions and an estimated decline in our trading and marketing operations due to projected decreases in volatility in energy commodity markets.

At times, we have open trading positions in the market, within established corporate risk management guidelines, resulting from the management of our trading portfolio. To the extent open trading positions exist, changes in commodity prices could negatively impact our financial results and financial position.

The risk management procedures we have in place may not always be followed or may not always work as planned. As a result of these and other factors, we cannot predict with precision the impact that our risk management decisions may have on our businesses, operating results or financial position. For information regarding our risk management policies, please read "Quantitative and Qualitative Disclosures about Market Risk -- Risk Management Structure" in Item 7A to this Form 10-K.

The trading, marketing and risk management services operations conducted by our Wholesale Energy business segment are also exposed to the risk that counterparties who owe us money or physical commodities, such as power, natural gas or coal, will not perform their obligations. Should the counterparties to these arrangements fail to perform, we might be forced to acquire alternative hedging arrangements or replace the underlying commitment at then-current market prices. In this event, we might incur additional losses to the extent of amounts, if any, already paid to the counterparties. For information regarding our credit risk, including exposure to Enron and utilities in California, please read "Quantitative and Qualitative Disclosure About Market Risk -- Credit Risk" in Item 7A of this Form 10-K and Notes 5(c), 14(g) and 21 to our consolidated financial statements.

In the ordinary course of business, and as part of our hedging strategy, we enter into long-term sales arrangements for power, as well as long-term purchase arrangements. For information regarding our long-term fuel supply contracts, purchase power and electric capacity contracts and commitments, electric energy and electric sale contracts and tolling arrangements, please read Notes 5, 14(a) and 14(b) to our consolidated financial statements.

Uncertainty in the California Market. During portions of 2000 and 2001, prices for wholesale electricity in California increased dramatically as a result of a combination of factors, including higher natural gas prices and emission allowance costs, reduction in available hydroelectric generation resources, increased demand, decreased net electric imports and limitations on supply as a result of maintenance and other outages. Because of the high prices that prevailed during this period, we, and several of Reliant Resources' subsidiaries, including Reliant Energy Services and REPG, as well as some of the officers of some of these companies, have been named as defendants in class action lawsuits and other lawsuits filed against a number of companies that own generation plants in California and other sellers of electricity in California markets.

In response to the filing of a number of complaints challenging the level of these wholesale prices, the FERC initiated a staff investigation and issued a number of orders implementing a series of wholesale market reforms and modifications to those reforms. On February 13, 2002, the FERC issued an order initiating a staff investigation into potential manipulation of electric and natural gas prices in the West region for the period

January 1, 2000 forward. Some of our long-term bilateral contracts already have been challenged by one of our many counterparties based on the alleged market dysfunction in Western power markets in 2000 and 2001. If these challenges are successful, the precedent set by the challenge could have larger ramifications to our business and operations beyond the challenged contracts at issue. Furthermore, in addition to FERC investigations, several state and other federal regulatory investigations have commenced in connection with the wholesale electricity prices in California and other neighboring Western states to determine the causes of the high prices and potentially to recommend remedial action.

Finally, there have been proposals in the California state legislature to regulate the operations of our California generating subsidiaries, beyond the existing state regulation regarding siting, environmental and other health and safety matters. For additional information regarding the litigation and market uncertainty in California, please read Notes 14(f) and 14(g) to our consolidated financial statements.

Industry Restructuring, the Risk of Re-regulation and the Impact of Current Regulations. The regulatory environment applicable to the United States electric power industry is undergoing significant changes as a result of varying restructuring initiatives at both the state and federal levels and the reassessment of existing regulatory mechanisms stemming from the California power market situation and the bankruptcy of Enron. These initiatives have had a significant impact on the nature of the industry and the manner in which its participants conduct their business. These changes are ongoing and we cannot predict the future development of restructuring in these markets or the ultimate effect that this changing regulatory environment will have on our business.

Moreover, existing regulations may be revised or reinterpreted, new laws and regulations may be adopted or become applicable to us, our facilities or our commercial activities, and future changes in laws and regulations may have a detrimental effect on our business. Some restructured markets, particularly California, have experienced supply problems and price volatility. These supply problems and volatility have been the subject of a significant amount of press coverage, much of which has been critical of the restructuring initiatives. In some markets, including California, proposals have been made by governmental agencies and/or other interested parties to delay or discontinue proposed restructuring or to re-regulate areas of these markets, especially with respect to residential retail customers, that have previously been deregulated. In this connection, state officials, the California Independent System Operator (Cal ISO) and the investor-owned utilities in California have argued to the FERC that our California generating subsidiaries should not continue to have market-based rate authority. While the FERC to date has consistently refused petitions to force entities with market-based rates to return to cost-based rates, some of these proceedings are ongoing and we cannot predict what action the FERC may take on such petitions in the future. If we were forced to adopt cost-based rates, future earnings would be affected. Furthermore, the Cal ISO is undertaking a market redesign process to fundamentally change the structure of wholesale electricity markets and transmission service in California. These changes, if approved by the FERC, could include a revised market monitoring and mitigation structure, a revised congestion management mechanism and an obligation for load-serving entities in California to maintain capacity reserves. The Cal ISO's stated goal is to complete the first phase of this redesign by September 30, 2002, when the existing FERC market mitigation scheme for California will expire.

On November 20, 2001, the FERC instituted an investigation under Section 206 of the Federal Power Act regarding the tariffs of all sellers with market-based rates authority, including Reliant Energy. For information regarding this FERC proceeding and other FERC actions relating to the California market, please read Note 14(g) to our consolidated financial statements. If the FERC does not modify or reject its proposed approach for dealing with anti-competitive behavior, our future earnings may be affected by the open-ended refund obligation.

Additionally, federal legislative initiatives have been introduced and discussed to address the problems being experienced in some of these markets, including legislation seeking to impose price caps on sales. We cannot predict whether other proposals to re-regulate will be made or whether legislative or other attention to the restructuring of the electric power industry will cause the restructuring to be delayed or reversed. If the trend towards competitive restructuring of the wholesale power markets is reversed, discontinued or delayed,

the business growth prospects and financial results of our Wholesale Energy and Retail Energy segments could be adversely affected.

If RTOs are established as envisioned by Order No. 2000, "rate pancaking," or multiple transmission charges that apply to a single point-to-point delivery of energy will be eliminated within a region, and wholesale transactions within the region, and between regions will be facilitated. The end result could be a more competitive, transparent market for the sale of energy and a more economic and efficient use and allocation of resources; however, considerable opposition exists to the development of RTOs.

The FERC also has initiated a rulemaking proceeding to establish standardized transmission service throughout the United States, a standard wholesale electric market design, including forward and spot markets for energy and an ancillary services market, and specifications regarding the entities that administer these markets and for market monitoring and mitigation, that could be used in all RTOs. We cannot predict at this time what effect FERC's standard market design will have on our business growth prospects and financial results.

Partly in response to the bankruptcy of Enron, there have been proposals in the United States Congress to make online platforms that trade energy and metals derivatives subject to oversight by the Commodities Futures Trading Commission (CFTC), to prohibit market price manipulation and fraud. Under some of these proposals, dealers in energy derivatives would be required to file reports with the CFTC and maintain amounts of capital, as determined by the CFTC, to support the risks of their transactions. Other proposals would require the CFTC to review these markets for potential regulatory recommendations. We do not know what impact, if any, these proposals would have on our business if enacted. Additionally, there may be other broader proposals introduced to submit energy trading to comprehensive regulation by the FERC or by the CFTC.

The acquisition, ownership and operation of power generation facilities require numerous permits, approvals and certificates from federal, state and local governmental agencies. The operation of our generation facilities must also comply with environmental protection and other legislation and regulations. At present, we have operations in Arizona, California, Florida, Illinois, Maryland, Nevada, New Jersey, New York, Ohio, Pennsylvania, Texas and West Virginia. Most of our existing domestic generation facilities are exempt wholesale generators that sell electricity exclusively into the wholesale market. These facilities are subject to regulation by the FERC regarding rate matters and by state public utility commissions regarding siting, environmental and other health and safety matters. The FERC has authorized us to sell our generation from these facilities at market prices. The FERC retains the authority to modify or withdraw our market-based rate authority and to impose "cost of service" rates if it determines that market pricing is not in the public interest.

Uncertainty Related to the New York Regulatory Environment. The New York market is subject to significant regulatory oversight and control. Our operating results are as dependent on the continuance of the regulatory structure as they are on fluctuations in the market price for electricity. The rules governing the current regulatory structure are subject to change. We cannot assure you that we will be able to adapt our business in a timely manner in response to any changes in the regulatory structure, which could have a material adverse effect on our revenues and costs. The primary regulatory risk in this market is associated with the oversight activity of the New York Public Service Commission, the New York Independent System Operator (NYISO) and the FERC.

Our assets located in New York are subject to "lightened regulation" by the New York Public Service Commission, including provisions of the New York Public Service Law that relate to enforcement, investigation, safety, reliability, system improvements, construction, excavation, and the issuance of securities. Because "lightened regulation" was accomplished administratively, it could be revoked.

The NYISO has the ability to revise wholesale prices, which could lead to delayed or disputed collection of amounts due to us for sales of energy and ancillary services. The NYISO also has the ability, in some cases subject to FERC approval, to impose cost-based pricing and/or price caps. The NYISO has implemented a measure known as the "Automated Mitigation Procedure" (AMP) under which day-ahead energy bids will be automatically reviewed and, if necessary, mitigated if economic or physical withholding is determined. Proposed modifications to the AMP provide a level of uncertainty over the impacts of that procedure in the

summer of 2002. FERC has also directed the NYISO to adopt mitigation measures for all limits in New York City consistent with its overall market-monitoring plan. NYISO has filed in-city mitigation measures with the FERC, which it is proposing to be implemented beginning in late spring of 2002. The full impact of these revisions may not be known until the summer of 2002.

Integration and Other Risks Associated with Our Orion Power Assets. We have made a substantial investment in our recent acquisition of Orion Power. If we are unable to profitably integrate, operate, maintain and manage our newly acquired power generation facilities our results of operations will be adversely affected.

Duquesne Light Company is obligated to supply electricity at predetermined tariff rates to all retail customers in its existing service territory who do not select another electricity supplier. Orion Power has committed to provide 100% of the energy that Duquesne Light Company needs to meet this obligation under a contract that was recently extended through December 2004. If our obligation under this contract exceeds the available output from the combination of Orion Power's generation facilities and our additional generation facilities in the region, we would be forced to buy additional energy at prevailing market prices and, in certain cases where we failed to deliver the required amount, we could incur penalties during periods of peak demand of up to \$1,000 per megawatt hour. If this situation were to occur during periods of peak energy prices, we could suffer substantial losses that could materially adversely affect our results of operations. In addition, our revenues generated under this contract may be adversely impacted if a substantial number of Duquesne Light Company's retail customers select other retail electric providers.

Operating Risks. Our Electric Generation, Wholesale Energy operations and our European Energy operations are exposed to risks relating to the breakdown or failure of equipment or processes, fuel supply interruptions, shortages of equipment, material and labor, and operating performance below expected levels of output or efficiency. A significant portion of our facilities were constructed many years ago. Older generating equipment, even if maintained in accordance with good engineering practices, may require significant capital expenditures to add or upgrade equipment to keep it operating at peak efficiency, to comply with changing environmental requirements, or to provide reliable operations. Such changes could affect operating costs. Any unexpected failure to produce power, including failure caused by breakdown or forced outage, could result in reduced earnings.

We depend on transmission and distribution facilities owned and operated by utilities and other power companies to deliver the electricity we sell from our power generation facilities to our customers, who in turn deliver these products to the ultimate consumers of the power. If transmission is disrupted, or transmission capacity is inadequate, our ability to sell and deliver our products may be hindered.

Factors Affecting Our Acquisition and Project Development Activities. Our plans for our Wholesale Energy business segment indicate a shift in emphasis from identifying and pursuing acquisition and development candidates to construction and integration of generation facilities. We believe this is a temporary shift based on the requirements of integrating the Orion Power assets and the maturation of both our and Orion Power's development projects and by the current state of the wholesale electricity and capital markets.

There are numerous risks relating to the acquisition and development of power generation plants and construction and integration of these facilities. We may not be able to identify attractive acquisitions or development opportunities, complete acquisitions or development projects we undertake, or we may not be able to integrate these plants, especially larger acquisitions, into the portfolios of our Wholesale Energy business segment and achieve the synergies, including cost savings, we originally envisioned.

Currently, our Wholesale Energy business segment has a select number of power generation facilities under development and many under construction (either owned or leased). Our completion of these facilities is subject to the following:

- market prices;
- shortages and inconsistent quality of equipment, material and labor;
- financial market conditions and the results of our financing efforts;

- actions by rating agencies with respect to us or our competitors;
- work stoppages, due to plant bankruptcies and contract labor disputes;
- permitting and other regulatory matters;
- unforeseen weather conditions;
- unforeseen equipment problems;
- environmental and geological conditions; and
- unanticipated capital cost increases.

Any of these factors could give rise to delays, cost overruns or the termination of the plant expansion, construction or development. Many of these risks cannot be adequately covered by insurance. While we maintain insurance, obtain warranties from vendors and obligate contractors to meet specified performance standards, the proceeds of such insurance, warranties or performance guarantees may not be adequate to cover lost revenues, increased expenses or liquidated damages payments we may owe.

If we were unable to complete the development of a facility, we would generally not be able to recover our investment in the project. The process for obtaining initial environmental, siting and other governmental permits and approvals is complicated, expensive, lengthy and subject to significant uncertainties. Transmission interconnection, fuel supply and cooling water represent some cost uncertainties during project development that may also result in termination of the project. In addition, construction delays and contractor performance shortfalls can result in the loss of revenues and may, in turn, adversely affect our results of operations. The failure to complete construction according to specifications can result in liabilities, reduced plant efficiency, higher operating costs and reduced earnings. We may not be successful in the development or construction of power generation facilities in the future.

As a result of several recent events, including the United States economic recession, the price decline of our industry sector in the equity capital markets and the downgrading of the credit ratings of several of our significant competitors, the availability and cost of capital for our business and the businesses of our competitors has been adversely affected. In response to these events and the intensified scrutiny of companies in our industry sector by the rating agencies, our Wholesale Energy business segment has reduced its planned capital expenditures by \$2.7 billion over the 2002-2006 time frame.

Successful integration of plants, especially acquisitions, is subject to a number of risks, including the following:

- unforeseen liabilities or other exposures;
- inaccurate due diligence of acquired facilities, such as underestimates of outage rates and operating costs;
- inability to achieve adequate cost savings in both overhead and operations;
- inability to achieve various commercial synergies with existing operations; and
- market prices for power and fuels.

Any of these factors could significantly affect the economic impact of an acquisition on our results of operations.

As part of this integration process and our temporary shift in emphasis, the Orion Power plants will be part of an operations improvement process that strives to achieve both reduced operating and maintenance costs and increase gross margins through improved availability and reliability of plants. This process is currently underway at our other plants and will be introduced at the Orion Power facilities beginning in the third quarter of 2002.

Increasing Competition in Our Industry. Our Wholesale Energy business segment competes with other energy merchants. In order to successfully compete, we must have the ability to aggregate supplies at

competitive prices from different sources and locations and must be able to efficiently utilize transportation services from third-party pipelines and transmission services from electric utilities. We also compete against other energy merchants on the basis of our relative skills, financial position and access to credit sources. Energy customers, wholesale energy suppliers and transporters often seek financial guarantees and other assurances that their energy contracts will be satisfied. As pricing information becomes increasingly available in the energy trading and marketing business, we anticipate that our operations will experience greater competition and downward pressure on per-unit profit margins. Furthermore, demands for liquidity to support trading and merchant asset businesses are increasing at the same time that the credit rating agencies are reviewing the liquidity and other credit criteria for trading, marketing and merchant generation firms. Other companies we compete with may not have similar credit ratings pressure or may have higher credit ratings. The growth of electronic trading platforms has increased the number of transactions, potential counterparties and level of price transparency in the energy commodity market. As a result, we are likely to transact with a wide range of customers potentially increasing our risk due to their changing credit circumstances, while at the same time potentially diversifying our reliance on a smaller number of customers.

Developments with respect to our competitors frequently have a collateral and tangible impact on us. Credit and liquidity concerns impact our ability to do business with counterparties. Adverse regulatory and political ramifications can result from activities and investigations directed at our competitors.

Hydroelectric Facilities Licensing. The Federal Power Act gives the FERC exclusive authority to license non-federal hydroelectric projects on navigable waterways and federal lands. The FERC hydroelectric licenses are issued for terms of 30 to 50 years. Some of the hydroelectric facilities in our Wholesale Energy business segment, representing approximately 90 MW of capacity, have licenses that expire within the next ten years. Facilities that we own representing approximately 160 MW of capacity have new or initial license applications pending before the FERC. Upon expiration of a FERC license, the federal government can take over the project and compensate the licensee, or the FERC can issue a new license to either the existing licensee or a new licensee. In addition, upon license expiration, the FERC can decommission an operating project and even order that it be removed from the river at the owner's expense. In deciding whether to issue a license, the FERC gives equal consideration to a full range of licensing purposes related to the potential value of a stream or river. It is not uncommon for the relicensing process to take between four and ten years to complete. Generally, the relicensing process begins at least five years before the license expiration date and the FERC issues annual licenses to permit a hydroelectric facility to continue operations pending conclusion of the relicensing process. We expect that the FERC will issue to us new or initial hydroelectric licenses for all the facilities with pending applications. Presently, there are no applications for competing licenses and there is no indication that the FERC will decommission or order any of the projects to be removed.

FACTORS AFFECTING THE RESULTS OF OUR EUROPEAN ENERGY OPERATIONS

General. Our European Energy segment, which is operated by subsidiaries of Reliant Resources, intends to focus its activities in existing trading markets in the Netherlands, the United Kingdom, Germany, the Scandinavian countries, Austria and Switzerland. Historical results of operations may not be indicative of future results of operations. In particular, results of operations for our European Energy segment prior to 2001 reflect the impact of a regulated generation price system that has been discontinued. In addition, in 2001 and prior years, under Dutch corporate income tax laws, the earnings of REPG were subject to a zero percent Dutch corporate income tax rate as a result of the Dutch tax holiday applicable to its electric industry. After December 31, 2001, all of European Energy's earnings in the Netherlands will be subject to the standard Dutch corporate income tax rate, which currently is 34.5%. Furthermore, European Energy's results of operations for 2001 include the effect of a number of non-recurring items, including the \$37 million net gain resulting from the settlement of a stranded cost indemnity agreement.

Future results of operations of our European Energy segment could be affected by, among other things, the following:

- increasing competition in the Dutch wholesale energy market, resulting in declining electric power margins;

- the timing and pace of the deregulation of other sectors of the European energy markets;
- the continuing negative impact of the bankruptcy of Enron on market liquidity and credit requirements in European trading markets;
- the mark-to-market price risk exposure associated with certain stranded cost electricity and natural gas supply contracts;
- the impact of any renegotiation of European Energy's stranded cost contracts;
- the impact and changes of natural gas tariffs pursuant to changes in the regulatory structure;
- the ability to negotiate new contracts or renew contracts with customers on favorable terms; and
- the impact of slowing economic growth on power generation demand in the markets in which our European Energy segment operates.

Competition in the European Market. Competition for energy customers in the markets in which our European Energy segment operates is high. The primary factors affecting our European Energy segment's competitive position are price, regulation, the economic resources of its competitors, and its market reputation and perceived creditworthiness.

Our European Energy segment competes in the Dutch Wholesale market against a variety of other companies, including other Dutch generation companies, cogenerators, various producers of alternate sources of power and non-Dutch generators of electric power, primarily from France and Germany. As of December 31, 2001, the Dutch electricity system had three operational interconnection points with Germany and two interconnection points with Belgium. There are also a number of projects that are at various stages of development and that may increase the number of interconnections in the future (post 2005), including interconnections with Norway and the United Kingdom. The Belgian interconnections are primarily used to import electricity from France, but a larger portion of Dutch electricity imports comes from Germany. It is anticipated that over time, transmission constraints between the Netherlands and other European markets will be reduced, thereby exposing our European Energy segment to even greater competitive pressures.

Our European Energy segment's trading and marketing operations are also subject to increasing levels of competition. Competition among power generators for customers is intense and is expected to increase as more participants enter increasingly deregulated markets. Many of our European Energy segment's existing competitors have geographic market positions far more extensive than that of our European Energy segment. In addition, many of these competitors possess significantly greater financial, personnel and other resources than our European Energy segment.

Deregulation of the Dutch Market. The Dutch wholesale electric market was completely opened to competition on January 1, 2001. Consistent with our expectations at the time we acquired our operations in the Netherlands, the gross margin of our European Energy segment declined in 2001 as a result of the deregulation of the market and the termination of an agreement with the other Dutch generators and the Dutch distributors. Commercial markets were generally opened to retail competition in January 2002. We expect the remainder of the market, consisting of mainly residential customers, will be open to competition by January 1, 2003. The timing of opening of the residential segment of the market is subject to change, however, at the discretion of the Dutch Minister of Economic Affairs. Since our European Energy segment's operations focus on the wholesale market, we do not expect that the opening of the Dutch commercial or residential electric market will have a significant impact on the segment's results of operations.

Plant Outages. During 2001, our margins were negatively impacted by unplanned outages at some of our Dutch generation facilities. The unplanned outages were primarily due to malfunctions of the generation turbines and related equipment and complications encountered in the maintenance of one of our facilities. We estimate that these unplanned outages resulted in losses of approximately \$11 million, a significant portion of which is covered by property damage and business interruption insurance. For additional information regarding operational risks applicable to our European Energy segment, including unplanned plant outages, please read "-- Factors Affecting the Results of Our Wholesale Energy Operations -- Operating Risks."

Other Factors. In December 2001, REPGC and its former shareholders entered into a settlement agreement resolving the former shareholders' stranded cost indemnity obligations under the purchase agreement of REPGC. For additional information regarding the stranded cost indemnity settlement and the potential impact on earnings from changes in the valuation in the future of the related stranded cost contracts, please read Notes 5(b) and 14(h) to our consolidated financial statements. We have begun discussions with the other parties to these contracts to modify the terms of certain of the out-of-market contracts. The structure of these settlements, if consummated, likely would entail an upfront cash payment to the counterparty in exchange for amendments to price and other terms intended to make the contracts more market conforming. REPGC would seek to fund these payments, if made, to the extent possible through the proceeds from the settlement of its stranded cost indemnity agreement and, possibly, anticipated distributions from NEA. We cannot currently predict the outcome of these negotiations. However, to the extent that these discussions result in amendments to the contracts, we could realize a gain.

We are in the process of reviewing our European Energy segment's goodwill and certain intangibles for impairment pursuant to SFAS No. 142. For information regarding assessing the impairment in 2002 under SFAS No. 142, please read "-- New Accounting Pronouncements."

Our European operations are subject to various risks incidental to investing or operating in foreign countries. These risks include economic risks, such as fluctuations in currency exchange rates, restrictions on the repatriation of foreign earnings and/or restrictions on the conversion of local currency earnings into U.S. dollars. For example, we estimate that the impact of the devaluation of the Euro relative to the U.S. dollar during 2001 negatively affected U.S. dollar net income by approximately \$2 million.

FACTORS AFFECTING THE RESULTS OF OUR RETAIL ENERGY OPERATIONS

General. The Texas retail electricity market fully opened to competition in January 2002. Therefore, we do not expect the earnings from our Retail Energy segment, which is operated by subsidiaries of Reliant Resources, for past years to be indicative of our future earnings and results. The level of future earnings generated by our Retail Energy segment will depend on numerous factors including:

- legislative and regulatory developments related to the newly opened retail electricity market in Texas and changes in the application of such laws and regulations;
- the effects of competition, including the extent and timing of the entry or exit of competitors in our markets and the impact of competition on retail prices and margins;
- customer attrition rates and cost associated with acquiring and retaining new customers;
- our ability to negotiate new contracts or renew contracts with customers on favorable terms;
- the timing and extent of changes in wholesale commodity prices and transmission and distribution rates;
- our ability to procure adequate electricity supply upon economic terms;
- our ability to effectively hedge commodity prices;
- our ability to pass increased supply costs on to customers in a timely manner;
- our ability to timely perform our obligations under our customer contracts;
- market liquidity for wholesale power;
- the financial condition and payment patterns of our customers;
- weather variations and other natural phenomena;
- the timely and accurate implementation of the new internal and external information technology systems and processes necessary to provide customer information and to implement customer switching in the retail electricity market in Texas which was established in late 2001;

- the costs associated with operating our internal customer service and other operating functions; and
- the timing and accuracy of ERCOT settlements, and the exchange of information between ERCOT, the T&D Utility and our Retail Energy segment's retail electric provider, which facilitates our Retail Energy business segment's billing, collection and supply management processes.

Competition in the Texas Market. Under the Texas Electric Restructuring Law, beginning in 2002, all classes of Texas customers of most investor-owned utilities, and those of any municipal utility and electric cooperative that opted to participate in the competitive marketplace, are able to choose their retail electric provider. In January 2002, Reliant Resources began to provide retail electric services to all customers of Reliant Energy HL&P who did not select another retail electric provider. Under the market framework established by the Texas Electric Restructuring Law, Reliant Resources is recognized as the affiliated retail electric provider of Reliant Energy's electric utility. The Distribution will not change this treatment, even though Reliant Resources will cease to be a subsidiary of Reliant Energy after the Distribution. As an affiliated retail electric provider, Reliant Resources is initially required to sell electricity to these Houston area residential and small commercial customers at a specified price, which is referred to in the law as the "price to beat," whereas other retail electric providers are allowed to sell electricity to these customers at any price. Reliant Resources' price to beat was set at a level resulting in an estimated average 17% reduction from December 31, 2001 rates for its residential customers and an estimated average 22% reduction from December 31, 2001 rates for its pre-existing small commercial customers. The wholesale energy supply cost component, or "fuel factor," included in its price to beat was initially set by the Texas Utility Commission at the then average forward 12 month gas price strip of approximately \$3.11/MMBtu.

Reliant Resources is not permitted to offer electricity to these customers at a price other than the price to beat until January 1, 2005, unless before that date the Texas Utility Commission determines that 40% or more of the amount of electric power that was consumed in 2000 by the relevant class of customers in the Houston metropolitan area is committed to be served by retail electric providers other than Reliant Resources. In addition, as the affiliated retail electric provider, Reliant Resources is obligated to offer the price to beat to requesting residential and small commercial customers in Reliant Energy's electric utility service territory through January 1, 2007. Because Reliant Resources will not be able to compete for residential and small commercial customers on the basis of price in the Houston area, it may lose a significant number of these customers to other retail electric providers. Customers were given the opportunity to switch beginning in August 2001 through the retail pilot project. Due to system related problems which restricted the timely switching of customers during the pilot project and in early 2002, we cannot be sure of the number of customers that have attempted to switch to other retail electric providers. For additional information regarding retail market systems problems, please read "-- Operational Risks." Between the beginning of the pilot project in August 2001 and February 28, 2002, Reliant Resources estimates that approximately 67,000 customers (or approximately 4% of their residential and small commercial customers) have switched to other retail electric providers. Due to the switching systems problems, the actual numbers of customers that switched or attempted to switch by this date may actually be higher.

Reliant Resources is providing commodity service to the large commercial, industrial and institutional customers previously served by Reliant Energy's electric utility who did not take action to select another retail electric provider. In addition, Reliant Resources has signed contracts to provide electricity and services to large commercial, industrial and institutional customers, both in the Houston area as well as outside of the Houston market. Reliant Resources or any other retail electric provider can provide services to these customers at any negotiated price. The market for these customers is very competitive, and any of these customers that select Reliant Resources as their provider may subsequently decide to switch to another provider at the conclusion of the term of their contract with Reliant Resources.

In most retail electric markets outside the Houston area, Reliant Resources' principal competitor may be the local incumbent utility company's retail affiliate. These retail affiliates have the advantage of long-standing relationships with their customers. In addition to competition from the incumbent utilities' affiliates, Reliant Resources may face competition from a number of other retail providers, including affiliates of other non-incumbent utilities, independent retail electric providers and, with respect to sales to large commercial and

industrial customers, independent power producers acting as retail electric providers. Some of these competitors or potential competitors may be larger and better capitalized than Reliant Resources.

Generally, retail electric providers will purchase electricity from the wholesale generators at unregulated rates, sell electricity to their retail customers and pay the transmission and distribution utility a regulated tariffed rate for delivering the electricity to their customers. Retail electric providers will then bill and collect payments from the customers. Because Reliant Resources is required to sell electricity to residential and small commercial customers in the Houston area at the price to beat, it may lose a significant number of these customers to non-affiliated retail electric providers if their cost to provide electricity to these customers is lower than the price to beat. In addition, the results of our Retail Energy operations for sales to residential and small commercial customers over the next several years in Texas will be largely dependent upon the amount of gross margin, or "headroom," available in our price to beat. Until 2004, when Reliant Resources will have the option to acquire our ownership interest in Texas Genco, Reliant Resources' results will be largely based on the ability of the Wholesale Energy segment to buy power at prices that yield acceptable gross margins at revenue levels determined by the price to beat set by the Texas Utility Commission. The available headroom in the price to beat is equal to the difference between the price to beat and the sum of the charges, fees and transmission and distribution utility rates approved by the Texas Utility Commission and the price Reliant Resources pays for power to serve its price to beat customers. The larger the amount of headroom, the more incentive new market entrants should have to provide retail electric services in that particular market. The Texas Utility Commission's regulations allow affiliated retail electric providers to adjust their price to beat fuel factor based on the percentage change in the price of natural gas. In addition, they may also request an adjustment as a result of changes in their price of purchased energy. In such a request, they may adjust the fuel factor to the extent necessary to restore the amount of headroom that existed at the time the initial price to beat fuel factor was set by the Texas Utility Commission. Affiliated retail electric providers may not request that their price to beat be adjusted more than twice a year. Reliant Resources cannot estimate with any certainty the magnitude and frequency of the adjustments they may seek, if any, and the eventual impact of such adjustments on the amount of headroom. Based on forward gas prices at the end of March 2002, Reliant Resources would be able to increase its price to beat rates by approximately 4-5%. Available headroom in the Houston market, as well as in other Texas markets where Reliant Resources intends to compete, will be affected by any changes in transmission and distribution rates that may be requested by the transmission and distribution provider in the respective service territory and in taxes, fees and other charges assessed or levied by third parties. Any changes in transmission and distribution rates must be approved by the Texas Utility Commission. The Texas Utility Commission has initiated a proceeding to determine what taxes a municipality or other local taxing authority can charge retail electric providers relating to the provision of electricity.

In Texas, our Wholesale Energy business segment and our Retail Energy business segment work together in order to determine the price, demand and supply of energy required to meet the needs of our Retail Energy business segments' customers. Reliant Resources may purchase capacity from non-affiliated parties in the state mandated auctions and from our Texas generation business in the contractually mandated auctions. Reliant Resources also enters into bilateral contracts with third parties for capacity, energy and ancillary services. Supply positions are continuously monitored and updated based on retail sales forecasts and market conditions. However, Reliant Resources does not expect to cover the entire exposure of these positions to market price volatility, and the coverage will vary over time. For a discussion of risks similar to those associated with our Retail Energy segment's hedging activities, please read "-- Factors Affecting the Results of Our Wholesale Energy Operations -- Price Volatility," and "-- Risks Associated with Our Hedging and Risk Management Activities." In addition to the factors noted in these sections, Reliant Resources' ability to adequately hedge its retail electricity requirements is also dependent on the accurate forecast of the number of our customers in each customer class and uncertainties associated with the recently established ERCOT settlement procedures.

Obligations as a Provider of Last Resort. The Texas Electric Restructuring Law requires the Texas Utility Commission to designate certain retail electric providers as providers of last resort in areas of the state in which retail competition is in effect. A provider of last resort is required to offer a standard retail electric service package for each class of customers designated by the Texas Utility Commission at a fixed,

nondiscountable rate approved by the Texas Utility Commission, and is required to provide the service package to any requesting retail customer in the territory for which it is the provider of last resort. In the event that another retail electric provider fails to serve any or all of its customers, the provider of last resort is required to offer that customer the standard retail service package for that customer class with no interruption of service to the customer. The Texas Utility Commission designated Reliant Resources' subsidiary, StarEn Power to serve as the provider of last resort for residential and small commercial customers in the western portion of the Dallas/Fort Worth metropolitan area formally served by Texas Utilities, Inc., a subsidiary of TXU, Inc. In addition, StarEn Power has been appointed as the provider of last resort for large commercial, industrial and institutional customers in Reliant Energy's electric utility service territory. StarEn Power will serve two consecutive six month terms as the provider of last resort. The first term began on January 1, 2002. The second six-month term, beginning July 1, 2002, will include a potential adjustment to the energy component of our provider of last resort rate based on a NYMEX Henry Hub natural gas index. The terms and rates for provider of last resort service are governed by a settlement between Reliant Resources and various interested parties, which settlement was approved by the Texas Utility Commission. In this role, StarEn Power retains the rights to require customer deposits and disconnect service in accordance with Texas Utility Commission rules, and to petition the Texas Utility Commission for a price change in the event it is determined that StarEn power will experience a net financial loss over the term of its provider of last resort obligations. In the first quarter of 2002, the Texas Utility Commission initiated a proceeding to review and possibly amend both the governing rules and structure of provider of last resort service and obligations. This proceeding is in its initial stages and we cannot be sure whether the structure of provider of last resort service and obligations will change, how they will change or what effect, if any, any changes would have on the financial condition, results of operations or cash flows of StarEn Power or our Retail Energy business segment.

"Clawback" Payment to Reliant Energy. To the extent the price to beat exceeds the market price of electricity, Reliant Resources will be required to make a payment to Reliant Energy in 2004 unless the Texas Utility Commission determines that, on or prior to January 1, 2004, 40% or more of the amount of electric power that was consumed in 2000 by residential or small commercial customers (at or below one MW), as applicable, within Reliant Energy HL&P's service territory is committed to be served by retail electric providers other than Reliant Resources. If the 40% test is not met and the reconciliation and a retail payment is required, the amount of this retail payment will be equal to (a) the amount that the price to beat, less non-bypassable delivery charges, is in excess of the prevailing market price of electricity during such period per customer, but not to exceed \$150 per customer, multiplied by (b) the number of residential or small commercial customers, as the case may be, that we serve on January 1, 2004 in Reliant Energy HL&P's service territory, less the number of new retail electric customers Reliant Resources serves in other areas of Texas. Amounts received from Reliant Resources with respect to the clawback payment, if any, will be included in the 2004 stranded cost true-up as a reduction of stranded costs.

Operational Risks. The price of purchased power could have an adverse effect on the costs incurred by our Retail Energy segment in acquiring power to serve the demand of its retail customers. For additional information regarding commodity price volatility, please read "-- Factors Affecting the Results of Our Wholesale Energy Operations -- Price Volatility."

Reliant Resources is dependent on local transmission and distribution utilities for maintenance of the infrastructure through which electricity is delivered to its retail customers. Any infrastructure failure that interrupts or impairs delivery of electricity to its customers could negatively impact the satisfaction of its customers with its service. Additionally, Reliant Resources is dependent on the local transmission and distribution utilities for the reading of its customers' energy meters. Reliant Resources is required to rely on the local utility or, in some cases, the independent transmission system operator, to provide it with its customers' information regarding energy usage, and Reliant Resources may be limited in its ability to confirm the accuracy of the information. The provision of inaccurate information or delayed provision of such information by the local utilities or system operators could have a material negative impact on our business and results of operations and cash flows.

The ERCOT ISO is the independent system operator responsible for maintaining reliable operations of the bulk electric power supply system in the ERCOT market. Its responsibilities include ensuring that

information relating to a customer's choice of retail electric provider is conveyed in a timely manner to anyone needing the information. Problems in the flow of information between the ERCOT ISO, the transmission and distribution utility and the retail electric providers have resulted in delays in switching customers. While the flow of information is improving, operational problems in the new system and processes are still being worked out.

The ERCOT ISO is also responsible for handling scheduling and settlement for all electricity supply volumes in the Texas deregulated electricity market. In addition, the ERCOT ISO plays a vital role in the collection and dissemination of metering data from the transmission and distribution utilities to the retail electric providers. Reliant Resources and other retail electric providers schedule volumes based on forecasts. As part of settlement, the ERCOT ISO communicates the actual volumes delivered compared to the forecast volumes scheduled. The ERCOT ISO calculates an additional charge or credit based on the difference between the actual and forecast volumes, utilizing a market clearing price for the difference. Settlement charges also include allocated costs such as unaccounted-for energy. Currently, there is a three to four month delay in receiving the final settlement information. As a result, Reliant Resources must estimate its supply costs. Timing delays in receiving final settlement information creates supply cost estimation risk.

FLUCTUATIONS IN COMMODITY PRICES AND DERIVATIVE INSTRUMENTS

For information regarding our exposure to risk as a result of fluctuations in commodity prices and derivative instruments, please read "Quantitative and Qualitative Disclosures About Market Risk" in Item 7A of this Form 10-K.

ENVIRONMENTAL EXPENDITURES

We are subject to numerous environmental laws and regulations, which require us to incur substantial costs to operate existing facilities, construct and operate new facilities, and mitigate or remove the effect of past operations on the environment. For additional information regarding environmental contingencies, please read Note 14(f) to our consolidated financial statements.

Clean Air Act Expenditures. We expect the majority of capital expenditures associated with environmental matters to be incurred by our Electric Generation and Wholesale Energy business segments in connection with emission limitations for NOx under the Clean Air Act, or to enhance operational flexibility under Clean Air Act requirements. In 2000, emission reduction requirements for NOx were finalized for our electric generating facilities in the United States. We currently estimate that up to \$476 million will be required to comply with the requirements through the end of 2004, with an estimated \$287 million to be incurred in 2002. The Texas regulations require additional reductions that must be completed by March 2007. Plans for the Texas units for the period 2004 through 2007 have not been finalized, but have been estimated at \$88 million. We are currently litigating the economic and technical viability of the Texas post-2004 reduction requirements, but cannot predict the outcome of this litigation. In addition, the Texas Electric Restructuring Law created a program mandating air emissions reductions for some generating facilities of our Electric Generation business segment. The Texas Electric Restructuring Law provides for stranded cost recovery of costs associated with this obligation incurred before May 1, 2003. For additional information regarding the Texas Electric Restructuring Law, please read "-- Regulation -- State and Local Regulations -- Texas -- Electric Operations -- The Texas Electric Restructuring Law" in Item 1 of this Form 10-K and Note 4(a) to our consolidated financial statements. For additional information regarding environmental regulation of air emissions, please read "Business -- Environmental Matters -- Air Emissions" in Item 1 of this Form 10-K.

Site Remediation Expenditures. From time to time we have received notices from regulatory authorities or others regarding our status as a potentially responsible party in connection with sites found to require remediation due to the presence of environmental contaminants. Based on currently available information, we believe that remediation costs will not materially affect our financial position, results of operations or cash flows. There can be no assurance, however, that future developments, including additional information about existing sites or the identification of new sites, will not require material revisions to our estimates. For

information about specific sites that are the subject of remediation claims, please read Note 14(f) to our consolidated financial statements.

Water, Mercury and Other Expenditures. As discussed under "Business -- Environmental Matters -- Water Issues" in Item 1 of this Form 10-K, regulatory authorities are in the process of implementing regulations and quality standards in connection with the discharge of pollutants into waterways. Once these regulations and quality standards are enacted, we will be able to determine if our operations are in compliance, or if we will have to incur costs in order to comply with the quality standards and regulations. Until that time, however, we are not able to predict the amount of these expenditures, if any. To date, however, our expenditures associated with respect to permits, registrations and authorizations for operation of facilities under the statutes regulating the discharge of pollutants into surface water have not been material. With regard to mercury remediation and other environmental matters, such as the disposal of solid wastes, our expenditures have not been, and are not expected to be material, based on our experiences and that of others in our industries. Please read "Business -- Environmental Matters -- Mercury Contamination" and "-- Other" in Item 1 of this Form 10-K.

OTHER FACTORS

Terrorist Attacks and Acts of War. We are currently unable to measure the ultimate impact of the terrorist attacks of September 11, 2001 on our industry and the United States economy as a whole. The uncertainty associated with the retaliatory military response of the United States and other nations and the risk of future terrorist activity may impact our results of operations and financial condition in unpredictable ways. These actions could result in adverse changes in the insurance markets and disruptions of power and fuel markets. In addition, our generation facilities or the power transmission and distribution facilities on which we rely could be directly or indirectly harmed by future terrorist activity. The occurrence or risk of occurrence of future terrorist attacks or related acts of war could also adversely affect the United States economy. A lower level of economic activity could result in a decline in energy consumption which could adversely affect our revenues, margins and limit our future growth prospects. The occurrence or risk of occurrence could also increase pressure to regulate or otherwise limit the prices charged for electricity or gas. Also, these risks could cause instability in the financial markets and adversely affect our ability to access capital.

Environmental Regulation. Our Electric Generation and Wholesale Energy business segments are subject to extensive environmental regulation by federal, state and local authorities. We are required to comply with numerous environmental laws and regulations, and to obtain numerous governmental permits, in operating our facilities. We may incur significant additional costs to comply with these requirements. If we fail to comply with these requirements, we could be subject to civil or criminal liability and fines. Existing environmental regulations could be revised or reinterpreted, new laws and regulations could be adopted or become applicable to us or our facilities, and future changes in environmental laws and regulations could occur, including potential regulatory and enforcement developments related to air emissions. If any of these events occur, our business, operations and financial condition could be adversely affected.

We may not be able to obtain or maintain from time to time all required environmental regulatory approvals. If there is a delay in obtaining any required environmental regulatory approvals or if we fail to obtain and comply with them, the operation of our facilities could be prevented or become subject to additional costs.

We are generally responsible for all on-site liabilities associated with the environmental condition of our power generation facilities which we have acquired and developed, regardless of when the liabilities arose and whether they are known or unknown. These liabilities may be substantial.

Holding Company Organizational Structure. We are a holding company, and we conduct a significant portion of our operations through our subsidiaries. After the Restructuring and Distribution, CenterPoint Energy will be a holding company that conducts substantially all of its operations through its respective subsidiaries. CenterPoint Energy's only significant assets will be the capital stock of its subsidiaries, and its subsidiaries will generate substantially all of CenterPoint Energy's operating income and cash flow. As a result, dividends or advances from CenterPoint Energy's subsidiaries will be the principal source of funds

necessary to meet its debt service obligations. In some circumstances, contractual provisions (including terms of indebtedness) or laws, as well as the financial condition or operating requirements of our respective subsidiaries, may limit our or CenterPoint Energy's ability to obtain cash from our respective subsidiaries. As of December 31, 2001, all conditions on payments to us by our subsidiaries that are contained in existing agreements were satisfied. After the Distribution, Reliant Resources will also be a holding company that conducts all of its operations through its subsidiaries and will be subject to similar structural limitations as described above with respect to CenterPoint Energy. For information regarding payment of dividends please read Item 5 of this Form 10-K.

In addition, the ability of REMA, a Reliant Resources subsidiary that owns some of the power generation facilities in our Northeast regional portfolio, to pay dividends or make restricted payments to Reliant Resources is restricted under the terms of three lease agreements under which we lease all or an undivided interest in these generating facilities. These agreements allow our Mid-Atlantic subsidiary to pay dividends or make restricted payments only if specified conditions are satisfied, including maintaining specified fixed charge coverage ratios.

Liquidity Concerns. For a discussion of factors affecting our sources of cash and liquidity, please read "-- Liquidity and Capital Resources -- Future Sources and Uses of Cash."

LIQUIDITY AND CAPITAL RESOURCES

HISTORICAL CASH FLOWS

The net cash provided by/used in operating, investing and financing activities for 1999, 2000 and 2001 is as follows (in millions):

YEAR ENDED DECEMBER 31, -----	-----	-----	-----
----- 1999	2000	2001	-----
---- Cash provided by (used in): Operating			
activities.....			
\$ 1,104	\$ 1,344	\$ 1,713	Investing
activities.....			
(2,870)	(3,286)	(2,085)	Financing
activities.....			
	1,823	2,032	337

CASH PROVIDED BY OPERATING ACTIVITIES

Net cash provided by operations in 2001 increased \$369 million compared to 2000. This increase primarily resulted from:

- an increase in recovered fuel costs by our Electric Operations business segment;
- a decrease in net margin deposits on energy trading activities as a result of reduced commodity volatility and relative price levels of natural gas and power compared to the fourth quarter of 2000; and
- an increase in operating margins from Wholesale Energy's power generation operations.

This increase is partially offset by:

- a prepayment of a lease obligation related to REMA sale/leaseback transactions (please read Note 14(b) to our consolidated financial statements);
- an increase in restricted cash related to our REMA operations;
- an increase in deposits in a collateral account related to an equipment financing structure (please read Note 14(1) to our consolidated financial statements);
- an increase in costs related to our Retail Energy business segments' increased staffing levels and preparation for competition in the retail electric market in Texas;

- reduced cash flows from our European Energy business segment primarily resulting from a decline in electric power generation gross margins as the Dutch electric market was completely opened to wholesale competition on January 1, 2001; and
- other changes in working capital.

Net cash provided by operations in 2000 increased \$240 million compared to 1999. This increase primarily resulted from:

- proceeds from the sale of an investment in marketable debt securities by REPGb;
- improved operating results of our Wholesale Energy business segment's California generating facilities;
- incremental cash flows provided by REPGb, acquired in the fourth quarter of 1999;
- cash flows from REMA, acquired in the second quarter of 2000; and
- increased sales from our Electric Operations business segment due to growth in usage and number of customers.

These increases were partially offset by increases in under-recovered fuel costs of our Electric Operations business segment and Wholesale Energy's net margin deposits on energy trading activities.

CASH USED IN INVESTING ACTIVITIES

Net cash used in investing activities decreased \$1.2 billion during 2001 compared to 2000. This decrease was primarily due to no acquisitions being made in 2001 as compared to the \$2.1 billion acquisition of REMA in 2000, and the funding of the remaining \$982 million purchase obligation for REPGb in 2000.

These decreases were partially offset by additional capital expenditures in 2001 of \$211 million primarily related to our Electric Operations business segment, proceeds of \$1.0 billion received in 2000 from the REMA sale-leaseback and \$642 million received in 2000 from the sale of our Latin America assets, net of investments and advances.

Net cash used in investing activities increased \$416 million during 2000 compared to 1999. This increase was primarily due to:

- the funding of the remaining purchase obligation for REPGb of \$982 million on March 1, 2000;
- the acquisition of REMA for \$2.1 billion on May 12, 2000; and
- increased capital expenditures related to the construction of domestic power generation projects.

Proceeds of \$1.0 billion from the REMA sale-leaseback in 2000, the sale of a substantial portion of our Latin America investments in 2000 and the purchase of \$537 million of AOL Time Warner securities in 1999 partially offset these increases.

CASH PROVIDED BY FINANCING ACTIVITIES

Cash flows provided by financing activities decreased \$1.7 billion in 2001 compared to 2000, primarily due to a decline in short term borrowings partially offset by \$1.7 billion in net proceeds from the initial public offering of Reliant Resources.

Cash flows provided by financing activities increased \$209 million in 2000 compared to 1999, primarily due to an increase in short-term borrowings partially offset by a decline in proceeds from long-term debt and the sale of trust preferred securities.

FUTURE SOURCES AND USES OF CASH

The following table sets forth our consolidated capital requirements for 2001, and estimates of our consolidated capital requirements for 2002 through 2006 (in millions).

2001	2002	2003	2004	2005	2006	--

---- Electric Operations (with nuclear fuel)						
(1).....						\$
936	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --
Electric Transmission and Distribution(1).....						
--	338	320	381	362	352	Electric Generation (with nuclear fuel)
(1).....						--
285	192	89	79	45		Natural Gas Distribution.....
209	219					231 231 234 231 Pipelines and Gathering.....
54	76	45				45 43 38 Wholesale Energy(2)
(3).....						658 3,579 322
147	215	146				European Energy.....
21	22					-- -- -- -- Retail Energy.....
117						40 19 18 14 16 Other Operations.....
58						111 80 46 73 38 Major maintenance cash outlays.....
88						94 87 106 86 85 -----

Total.....						
\$2,141	\$4,764	\$1,296	\$1,063			
\$1,106	\$951	=====	=====	=====		
		=====	=====	=====		

- (1) Beginning in 2002, the Electric Operations business segment will be replaced by the Electric Transmission and Distribution business segment and the Electric Generation business segment. In December 2001, we formed Texas Genco, LP, a Texas limited partnership, as an indirect, wholly owned subsidiary (Texas Genco). It is anticipated that the majority interest in Texas Genco held by CenterPoint Energy will be purchased by Reliant Resources in early 2004 pursuant to the terms of an option that Reliant Resources holds, or will otherwise be sold to one or more other parties. The Texas generation operations referred to as our "Texas generation business" throughout this Form 10-K will be reported as the "Electric Generation" business segment beginning in 2002. Capital requirements for current generation operations of Reliant Energy HL&P are included in the Electric Generation business segment. Capital requirements for the remainder of Reliant Energy HL&P's operations are included in the Electric Transmission and Distribution business segment.
- (2) Capital requirements for 2002 include \$2.9 billion for the acquisition of Orion Power by Reliant Resources.
- (3) We currently estimate the capital expenditures by off-balance sheet special purpose entities to be \$704 million, \$343 million, \$163 million and \$48 million in 2002, 2003, 2004 and 2005, respectively. Capital expenditures for these projects have been excluded from the table above. Please read "Future Sources and Uses -- Reliant Resources (unregulated businesses)," "-- Off-Balance Sheet Transactions -- Construction Agency Agreements" and "-- Equipment Financing Structure" below for additional information.

The following table sets forth estimates of our consolidated contractual obligations as of December 31, 2001 to make future payments for 2002 through 2006 and thereafter (in millions):

2007 AND CONTRACTUAL OBLIGATIONS						
TOTAL	2002	2003	2004	2005	2006	THEREAFTER

----- Long-term						
debt, including capital						
leases(1).....						
\$ 6,403	\$ 538	\$1,226	\$ 90	\$ 390		
\$218	\$3,941	Short-term borrowing,				
including credit						
facilities(1).....	3,435					
3,435	--	--	--	--	--	Trust
preferred securities(2).....						
706	--	--	--	--	--	706 REMA
operating lease payments(3)....						
1,560	136	77	84	75	64	1,124 Other
operating lease payments(3)...						
969	66	84	94	95	95	535 Trading
and marketing						
liabilities(4).....						
1,840	1,478	216	85	33	13	15 Non-
trading derivative						
liabilities(4).....						
936	396	122	82	62	35	239 Other
commodity commitments(5).....						
4,014	451	314	340	344	348	2,217
Other long-term						
obligations.....	300	10	10	10		
10	10	250	-----	-----	-----	-----
----- Total						
contractual cash						
obligations.....						
\$20,163	\$6,510	\$2,049	\$785	\$1,009		
\$783	\$9,027	=====	=====	=====		
=====						

- (1) For a discussion of short-term and long-term debt, please read Note 10 to our consolidated financial statements.
- (2) For a discussion of trust preferred securities, please read Note 11 to our consolidated financial statements.
- (3) For a discussion of REMA and other operating leases, please read Note 14(b) to our consolidated financial statements.
- (4) For a discussion of trading and marketing liabilities and non-trading derivative liabilities, please read Note 5 to our consolidated financial statements.
- (5) For a discussion of other commodity commitments, please read Note 14(a) to our consolidated financial statements. Excluded from the table above are amounts to be acquired by Reliant Resources from Texas Genco under purchase power and electric capacity commitments of \$213 million and \$57 million in 2002 and 2003, respectively.

The following discussion regarding future sources and uses of cash over the next twelve months is presented separately for our regulated businesses and unregulated businesses consistent with the separate liquidity plans that our management has developed for CenterPoint Energy and Reliant Resources. We believe that our borrowing capability combined with cash flows from operations will be sufficient to meet the operational needs of our businesses for the next twelve months.

RELiant ENERGY (TO BECOME CENTERPOINT ENERGY SUBSEQUENT TO THE RESTRUCTURING)

Our liquidity and capital requirements will be affected by:

- capital expenditures;
- debt service requirements;
- the repayment of notes payable to Reliant Resources;
- the reduction in, and elimination of, programs under which we have sold customer accounts receivable;
- proceeds from the expected initial public offering of Texas Genco;

- various regulatory actions; and
- working capital requirements.

Credit Facilities. As of December 31, 2001, we had credit facilities, including facilities of Houston Industries FinanceCo LP (FinanceCo) and RERC Corp., that provided for an aggregate of \$5.4 billion in committed credit. As of December 31, 2001, \$3.1 billion was outstanding under these facilities including \$2.5 billion of commercial paper supported by the facilities, borrowings of \$636 million and letters of credit of \$2.5 million.

The following table summarizes amounts available under these credit facilities at December 31, 2001 and commitments expiring in 2002 (in millions):

AMOUNT OF TOTAL UNUSED COMMITMENTS		COMMITTED AMOUNT AT EXPIRING	
BORROWER TYPE OF FACILITY CREDIT			
12/31/01 IN 2002 - -----			

---- Reliant			
Energy.....			
Revolver \$ 400	\$ 236	\$ 400	
FinanceCo.....			
Revolvers 4,300	1,671	4,300	RERC
Corp.			
Revolver 350	347	--	RERC Corp.
.....			
Receivables 350	4	350	-----

Total.....			
\$5,400	\$2,258	\$5,050	=====
			=====

The RERC Corp. receivables facility was reduced from \$350 million to \$150 million in January 2002. Proceeds for the repayment of \$196 million of advances under the facility were obtained from the liquidation of a temporary investment and the sale of commercial paper.

The revolving credit facilities contain various business and financial covenants requiring us to, among other things, maintain leverage (as defined in the credit facilities) below specified ratios. We are in compliance with the covenants under all of these credit agreements. We do not expect these covenants to materially limit our ability to borrow under these facilities. For additional discussion, please read Note 10(a) to our consolidated financial statements.

The revolving credit facilities support commercial paper programs. The maximum amount of outstanding commercial paper of an issuer is limited to the amount of the issuer's aggregate revolving credit facilities less any direct loans or letters of credit obtained under its revolvers. Due to an inability to consistently satisfy all short-term borrowing needs by issuing commercial paper, short-term borrowing needs have been met with a combination of commercial paper and bank loans. The extent to which commercial paper will be issued in lieu of bank loans will depend on market conditions and our credit ratings.

Pursuant to the terms of the existing agreements (but subject to certain conditions precedent which we anticipate will be met) the revolving credit agreements aggregating \$4.3 billion of FinanceCo will terminate and CenterPoint Energy revolving credit facilities of the same amount and with the same termination dates will become effective on the date of Restructuring.

To the extent that we continue to need access to current amounts of committed credit prior to the Distribution, we expect to extend or replace the credit facilities on a timely basis. The terms of any new credit facilities are expected to be adversely affected by the leverage of Reliant Energy, the amount of bank capacity utilized by Reliant Energy, any delay in the date of Restructuring and Distribution and conditions in the bank market. These same factors are expected to make the syndication of new credit facilities more difficult in the future. Proceeds from any issuance of debt in the capital markets are expected to be used to retire a portion of our short-term debt and reduce our need for committed revolving credit facilities.

Shelf Registrations. The following table lists shelf registration statements existing at December 31, 2001 for securities expected to be sold in public offerings.

TERMINATING ON DATE OF REGISTRANT SECURITY	AMOUNT(1) RESTRUCTURING -
-----	-----
Reliant	
Energy.....	
Preferred Stock \$230	
million Yes Reliant	
Energy..... Debt	
Securities 580 million	
Yes Reliant	
Energy.....	
Common Stock 398 million	
No REI Trust II/Reliant	
Trust Preferred and	
related Junior 125	
million Yes	
Energy.....	
Subordinated Debentures	
RERC	
Corp.....	
Debt Securities 50	
million No	
-----	-----

(1) The amount reflects the principal amount of debt securities, the aggregate liquidation value of trust preferred securities and the estimated market value of common stock based on the number of shares registered as of December 31, 2001 and the closing market price of Reliant Energy common stock on that date.

We expect to register \$2.5 billion of debt securities some or all of which may be issued either by Reliant Energy prior to the Restructuring or by CenterPoint Energy after the Restructuring. Proceeds from the sale of these debt securities are expected to be used to repay short-term borrowings. The amount actually issued will depend on interest rates and other market conditions.

Debt Service Requirements. Excluding the repayments expected to be made on the transition bonds described in Note 4(a) to our consolidated financial statements, we have maturing long-term debt in 2002 aggregating \$500 million. Maturing debt is expected to be refinanced with new debt. In addition, Reliant Energy has \$175 million of 5.20% pollution control bonds that are expected to be remarketed in 2002 as multi-year fixed-rate debt.

Debt service requirements will be affected by the overall level of interest rates in 2002 and credit spreads applicable to the various issuers of debt in 2002. Up to \$2.7 billion of long-term debt is expected to be issued or remarketed in 2002 and we expect to have large amounts of short-term floating-rate debt in 2002. At December 31, 2001, we had entered into five year forward starting interest rate swaps having an aggregate notional amount of \$500 million to hedge the interest rate on an anticipated 2002 offering of five year notes. The weighted average rate on the swaps was 5.6%. At December 31, 2001, we also had entered into interest rate swaps to fix the rate on \$1.8 billion of our floating rate debt. The weighted average rate on these swaps was 4.1% and the swaps expire in 2002 and 2003. While we have, in some instances, hedged our exposure to changes in interest rates by entering into interest rate swaps, the swaps leave us exposed to changes in our credit spread relative to the market indices reflected in the swaps.

Money Fund. We have a "money fund" through which Reliant Energy and participating subsidiaries can borrow or invest on a short-term basis. Funding needs are aggregated and external borrowing or investing is based on the net cash position. The money fund's net funding requirements are generally met with commercial paper and/or bank loans. At December 31, 2001, Reliant Resources had \$390 million invested in the money fund. Reliant Resources is expected to withdraw its investment from the money fund on or before the Distribution. Funds for repayment of the notes payable to Reliant Resources will be obtained from bank loans or the issuance of commercial paper.

Environmental Issues. We anticipate investing up to \$397 million in capital and other special project expenditures between 2002 and 2006 for environmental compliance. Of this amount, we anticipate expenditures to be approximately \$234 million and \$132 million in 2002 and 2003, respectively. These environmental compliance expenditures are included in the capital requirements table presented above. For additional information related to environmental issues, please read Note 14(f) to our consolidated financial statements.

Initial Public Offering of Texas Genco. In 2002, approximately 20% of Texas Genco is expected to be sold in an initial public offering or distributed to holders of CenterPoint Energy common stock. The decision

whether to distribute the Texas Genco shares or to sell the shares in an initial public offering will depend on numerous factors, including market conditions. Proceeds, if any, are expected to be used to retire short-term debt.

Fuel Filing. As of December 31, 2000 and 2001, Reliant Energy HL&P was under-collected on fuel recovery by \$558 million and \$200 million, respectively. In two separate filings with the Texas Utility Commission in 2000, Reliant Energy HL&P received approval to implement fuel surcharges to collect the under-recovery of fuel expenses, as well as to adjust the fuel factor to compensate for significant increases in the price of natural gas. Under the Texas Electric Restructuring Law, a final settlement of these stranded costs will occur in 2004.

Reliant Energy HL&P Rate Matters. The October 3, 2001 Order established the transmission and distribution rates that became effective in January 2002. The Texas Utility Commission determined that Reliant Energy HL&P had overmitigated its stranded costs by redirecting transmission and distribution depreciation and by accelerating depreciation of generation assets as provided under the Transition Plan and Texas Electric Restructuring Law. In this final order, Reliant Energy HL&P is required to reverse the amount of redirected depreciation and accelerated depreciation taken for regulatory purposes as allowed under the Transition Plan and the Texas Electric Restructuring Law. Per the October 3, 2001 Order, our Electric Operations business segment recorded a regulatory liability to reflect the prospective refund of the accelerated depreciation. Our Electric Operations business segment began refunding excess mitigation credits with the January 2002 unbundled bills, to be refunded over a seven year period. The annual cash flow impact of the reversal of both redirected and accelerated depreciation is a decrease of approximately \$225 million. Under the Texas Electric Restructuring Law, a final settlement of these stranded costs will occur in 2004. For further discussion, please read Note 4(a) to our consolidated financial statements.

In addition to the above factors, our liquidity and capital requirements could be affected by:

- a downgrade in credit ratings;
- the need to provide cash collateral in connection with trading activities;
- various regulatory actions; and
- funding of our pension plan.

Impact on Liquidity of a Downgrade in Credit Ratings. At December 31, 2001, Moody's Investors Service, Inc. (Moody's), Standard & Poor's, a division of The McGraw Hill Companies (S&P) and Fitch, Inc. (Fitch) had assigned the following credit ratings to senior debt of Reliant Energy and certain subsidiaries:

```

MOODY'S S&P -----
-----
-----
COMPANY/INSTRUMENT
RATING OUTLOOK
RATING OUTLOOK
RATING FITCH WATCH
OUTLOOK - -----
-----
-----
-----
- Reliant Energy
  Senior Secured
  Debt..... A3
  Stable(1) BBB+
  Stable(2) A-
  Negative(3) N/A
  Senior Unsecured
  Debt..... Baa1
  Stable(1) BBB
  Stable(2) BBB+
  Negative(3) N/A
  Reliant Energy
  FinanceCo II LP
  Senior
  Debt.....
  Baa1 Stable(1) BBB
  Stable(2) BBB N/A
  Stable(4) RERC
  Corp. Senior
  Debt.....
  Baa2 Stable(1)
  BBB+ Stable(2)

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- (1) A "stable" outlook from Moody's indicates that Moody's does not expect to put the rating on review for an upgrade or downgrade within 18 months from when the outlook was assigned or last affirmed.
- (2) A "stable" outlook from S&P indicates that the rating is not likely to change over the intermediate to longer term.
- (3) A "negative" watch from Fitch signals that the rating may be downgraded or affirmed in the near term. Fitch has indicated that the Reliant Energy senior secured debt ratings will change from A- to BBB+

upon the distribution of Reliant Resources shares and that the RERC Corp. senior debt ratings will change from BBB+ to BBB upon the distribution of Reliant Resources shares.

- (4) A "stable" outlook from Fitch signals that the medium term view of the credit trend of an issuer is stable rather than positive or negative.

We cannot assure you that these ratings will remain in effect for any given period of time or that one or more of these ratings will not be lowered or withdrawn entirely by a rating agency. We note that these credit ratings are not recommendations to buy, sell or hold our securities and may be revised or withdrawn at any time by the rating agency. Each rating should be evaluated independently of any other rating. Any future reduction or withdrawal of one or more of our credit ratings could have a material adverse impact on our ability to access capital on acceptable terms.

A decline in credit ratings would increase commitment fees and borrowing costs under our existing bank credit facilities. A decline in credit ratings would also adversely affect our ability to issue commercial paper and the interest rates applicable to commercial paper. Increased direct borrowings under our bank credit facilities could also result in the payment of usage fees under the terms of these arrangements. A decline in credit ratings would also increase the interest rate on long-term debt to be issued in the capital markets.

Our revolving credit agreements are broadly syndicated committed facilities which contain "material adverse change" clauses that could impact our ability to borrow under these facilities. The "material adverse change" clauses generally relate to our ability to perform our obligations under the agreements.

The \$150 million receivables facility of RERC Corp. requires the maintenance of credit ratings of at least BB from S&P and Ba2 from Moody's. Advances under the facility would need to be repaid in the event a credit rating fell below the threshold.

As previously discussed, bank facilities of FinanceCo are expected to be converted into bank facilities of CenterPoint Energy on the date of Restructuring. There is a ratings-related condition precedent to the conversion from the existing FinanceCo bank credit facilities (totaling \$4.3 billion) to facilities under which CenterPoint Energy will become the obligor. The condition precedent requires that CenterPoint Energy be rated at least BBB by S&P and Baa2 by Moody's at the time of Restructuring. We believe that we could obtain a waiver of this condition, if necessary. However, if we were unable to obtain such a waiver, the facilities would remain obligations of FinanceCo until the earlier of 90 days after the date of Restructuring or the expiration of the facilities in July 2002, subject to compliance with applicable covenants.

Similar ratings-related provisions govern the transfer to CenterPoint Energy of rights and obligations under certain interest rate swap agreements entered into by Reliant Energy and Houston Industries FinanceCo LP to effect interest rate hedging. Interest rate swaps having an aggregate notional amount of \$1.5 billion as of December 31, 2001 contained such provisions. These agreements are generally assumable by CenterPoint Energy without the consent of the counterparties, provided that CenterPoint Energy's rating is at least BBB- from S&P or Baa3 from Moody's. We believe that we could obtain the consent of the counterparties if necessary, but if we were unable to do so, the swaps would remain obligations of the current counterparties until their expiration. All of the swaps terminate no later than 2004.

As discussed in Note 8 to our consolidated financial statements, each ZENS note is exchangeable at the holder's option at any time for an amount of cash equal to 95% of the market value of the reference shares of AOL TW common stock attributable to each ZENS note. If our credit worthiness were to drop such that ZENS note holders felt our liquidity was adversely affected or the market for the ZENS notes was to become illiquid, some ZENS holders might decide to exchange their ZENS for cash. Funds for the payment of cash upon exchange could be obtained from the sale of the AOL TW common stock that we own or from other sources. We own shares of AOL TW common stock equal to 100% of the "reference shares" used to calculate our obligation to the holders of the ZENS notes.

Certain of the contracts that we have entered into on behalf of Texas Genco for the sale of capacity from our Texas generation business contain requirements obligating us to put up additional security in the event that our rating or the rating of CenterPoint Energy falls below BBB- from S&P or Baa3 from Moody's. These

requirements stem from reciprocal provisions under power purchase and sale agreements with purchasers of capacity to be delivered in various monthly, 12-month or 24-month periods or "strips" until December 2003. If a downgrade below either of these levels were to occur, the purchasers would be entitled to call upon us to provide collateral to secure our obligations in a "commercially reasonable" amount within three business days of notice. Failure to provide this collateral entitles the other party to terminate the agreement and unwind all pending transactions under the agreement. Our Texas generation business is always the seller under these agreements, and its performance obligation in all cases is one of delivery, rather than payment. Accordingly, it is difficult to quantify the amount of collateral we would be required to provide as assurance for these delivery obligations. We believe that any such quantification should be predicated on our Texas generation business' ultimate exposure under these agreements. Our Texas generation business has no exposure until (1) it cannot deliver power as called for in the agreements and (2) the market cost of replacement power has increased above the contract price. In the unlikely event that our Texas generation business could not deliver any of this power as agreed, we estimate that our Texas generation business' total exposure under these contracts at December 31, 2001 was approximately \$73 million.

As part of its normal business operations, our Texas generation business has also entered power purchase and sale agreements with counterparties that contain similar provisions that require a party to provide additional collateral on three business days notice when that party's rating falls below BBB- from S&P or Baa3 from Moody's. Our Texas generation business both buys and sells under these agreements, and we use them whenever possible either to locate less expensive power than our Texas generation business' marginal cost of generation or to sell power to another party who is willing to pay more than our marginal cost of generation. Our Texas generation business' purchases for 2001 under agreements with ratings triggers were approximately \$23 million and its sales under those agreements were approximately \$8 million. This compares to total purchases of approximately \$125 million and total sales of approximately \$32 million under all buy/sell agreements in 2001. We believe that this risk is mitigated because most of the purchases and sales under these arrangements take place over relatively short time periods; typically, these transactions are for one-day deliveries and rarely exceed periods of one month.

Entex Gas Resources Corp., a wholly owned subsidiary of RERC Corp., provides comprehensive natural gas sales and services to industrial and commercial customers who are primarily located within or near the territories served by our pipelines and distribution subsidiaries. In order to hedge its exposure to natural gas prices, Entex Gas Resources Corp. will have agreements with provisions standard to the industry that establish credit thresholds and then require a party to provide additional collateral on two business days' notice when that party's rating or the rating of a credit support provider for that party (RERC Corp. in this case), falls below those levels. The senior unsecured debt of RERC Corp. is currently rated BBB+ by S&P and Baa2 by Moody's. Based on these ratings, we estimate that unsecured credit limits extended to Entex Gas Resources Corp. by counterparties could aggregate \$250 million; however, utilized credit capacity would typically be lower.

Regulatory Matters. Our liquidity can be impacted by regulatory actions affecting our Electric Operations and our Natural Gas Distribution business segments. For further discussion, please read Note 4 to our consolidated financial statements.

Treasury Stock Purchases. As of December 31, 2001, we were authorized under our common stock repurchase program to purchase an additional \$271 million of our common stock. Our purchases under our repurchase program depend on market conditions, might not be announced in advance and may be made in open market or privately negotiated transactions. CenterPoint Energy has no current plans to engage in a significant stock buy-back program, but may seek to repurchase shares in the open market for use in various benefit and employee compensation plans, or to maintain a targeted balance of outstanding shares to the extent that original issue stock is used for such purposes.

Pension and Postretirement Benefits Funding. We make contributions to achieve adequate funding of Company sponsored pension and postretirement benefits in accordance with applicable regulations and rate orders. Based on current estimates, we expect to have funding requirements, excluding Reliant Resources, of

approximately \$330 million for the period 2002-2006. These anticipated funding requirements are not reflected in the table of contractual obligations presented above.

RELIANT RESOURCES -- UNREGULATED BUSINESSES

Liquidity and capital requirements for these businesses are affected primarily by the results of operations, capital expenditures, debt service requirements and working capital needs. Reliant Resources expects to grow these businesses through the construction of new generation facilities and the acquisition of generation facilities, the expansion of their energy trading and marketing activities and the expansion of their energy retail business. Reliant Resources expects any resulting capital requirements to be met with cash flows from operations, and proceeds from debt and equity offerings, project financings, securitization of assets, other borrowings and off-balance sheet financings. Additional capital expenditures, some of which may be substantial, depend to a large extent upon the nature and extent of future project commitments which are discretionary. In the discussion below, Reliant Resources has provided several tables outlining their expected future capital requirements by category of expenditure followed by more detailed descriptions of the most significant of their currently known future capital requirements and descriptions of known uncertainties that could impact these items.

The following table sets forth Reliant Resources' consolidated capital requirements for 2001, and estimates of their consolidated capital requirements for 2002 through 2006 (in millions).

2001	2002	2003	2004	2005	2006	----	----
----- Wholesale							
Energy(1)(2)(3).....					\$658		
\$3,579	\$322	\$147	\$215	\$146	European		
Energy.....					21	22	
----- Retail							
Energy.....						117	
	40	19	18	14	16	Other	
Operations.....						44	
75	46	31	32	33	Major maintenance cash		
outlays.....					88	94	87 106 86 85

Total.....							
\$928	\$3,810	\$474	\$302	\$347	\$280	====	
	=====	=====	=====	=====	=====		

- (1) Capital requirements for 2002 includes \$2.9 billion for the acquisition of Orion Power.
- (2) In connection with Reliant Resources' separation from Reliant Energy, Reliant Energy has granted Reliant Resources an option, subject to completion of the Distribution, to purchase the majority interest in Texas Genco held by CenterPoint Energy in January 2004. This option may be exercised between January 10, 2004 and January 24, 2004. The purchase of Texas Genco has been excluded from the above table. For additional information regarding this option to purchase Texas Genco, please read Note 4(b) to our consolidated financial statements.
- (3) Reliant Resources currently estimates the capital expenditures by off-balance sheet special purpose entities to be \$704 million, \$343 million, \$163 million and \$48 million in 2002, 2003, 2004 and 2005, respectively. Capital expenditures for these projects have been excluded from the table above. Please read "Future Sources and Uses -- Reliant Resources -- unregulated businesses," "-- Off-Balance Sheet Transactions -- Construction Agency Agreements" and "-- Equipment Financing Structure" below for additional information.

Acquisition of Orion Power. On February 19, 2002, Reliant Resources acquired all of the outstanding shares of common stock of Orion Power for \$26.80 per share in cash for an aggregate purchase price of \$2.9 billion. As of February 19, 2002, Orion Power's debt obligations were \$2.4 billion (\$2.1 billion net of cash acquired, some of which is restricted pursuant to debt covenants). Reliant Resources funded the purchase of Orion Power with a \$2.9 billion credit facility (Orion Bridge Facility) and \$41 million of cash on hand. Please read "-- Consolidated Sources of Cash -- Orion Bridge Facility" for further information.

Generating Projects. As of December 31, 2001, Reliant Resources had three generating facilities under construction. Total estimated costs of constructing these facilities are \$1.1 billion, including \$304 million in commitments for the purchase of combustion turbines. As of December 31, 2001, Reliant Resources had

incurred \$690 million of the total projected costs of these projects, which were funded primarily from equity and debt facilities. In addition, Reliant Resources has options to purchase additional combustion turbines for a total estimated cost of \$42 million, but is actively attempting to market these turbines, having determined that they are in excess of their current needs. In addition to these facilities, Reliant Resources is constructing facilities as construction agents under the construction agency agreements under synthetic leasing arrangements, which permit them to lease or buy each of these facilities at the conclusion of their construction. For more information regarding the construction agency agreements, please read "-- Off Balance Sheet Transactions -- Construction Agency Agreements."

Environmental Expenditures. Reliant Resources anticipates investing up to \$135 million in capital and other special project expenditures between 2002 and 2006 for environmental compliance, totaling approximately \$53 million, \$20 million, \$9 million, \$29 million and \$24 million in 2002, 2003, 2004, 2005 and 2006, respectively, which is included in the above table. Additionally, environmental capital expenditures for the recently acquired Orion Power assets were estimated by Orion Power to be approximately \$241 million over the same time period. Reliant Resources is currently reviewing Orion Power's estimates.

The following table sets forth estimates of Reliant Resources' consolidated contractual obligations as of December 31, 2001 to make future payments for 2002 through 2006 and thereafter (in millions):

2007 AND CONTRACTUAL OBLIGATIONS						
TOTAL	2002	2003	2004	2005	2006	
THEREAFTER -	-----	-----	-----	-----	-----	-----
-----	-----	-----	-----	-----	-----	-----
--- ----	-----	-----	-----	-----	-----	-----
debt.....	\$ 892					
\$ 24 \$ 539 \$ 42 \$ 12 \$ 12 \$ 263						
Short-term borrowing, including credit facilities.....	297					
297 -- -- -- -- -- Mid-Atlantic generating assets operating lease payments.....	1,560					
136 77 84 75 64 1,124 Other operating lease payments....						
859 52 72 87 89 90 469 Trading and marketing liabilities.....	1,840	1,478	216	85	33	13
1,840 1,478 216 85 33 13 15 Non-trading derivative liabilities.....	853	323	115	80	61	35
853 323 115 80 61 35 239 Other commodity commitments.....	3,134	465	242	207	207	207
3,134 465 242 207 207 207 1,806 Other long-term obligations.....	300	10	10	10		
10 10 250 -----						
--- ----	-----	-----	-----	-----	-----	-----
----- Total contractual cash obligations.....	\$9,735	\$2,785	\$1,271	\$595	\$487	
\$9,735 \$2,785 \$1,271 \$595 \$487						
\$431 \$4,166 =====						
=====						

Long-term debt obligations as of December 31, 2001, include \$829 million of borrowings under credit facilities that have been classified as long-term debt, based upon the availability of committed credit facilities and management's intention to maintain these borrowings in excess of one year.

As of December 31, 2001, Reliant Resources has issued \$396 million of letters of credit, of which \$345 million were issued under two credit facilities expiring in 2003 and \$51 million were issued under a credit facility expiring in 2004.

Mid-Atlantic Assets Lease Obligation. In August 2000, Reliant Resources' subsidiaries entered into separate sale-leaseback transactions with each of the three owner-lessors for their respective 16.45%, 16.67% and 100% interests in the Conemaugh, Keystone and Shawville generating stations, respectively, which Reliant Resources acquired as part of the REMA acquisition. These lessees lease an interest in each facility from each owner-lessor under a facility lease agreement. The equity interests in all the subsidiaries of REMA are pledged as collateral for REMA's lease obligations. In addition, the subsidiaries have guaranteed the lease obligations. The lease documents contain restrictive covenants that restrict REMA's ability to, among other things, make dividend distributions unless REMA satisfies various conditions. The covenant restricting dividends would be suspended if the direct or indirect parent of REMA, meeting specified criteria, including having a credit rating on its long-term unsecured senior debt of at least BBB from Standard & Poor's and Baa2 from Moody's, guarantees the lease obligations. For additional discussion of these lease

transactions, please read Notes 3(a) and 14(b) to our consolidated financial statements. Reliant Resources expects to make lease

payments through 2029 under these leases, with total cash payments of \$1.6 billion. The lease terms expire in 2034. During 2000 and 2001, cash lease payments totalled \$1 million and \$259 million, respectively.

Other Operating Lease Commitments. For a discussion of other operating leases, please read Note 14(b) to our consolidated financial statements.

Other Commodity Commitments. For a discussion of other commodity commitments, please read Note 14(a) to our consolidated financial statements.

Naming Rights to Houston Sports Complex. In October 2000, Reliant Resources acquired the naming rights for the new football stadium for the Houston Texans, the National Football League's thirty-second franchise. The agreement extends for 31 years. The aggregate undiscounted cost of the naming rights under this agreement is expected to be \$300 million. Starting in 2002, when the new stadium is operational, Reliant Resources will pay \$10 million each year through 2032 for annual advertising under this agreement. For additional information on the naming rights agreement, please read Note 14(d) to our consolidated financial statements.

Payment to Reliant Energy. To the extent that Reliant Resources' price for providing retail electric service to residential and small commercial customers in Reliant Energy HL&P's historical service territory during 2002 and 2003, which price is mandated by the Texas Electric Restructuring Law, exceeds the market price of electricity, Reliant Resources will be required to make a payment to Reliant Energy in early 2004. Due to the nature of this possible payment, Reliant Resources currently cannot reasonably estimate this payment, and accordingly, it is excluded from the above tables.

Treasury Stock Purchases. On December 6, 2001, the Reliant Resources' board of directors authorized the purchase of up to 10 million additional shares of common stock through June 2003. Purchases will be made on a discretionary basis in the open market or otherwise at times and in amounts as determined by management subject to market conditions, legal requirements and other factors. Since the date of such authorization through March 28, 2002, Reliant Resources has not purchased any of these shares of their common stock under this program.

In addition to the capital requirements discussed above, the following items, among others, could impact future capital requirements for Reliant Resources.

Downgrade in Credit Rating. In accordance with industry practice, Reliant Resources has entered into commercial contracts or issued guarantees related to their trading, marketing and risk management operations that require them to maintain an investment grade credit rating. If one or more of their credit ratings decline below investment grade, Reliant Resources may be obligated to provide additional or other credit support to the guaranteed parties in the form of a pledge of cash collateral, a letter of credit or other similar credit support.

Counterparty Credit Risk. Reliant Resources is exposed to the risk that counterparties who owe them money or physical commodities, such as energy or gas, as a result of market transactions fail to perform their obligations. Should the counterparties to these arrangements fail to perform, Reliant Resources might incur losses if they are forced to acquire alternative hedging arrangements or replace the underlying commitment at then-current market prices. In addition, Reliant Resources might incur additional losses to the extent of amounts, if any, already paid to the defaulting counterparties.

CONSOLIDATED SOURCES OF CASH

Reliant Resources believes that their current level of cash and borrowing capability, along with their future anticipated cash flows from operations and assuming successful refinancings of credit facilities as they mature, will be sufficient to meet the existing operational needs of their business for the next 12 months. If cash generated from operations is insufficient to satisfy their liquidity requirements, Reliant Resources may seek to sell either equity or debt securities or obtain additional credit facilities or long-term financings from financial institutions. In the discussion below, Reliant Resources has provided a description of the significant

factors that could impact their cash flows from operations, their currently available liquidity sources, currently contemplated future liquidity sources and known uncertainties that could impact these sources.

The following items will affect Reliant Resources' future cash flows from operations:

Reliant Resources Restricted Cash. Covenants under the Mid-Atlantic assets lease, discussed above, restrict REMA's ability to make dividend distributions. The restricted cash is available for REMA's working capital needs and for it to make future lease payments. As of December 31, 2001, REMA had \$167 million of restricted cash. Reliant Resources currently anticipates that REMA will be able to satisfy the conditions necessary to distribute these restricted funds in 2002. In addition, the terms of two of their subsidiaries' indebtedness restrict the subsidiaries' ability to pay dividends or make restricted payments to Reliant Resources in some circumstances. Specifically, their subsidiary which holds an electric power generation facility in Channelview, Texas (Channelview) and their subsidiary which holds an equity investment in the entity owning and operating an electric power generation facility in Nevada (El Dorado) are each party to credit agreements used to finance construction of these generating plants. Both the Channelview credit agreement and the El Dorado credit agreement allow the respective subsidiary to pay dividends or make restricted payments only if specified conditions are satisfied, including maintaining specified debt service coverage ratios and debt service reserve account balances. In both cases, the amount of the dividends or restricted payments that may be paid if the conditions are met is limited to a specified level and may be paid only from a particular account.

Orion Power Restricted Cash. Substantially all of Orion Power's operations are conducted by its subsidiaries. The terms of some of its subsidiaries' indebtedness restrict the subsidiaries' ability to pay dividends to Orion Power or Reliant Resources. Restricted funds are available for such subsidiaries to make debt service payments and to meet their working capital needs. In addition, covenants under some indebtedness of Orion Power restrict its ability to pay dividends to Reliant Resources unless Orion Power meets certain conditions, including the ability to incur additional indebtedness without violating the required fixed charge coverage ratio of 2.0 to 1.0. A credit facility of Orion Power also restricts its ability to pay dividends to Reliant Resources unless the restrictions contained in certain of its subsidiaries' credit agreements have terminated and no restrictions remain under its credit agreements.

California Trade Receivables. As of December 31, 2001, Reliant Resources was owed \$302 million by Cal ISO, the California Power Exchange (Cal PX) and the California Department of Water Resources (CDWR) and California Energy Resource Scheduling for energy sales in the California wholesale market, during the fourth quarter of 2000 through December 31, 2001 and has recorded an allowance against such receivables of \$68 million. From January 1, 2002 through March 26, 2002, Reliant Resources has collected \$45 million of these receivable balances. For additional information regarding uncertainties in the California wholesale market, please read Notes 14(f) and 14(g) to our consolidated financial statements.

Other Items. For other items that may affect our future cash flows from operations, please read "-- Certain Factors Affecting Our Future Earnings" related to the Reliant Resources business segments.

The following discussion summarizes Reliant Resources' currently available liquidity sources and material factors that could impact that availability.

Credit Facilities. The following table provides a summary of the amounts owed and amounts available under Reliant Resources' various credit facilities (in millions).

TOTAL EXPIRING BY COMMITTED DRAWN				
LETTERS UNUSED DECEMBER 31, CREDIT				
AMOUNT OF CREDIT AMOUNT 2002(1) -----				

---- Reliant Resources, as of				
December 31,				
2001.....				
	\$5,563	\$1,078	\$396	\$4,089
			\$1,114	
Orion Power, as of February 19,				
2002....	2,028	1,827	95	106
			1,736	---

Total.....				
	\$2,850 =====			

- - - - -
(1) Excludes \$383 million of facilities expiring in November 2002 as borrowings under such facilities are convertible into a long-term loan.

As of February 19, 2002, Reliant Resources has \$2.9 billion of credit facilities which will expire in 2002. To the extent that they continue to need access to this amount of committed credit, Reliant Resources expects to extend or replace these facilities. The current credit environment currently impacting their industry may require their future facilities to include terms that are more restrictive or burdensome or at higher borrowing rates than those of their current facilities.

Reliant Resources Credit Facilities Covenants. As of December 31, 2001, Reliant Resources, including certain of their subsidiaries, had committed credit facilities of \$5.6 billion. Of these facilities, \$5.0 billion contain various business and financial covenants requiring them to, among other things, maintain a ratio of net balance sheet debt to the sum of net balance sheet debt, subordinated affiliate balance sheet debt and stockholders' equity not to exceed 0.60 to 1.00. These covenants are not anticipated to materially restrict Reliant Resources from borrowing funds or obtaining letters of credit under these facilities. The remaining credit facilities of \$0.6 billion, which were held by certain of their domestic power generation subsidiaries, contain various business and financial covenants that are typical for limited or non-recourse project financings. Such covenants include restrictions on dividends and capital expenditures, as well as requirements regarding insurance, approval of operating budgets and commercial contracts. These covenants are not anticipated to materially restrict Reliant Resources from borrowing funds or obtaining letters of credit under their credit facilities. None of the above committed bank credit facilities have any defaults or prepayments triggered by changes in credit ratings, or are in any way linked to the price of Reliant Resources' common stock or any other traded instrument.

For additional information regarding the terms and related interest rates of these credit facilities, please read Note 10 of our consolidated financial statements.

Orion Power Credit Facilities. The credit facilities of Orion Power and its subsidiaries contain various business and financial covenants that are typical for limited or non-recourse project financings. Such covenants include restrictions on dividends and capital expenditures, as well as requirements regarding insurance, approval of operating budgets and commercial contracts. These include covenants that require two of Orion Power's significant subsidiaries which have credit facilities with outstanding borrowings of \$1.6 billion as of December 31, 2001, to, among other things, maintain a debt service coverage ratio of at least 1.5 to 1.0, and for Orion Power, which has a \$75 million credit facility, to, among other things, maintain a debt service coverage ratio of at least 1.4 to 1.0. One of the subsidiaries may not be able to meet this debt service coverage ratio for the quarter ended June 30, 2002, and Orion Power did not meet the debt service coverage ratio for the quarter ended March 31, 2002. In the event that Orion Power is unable to meet this financial covenant for a second consecutive fiscal quarter, it would constitute a default under its credit facility. Reliant Resources currently intends to arrange for the repayment, refinancing or amendment of these facilities prior to June 30, 2002. If these facilities are not repaid, refinanced or amended prior to that date, and if a waiver is required under either or both of these credit facilities, Reliant Resources believes that they will be able to obtain such a waiver on or prior to June 30, 2002. Reliant Resources currently has no assurance that they will be able to obtain such a waiver or amendment from the respective lender groups if required under either or both of these credit facilities.

Orion Bridge Facility. In November 2001, Reliant Resources entered into a \$2.2 billion term loan facility to be utilized for the acquisition of Orion Power. In January 2002, the facility was increased to \$2.9 billion. On February 19, 2002, in connection with the Orion Power acquisition Reliant Resources borrowed \$2.9 billion under the Orion Bridge Facility, which is required to be repaid on or before February 19, 2003.

Potential Future Liquidity Sources. Reliant Resources is currently considering pursuing the following sources of cash to meet their future capital requirements.

Commercial Paper Program. Reliant Resources plans to commence a commercial paper program in 2002, which will be supported by their existing credit facilities. Although they have not yet determined the size

of such program, Reliant Resources does not expect that it would exceed \$300 million initially, due to market conditions and their current credit ratings. To the extent that they are not successful in placing commercial paper consistently, Reliant Resources will borrow directly under their existing credit facilities.

Debt Securities in the Capital Markets. As part of refinancing the Orion Bridge Facility, Reliant Resources currently expects that they will issue various fixed and floating rate debt securities in 2002 having maturities up to ten years or greater depending upon market conditions. Reliant Resources expects to offer debt securities in the amount of \$2.5 to \$3.0 billion, depending on market conditions. Their ability to complete such debt offerings in the capital markets will depend on their future performance and prevailing market conditions. This Form 10-K does not constitute an offer to sell or the solicitation of an offer to buy debt securities of Reliant Resources or their subsidiaries.

Settlement of Indemnification of REPG B Stranded Costs. In December 2001, REPG B and its former shareholders entered into a settlement agreement resolving the former shareholders' stranded cost indemnity obligations under the purchase agreement of REPG B. Under the settlement agreement, the former shareholders paid to REPG B NLG 500 million (\$202 million based on an exchange rate of 2.48 NLG per U.S. dollar as of December 31, 2001) in January and February 2002. In addition, under the settlement agreement, the former shareholders waived all rights under the original indemnification agreement to claim distributions from NEA, a 22.5% owned equity investment. Reliant Resources estimates that there will be future distributions from 2002 through 2005 from NEA to REPG B totaling approximately \$299 million. For additional information regarding the settlement agreement, Reliant Resources' investment in NEA and indemnification of district heat contract obligations, please read Note 14(h) to our consolidated financial statements.

Factors Affecting Our Sources of Cash and Liquidity. As a result of several recent events, including the United States economic recession, the price decline of the common stock of participants in Reliant Resources' industry sector and the downgrading of the credit ratings of several of Reliant Resources' significant competitors, the availability and cost of capital for their business and the businesses of their competitors have been adversely affected. Any future acquisition or development projects will likely require Reliant Resources to access substantial amounts of capital from outside sources on acceptable terms. Reliant Resources may also need external financing to fund capital expenditures, including capital expenditures necessary to comply with air emission regulations or other regulatory requirements. If Reliant Resources is unable to obtain outside financing to meet their future capital requirements on terms that are acceptable to them, their financial condition and future results of operations could be materially adversely affected. In order to meet their future capital requirements, Reliant Resources may increase the proportion of debt in their overall capital structure. Increases in their debt levels may adversely affect their credit ratings thereby increasing the cost of their debt. In addition, the capital constraints currently impacting their industry may require Reliant Resources' future indebtedness to include terms and/or pricing that are more restrictive or burdensome than those of their current indebtedness. This may negatively impact their ability to operate their business, or severely restrict or prohibit distributions from their subsidiaries.

Reliant Resources' ability to arrange financing, including refinancing, and their cost of capital are dependent on the following factors:

- general economic and capital market conditions;
- maintenance of acceptable credit ratings;
- credit availability from banks and other financial institutions;
- investor confidence in Reliant Resources, their competitors and peer companies and their wholesale power markets;
- market expectations regarding their future earnings and probable cash flows;
- market perceptions of Reliant Resources' ability to access capital markets on reasonable terms;
- the success of current power generation projects;
- the perceived quality of new power generation projects; and
- provisions of relevant tax and securities laws.

construction period or during the lease, Reliant Resources may purchase a facility by paying an amount approximately equal to the outstanding balance plus costs. As of December 31, 2001, the special purpose entities had property, plant and equipment of \$428 million and net other assets of \$52 million, which were primarily restricted cash and debt obligations of \$465 million. As of December 31, 2001, the special purpose entities had equity from unaffiliated third parties of \$15 million. Reliant Resources currently estimates the aggregate cost of the three generating facilities that are currently under construction by the special purpose entities to be approximately \$1.8 billion.

Equipment Financing Structure. Reliant Resources, through their subsidiary, REPG, has entered into an agreement with a bank whereby the bank, as owner, entered or will enter into contracts for the purchase and construction of power generation equipment and REPG, or its subagent, acts as the bank's agent in connection with administering the contracts for such equipment. Under the agreement, the bank has agreed to provide up to a maximum aggregate amount of \$650 million. REPG and its subagents must cash collateralize their obligation to administer the contracts. This cash collateral is approximately equivalent to the total payments by the bank for the equipment, interest and other fees. As of December 31, 2001, the bank had assumed contracts for the purchase of eleven turbines, two heat recovery steam generators and one air-cooled condenser with an aggregate cost of \$398 million. REPG, or its designee, has the option at any time to purchase or, at equipment completion, subject to certain conditions, including the agreement of the bank to extend financing, to lease equipment, or to assist in the remarketing of the equipment under terms specified in the agreement. All costs, including the purchase commitment on the turbines, are the responsibility of the bank. The cash collateral is deposited by REPG or an affiliate into a collateral account with the bank and earns interest at the London inter-bank offered rate (LIBOR) less 0.15%. Under certain circumstances, the collateral deposit or a portion of it will be returned to REPG or its designee. Otherwise it will be retained by the bank. At December 31, 2001, REPG and its subsidiary had deposited \$230 million into the collateral account. The bank's payments for equipment under the contracts totaled \$227 million as of December 31, 2001. In January 2002, the bank sold to the parties to the construction agency agreements discussed above, equipment contracts with a total contractual obligation of \$258 million under which payments and interest during construction totaled \$142 million. Accordingly, \$142 million of our collateral deposits were returned to Reliant Resources. As of December 31, 2001, there were equipment contracts with a total contractual obligation of \$140 million under which payments during construction totaled \$83 million. Currently this equipment is not designated for current planned power generation construction projects. Therefore, Reliant Resources anticipates that it will either purchase the equipment, assist in the remarketing of the equipment or negotiate to cancel the related contracts.

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) BACKGROUND AND BASIS OF PRESENTATION

Reliant Energy, Incorporated (Reliant Energy), together with its subsidiaries (collectively, the Company), is a diversified international energy services company that provides energy and energy services primarily in North America and Western Europe. Reliant Energy is both an electric utility company and a utility holding company through its wholly owned subsidiary Reliant Energy Resources Corp. (RERC).

The Company's financial reporting business segments include the following: Electric Operations, Natural Gas Distribution, Pipelines and Gathering, Wholesale Energy, European Energy, Retail Energy, Latin America and Other Operations. Electric Operations includes the operations of Reliant Energy HL&P, an electric utility. Natural Gas Distribution consists of intrastate natural gas sales to, and natural gas transportation and distribution for, residential, commercial, industrial and institutional customers and some non-rate regulated retail gas marketing operations to commercial and industrial customers. Pipelines and Gathering includes the interstate natural gas pipeline operations and the natural gas gathering and pipelines services businesses. Wholesale Energy is engaged in the acquisition, development and operation of non-rate regulated power generation facilities as well as the wholesale energy trading, marketing, power origination and risk management services in North America. European Energy is engaged in the operation of power generation facilities in the Netherlands as well as wholesale energy trading and power origination activities in Europe. Retail Energy consists of the Company's unregulated retail electric operations, and has historically been reported in the Other Operations business segment. Other Operations includes unallocated general corporate expenses, a communications business and non-operating investments. Latin America primarily consists of an electric utility and an electric cogeneration plant located in Argentina. Wholesale Energy, European Energy, Retail Energy and certain operations included within Other Operations are currently owned by Reliant Resources.

Reliant Energy is in the process of separating its regulated and unregulated businesses into two publicly traded companies. In December 2000, Reliant Energy transferred a significant portion of its unregulated businesses to Reliant Resources, Inc. (Reliant Resources) which, at the time, was a wholly owned subsidiary. In May 2001, Reliant Resources conducted an initial public offering (Offering) of approximately 20% of its common stock (59.8 million shares of its common stock) at a price of \$30 per share, and received net proceeds from the Offering of \$1.7 billion. After the Offering, Reliant Energy owned approximately 80% of Reliant Resources. As of December 31, 2001, Reliant Energy owns approximately 83% of Reliant Resources due to treasury stock repurchases of \$189 million during 2001 by Reliant Resources. As a result of the Offering, the Company recorded directly into stockholders' equity as a component of common stock a \$509 million unrealized gain on the sale of subsidiaries' stock. Pursuant to a master separation agreement between Reliant Energy and Reliant Resources, Reliant Resources used \$147 million of the net proceeds to repay certain indebtedness owed to Reliant Energy. In connection with the Offering, Reliant Energy converted \$1.7 billion of intercompany indebtedness owed by Reliant Resources and its subsidiaries prior to the closing of the Offering to equity as a capital contribution to Reliant Resources. In December 2001, Reliant Energy's shareholders approved an agreement and plan of merger by which the following will occur (which we refer to as the Restructuring):

- CenterPoint Energy will become the holding company for Reliant Energy and its subsidiaries;
- Reliant Energy and its subsidiaries will become subsidiaries of CenterPoint Energy; and
- each share of Reliant Energy common stock will be converted into one share of CenterPoint Energy common stock.

After the Restructuring, Reliant Energy plans, subject to further corporate approvals, market and other conditions, to complete the separation of its regulated and unregulated businesses by distributing the shares of common stock of Reliant Resources that the Company owns to its shareholders (Distribution). The Company's goal is to complete the Restructuring and subsequent Distribution as quickly as possible after all

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

the necessary conditions are fulfilled, including receipt of an order from the Securities and Exchange Commission (SEC) granting the required approvals under the Public Utility Holding Company Act of 1935 (1935 Act) and an extension from the IRS of its private letter ruling that the Company has obtained regarding the tax-free treatment of the Distribution. Although receipt or timing of regulatory approvals cannot be assured, the Company believes it meets the standards for such approvals. Reliant Energy currently expects to complete the Restructuring and Distribution in the summer of 2002.

Effective December 1, 2000, Reliant Energy's board of directors approved a plan to dispose of the Company's Latin America business segment through sales of its assets. Accordingly, in its 2000 consolidated financial statements, the Company reported the results of its Latin America business segment as discontinued operations in accordance with Accounting Principles Board (APB) Opinion No. 30 "Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," (APB Opinion No. 30) for each of the three years in the period ended December 31, 2000. On December 20, 2001, negotiations for the sale of the remaining Latin America investments were terminated as a result of the recent economic developments in Argentina. The Company will continue to evaluate options related to the future disposition of these assets.

Accordingly, the Latin America business segment is no longer reported as discontinued operations. The related operating results and loss on disposal have been reclassified within the Consolidated Statements of Income for all periods into operating income with respect to consolidated subsidiaries and other income with respect to equity investments in unconsolidated subsidiaries as required for assets held for sale by Emerging Issues Task Force (EITF) Issue No. 90-6 (EITF 90-6). For additional information regarding the disposal of the Latin America business segment, see Note 19.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(d) REVENUES

The Company records revenue for electricity and natural gas sales and services to retail customers, except for certain contracted sales to large commercial, industrial and institutional customers, under the accrual method and these revenues are generally recognized upon delivery. Pipelines and Gathering record revenues as transportation services are provided. Energy sales and services not billed by month-end are accrued based upon estimated energy and services delivered. Domestic non-rate regulated electric power and other non-rate regulated energy services are sold at market-based prices through existing power exchanges or through third-party contracts. Prior to January 1, 2001, energy revenues related to the Company's power generation facilities in Europe were generated under a regulated pricing structure, which included compensation for the cost of fuel, capital and operation and maintenance expenses. The wholesale electric market in the Netherlands opened to competition on January 1, 2001. Accordingly, beginning in 2001, electric power and other energy services in Europe are sold at market-based prices or through third-party contracts.

The Company's energy trading, marketing, power origination and risk management services activities and contracted sales of electricity to large commercial, industrial and institutional customers are accounted for under mark-to-market accounting. Under the mark-to-market method of accounting, financial instruments and contractual commitments are recorded at fair value in revenues upon contract execution. The net changes in their fair values are recognized in the Statements of Consolidated Income as revenues in the period of change. Trading and marketing revenues related to the physical sale of natural gas, electric power and other energy related commodities are recorded on a gross basis in the delivery period. For additional discussion regarding trading and marketing revenue recognition and the related estimates and assumptions that can affect reported amounts of such revenues, see Note 5.

The gains and losses related to financial instruments and contractual commitments qualifying and designated as hedges related to the sale of electric power and sales and purchases of natural gas are recognized in the same period as the settlement of the underlying physical transaction. These realized gains and losses are included in operating revenues and operating expenses in the Statements of Consolidated Income. For additional discussion, see Note 5.

(e) LONG-LIVED ASSETS AND INTANGIBLES

The Company records property, plant and equipment at historical cost. The Company recognizes repair and maintenance costs incurred in connection with planned major maintenance, such as turbine and generator overhauls, control system upgrades and air conditioner replacements, under the "accrual in advance" method for its non-rate regulated power generation operations acquired or developed prior to December 31, 1999. Planned major maintenance cycles primarily range from two to ten years. Under the accrual in advance method, the Company estimates the costs of planned major maintenance and accrues the related expense over the maintenance cycle. As of December 31, 2000 and 2001, the Company's maintenance reserve was \$27 million and \$19 million, respectively, of which \$20 million and \$17 million, respectively, were included in

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

other long-term liabilities and the remainder in other current liabilities. The Company expenses all other repair and maintenance costs as incurred. Property, plant and equipment includes the following:

DECEMBER 31, ESTIMATED USEFUL		-----	
LIVES (YEARS)	2000	2001	-----
----- (IN MILLIONS)			
Electric.....	5-75	\$18,754	\$20,135
distribution.....	5-50	1,809	
gathering.....	5-75	1,582	
property.....	3-40		
	247	450	-----
Total.....			
amortization.....		(7,132)	(8,357)
net.....		\$15,260	\$15,857

The Company records goodwill for the excess of the purchase price over the fair value assigned to the net assets of an acquisition. Goodwill has been amortized on a straight-line basis over 5 to 40 years. See Note 3 and the following table for additional information regarding goodwill and the related amortization periods.

DECEMBER 31, ESTIMATED USEFUL		-----		LIVES
(YEARS)	2000	2001	-----	(IN
MILLIONS)				
Reliant Energy Resources Corp. (RERC Corp.).....	40	\$1,955	\$1,955	Reliant Energy
Mid-Atlantic Power Holdings, LLC.....	35	7	5	
Reliant Energy Power Generation Benelux N.V.	30	897	834	Florida Generation
Plant.....	35	2	2	California
Generation Plants.....	30	70	70	
Reliant Energy Services, Inc.	40	131	131	
Other.....	5-35	64	45	-----
Total.....				
amortization.....		3,126	3,042	Accumulated
impact.....		(107)	(150)	-----
net.....		\$2,797	\$2,589	=====

The Company recognizes specifically identifiable intangibles, including air emissions regulatory allowances and water rights and permits, when specific rights and contracts are acquired. As of December 31, 2000 and 2001, specific intangibles were \$284 million and \$315 million, respectively. The Company amortizes air emissions regulatory allowances primarily on a units-of-production basis as utilized. The Company amortizes other acquired intangibles on a straight-line basis over the lesser of their contractual or estimated useful lives that range between 5 and 35 years.

The Company periodically evaluates long-lived assets, including property, plant and equipment, goodwill and specifically identifiable intangibles, when events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. The determination of whether an impairment has occurred is based on an estimate of undiscounted cash flows attributable to the assets, as compared to the carrying value of the assets. An impairment analysis of generating facilities requires estimates of possible future market prices, load growth, competition and many other factors over the lives of the facilities. A resulting impairment loss is highly dependent on these underlying assumptions. During 2001, the Company determined equipment and goodwill associated with its Communications business was impaired and accordingly recognized

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

\$22 million of fixed asset impairments and \$19 million of goodwill impairments (see Note 20). For discussion of goodwill impairment analysis in 2002, see Note 2(q).

During December 2001, the Company evaluated its European Energy business segment's long-lived assets and goodwill for impairment. As of December 31, 2001, pursuant to Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (SFAS No. 121), no impairment had been indicated. For discussion of goodwill impairment analysis in 2002, see Note 2(q).

During the fourth quarter of 2001, the Distribution of Reliant Resources was deemed to be a probable event. As Reliant Resources has an option, subject to the completion of the Distribution, to purchase the Company's Texas generation assets in 2004 (see Note 4(b)), the Company was required to evaluate these assets for potential impairment in accordance with SFAS No. 121, due to an expected decrease in the number of years the Company expects to hold and operate these assets. As of December 31, 2001, no impairment had been indicated. The Company anticipates that future events, such as the expected public offering of the Company's Texas generation operations (see Note 4(b)), or change in the estimated holding period of the Texas generation assets, will require the Company to re-evaluate these assets for impairment between now and 2004. If an impairment is indicated, it could be material and will not be fully recoverable through the 2004 true-up proceeding calculations (see Note 4(a)).

The Texas Electric Restructuring Law provides the Company recovery of the regulatory book value of its Texas generating assets for the amount the regulatory book value exceeds the estimated market value. If the Texas generating assets are sold to Reliant Resources, or to a third party in the future, a loss on sale of these assets, or an impairment of the recorded recoverable electric generation plant mitigation regulatory asset (see Note 2(f)), will occur to the extent the recorded book value of the Texas generating assets exceeds the regulatory book value. As of December 31, 2001, the recorded book value was \$638 million in excess of the regulatory book value. This amount declines each year as the recorded book value is depreciated and increases by the amount of non-environmental capital expenditures. For further discussion of the difference between the regulatory book value and the recorded book value, see Note 4.

(f) REGULATORY ASSETS AND LIABILITIES

The Company applies the accounting policies established in SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71) to the accounts of transmission and distribution operations of Reliant Energy HL&P and the utility operations of Natural Gas Distribution and to some of the accounts of Pipelines and Gathering. For information regarding Reliant Energy HL&P's electric generation operations' discontinuance of the application of SFAS No. 71 in 1999 and the effect on its regulatory assets and the Texas Electric Choice Plan (Texas Electric Restructuring Law), see Note 4(a).

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The following is a list of regulatory assets/liabilities reflected on the Company's Consolidated Balance Sheets as of December 31, 2000 and 2001:

DECEMBER 31, -----	2000	2001	-----
(IN MILLIONS) Recoverable impaired plant costs, net.....	\$ 281	\$ --	Recoverable
electric generation related regulatory assets, net.....	1,150	160	Securitized regulatory
asset.....	--	740	Regulatory
tax asset, net.....	186	111	Unamortized loss on reacquired
debt.....	66	62	Recoverable electric
generation plant mitigation.....	--	1,967	Excess
mitigation liability.....	--	(1,126)	Other long-term
assets/liabilities.....	6	3	-----
Total.....	\$1,689	\$ 1,917	=====

If, as a result of changes in regulation or competition, the Company's ability to recover these assets and liabilities would not be assured, then pursuant to SFAS No. 101, "Regulated Enterprises Accounting for the Discontinuation of Application of SFAS No. 71" (SFAS No. 101) and SFAS No. 121, the Company would be required to write off or write down these regulatory assets and liabilities. In addition, the Company would be required to determine any impairment to the carrying costs of plant and inventory assets. See Note 4(a) for a discussion of the discontinuation of SFAS No. 71 related to Reliant Energy HL&P's electric generation operations.

Through December 31, 2001, the Texas Utility Commission provided for the recovery of most of Reliant Energy HL&P's fuel and purchased power costs from customers through a fixed fuel factor included in electric rates. Included in the above table in recoverable electric generation related regulatory assets, net are \$558 million and \$200 million of regulatory assets related to the recovery of fuel costs as of December 31, 2000 and 2001.

In December 2001, the Company recorded a regulatory asset for recoverable electric generation plant mitigation for \$2.0 billion and recorded a regulatory liability of \$1.1 billion for excess mitigation, resulting in net regulatory assets of \$841 million on which the Company will not earn a return and which are not included in the Company's rate base. Recoverable electric plant generation regulatory assets are anticipated to be recovered in the 2004 true-up proceedings as further discussed in Note 4(a). The Company is entitled to recover its full amount of stranded costs in the 2004 true-up proceeding. That recovery would include any amounts whose earlier mitigation was prevented by excess mitigation credits and the reversal of redirected depreciation ordered by the Texas Utility Commission.

In 2001, the Company monetized \$738 million of regulatory assets in a securitization financing authorized by the Texas Utility Commission pursuant to the Texas Electric Restructuring Law. For additional information regarding the securitization financing, see Note 4(a).

For additional information regarding recoverable impaired plant costs and recoverable electric generation related assets and the related amortization during 1999, 2000 and 2001, see Notes 2(g) and 4(a).

(3) BUSINESS ACQUISITIONS

(a) RELIANT ENERGY MID-ATLANTIC POWER HOLDINGS, LLC

On May 12, 2000, a subsidiary of the Company purchased entities owning electric power generating assets and development sites located in Pennsylvania, New Jersey and Maryland having an aggregate net generating capacity of approximately 4,262 MW. With the exception of development entities that were sold to another subsidiary of Reliant Resources in July 2000, the assets of the entities acquired are held by REMA. The purchase price for the May 2000 transaction was \$2.1 billion. In 2002, the Company made an \$8 million payment to the prior owner for post-closing adjustments which resulted in an adjustment to purchase price. The Company accounted for the acquisition as a purchase with assets and liabilities of REMA reflected at their estimated fair values. The Company's fair value adjustments related to the acquisition primarily included adjustments in property, plant and equipment, air emissions regulatory allowances, specific intangibles, materials and supplies inventory, environmental reserves and related deferred taxes. The air emissions regulatory allowances of \$153 million are being amortized on a units-of-production basis as utilized. The specific intangibles which relate to water rights and permits of \$43 million will be amortized over the estimated life of the related facility of 35 years. The excess of the purchase price over the fair value of the net assets acquired of \$5 million was recorded as goodwill and historically was amortized over 35 years. The

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Company finalized these fair value adjustments in May 2001. There were no additional material modifications to the preliminary adjustments from December 31, 2000. Funds for the acquisition of REMA were made available through commercial paper borrowings by a finance subsidiary, which borrowings were supported by credit facilities.

The net purchase price of REMA was allocated and the fair value adjustments to the seller's book value are as follows:

PURCHASE PRICE FAIR VALUE ALLOCATION ADJUSTMENTS -----	
----- (IN MILLIONS) Current	
assets.....	\$ 85 \$
(27) Property, plant and	
equipment.....	1,898 627
Goodwill.....	
5 (146) Other	
intangibles.....	196
33 Other	
assets.....	3
(5) Current	
liabilities.....	(50)
(13) Other	
liabilities.....	(39)
(15) -----	
Total.....	\$2,098 \$ 454 =====

Adjustments to property, plant and equipment, other intangibles which includes air emissions regulatory allowances and other specific intangibles, and environmental reserves included in other liabilities are based primarily on valuation reports prepared by independent appraisers and consultants.

In August 2000, the Company, through subsidiaries, entered into separate sale-leaseback transactions with each of three owner-lessors covering the subsidiaries' respective 16.45%, 16.67% and 100% interests in the Conemaugh, Keystone and Shawville generating stations, respectively, acquired as part of the REMA acquisition. As lessee, Reliant Resources leases an interest in each facility from each owner-lessor under a facility lease agreement. As consideration for the sale of the Company's interest in the facilities, the Company received \$1.0 billion in cash. The Company used the \$1.0 billion of sale proceeds to repay certain commercial paper borrowings as described above.

The Company's results of operations include the results of REMA only for the period beginning May 12, 2000. The following table presents selected actual financial information and unaudited pro forma information for 1999 and 2000, as if the acquisition had occurred on November 24, 1999 and January 1, 2000, as applicable. Pro forma information for operations prior to November 24, 1999 would not be meaningful since historical financial results of the business and the revenue generating activities underlying that period are substantially different from the wholesale generation activities that REMA has been engaged in after November 24, 1999. Pro forma amounts also give effect to the sale and leaseback of interests in three of the REMA generating plants, which were consummated in August 2000.

YEAR ENDED DECEMBER 31, -----	-----	-----
----- 1999 2000 -----	-----	-----
----- UNAUDITED	-----	-----
UNAUDITED ACTUAL PRO FORMA ACTUAL PRO FORMA	-----	-----
----- (IN	-----	-----
MILLIONS)	-----	-----
Revenues.....		
\$15,211 \$15,241 \$29,339 \$29,506	Income after	
tax and before extraordinary		
items.....		
1,666 1,656 440 431	Net income attributable	
to common		
stockholders.....		
1,482 1,472 447 438		

These unaudited pro forma results, based on assumptions deemed appropriate by the Company's management, have been prepared for informational purposes only and are not necessarily indicative of the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

amounts that would have resulted if the acquisition of the REMA entities had occurred on November 24, 1999 and January 1, 2000, as applicable. Purchase-related adjustments to the results of operations include the effects on depreciation and amortization, interest expense and income taxes.

(b) RELIANT ENERGY POWER GENERATION BENELUX N.V.

Effective October 7, 1999, a subsidiary of the Company acquired REPGb, a Dutch electric generation company, for a total net purchase price, payable in Dutch Guilders (NLG), of \$1.9 billion based on an exchange rate on October 7, 1999 of 2.06 NLG per U.S. dollar. The aggregate purchase price paid in 1999 by the Company consisted of \$833 million in cash. On March 1, 2000, under the terms of the acquisition agreement, the Company funded the remaining purchase obligation for \$982 million. A portion (\$596 million) of this obligation was financed with a three-year term loan facility obtained in the first quarter of 2000.

The Company recorded the REPGb acquisition under the purchase method of accounting, with assets and liabilities of REPGb reflected at their estimated fair values. As outlined in the table below, the Company's fair value adjustments related to the acquisition of REPGb primarily included increases in property, plant and equipment, long-term debt, severance liabilities, post-employment benefit liabilities and deferred foreign taxes. Additionally, a \$19 million receivable was recorded in connection with the acquisition as the selling shareholders agreed to reimburse REPGb for some obligations incurred prior to the purchase of REPGb. Adjustments to property, plant and equipment are based on valuation reports prepared by independent appraisers and consultants. The excess of the purchase price over the fair value of net assets acquired of \$877 million was recorded as goodwill and was historically amortized on a straight-line basis over 30 years. The Company finalized these fair value adjustments in September 2000. In 2002, the Company recorded a \$43 million reduction in goodwill related to the accounting for the purchase of treasury shares. The Company finalized a severance plan (REPGb Plan) in connection with the REPGb acquisition in September 2000 (commitment date) and in accordance with EITF Issue No. 95-3 "Recognition of Liabilities in Connection with a Purchase Business Combination," recorded this liability of \$19 million in the third quarter of 2000. During 2001, the Company utilized \$8 million of the reserve for the REPGb Plan. As of December 31, 2001, the remaining severance liability is \$11 million. The majority of the \$11 million of remaining severance liability will be disbursed in accordance with the terms and conditions outlined by a collective labor bargaining agreement regarding employees near retirement age (Social Plan) in accordance with applicable Dutch labor law. The Social Plan, which by formula defines termination benefits, prescribes a payout period for up to five years for an employee subsequent to termination date. In the fourth quarter of 2001, the Dutch taxing authority finalized REPGb's tax basis of property, plant and equipment as of October 1999. As a result, the Company recorded an adjustment to decrease goodwill and accumulated deferred tax liability by \$5 million in the fourth quarter of 2001. As of December 31, 2001, the tax basis of other certain assets and liabilities has not been finalized.

In connection with the acquisition of REPGb, the Company developed a comprehensive business process reengineering and employee severance plan intended to make REPGb competitive in the deregulated Dutch electricity market that began January 1, 2001. The REPGb Plan's initial conceptual formulation was initiated prior to the acquisition of REPGb in October 1999. The finalization of the REPGb Plan was approved and completed in September 2000. The Company identified 195 employees who were involuntarily terminated in REPGb's following functional areas: plant operations and maintenance, procurement, inventory, general and administrative, legal, finance and support. The Company has notified all employees identified under the severance component of the REPGb Plan that they are subject to involuntary termination and the majority of terminations occurred during 2001. The termination benefits under the REPGb Plan are governed by REPGb's Social Plan, a collective bargaining agreement between REPGb and its various representative labor unions signed in 1998. The Social Plan provides defined benefits for involuntarily severed employees depending upon age, tenure and other factors, and was agreed to by the management of REPGb as a result of the anticipated deregulation of the Dutch electricity market. The Social Plan is still in force and binding on

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

the current management of the Company and REPG. The Company is still executing the REPG Plan as of the date of these consolidated financial statements.

The net purchase price of REPG was allocated and the fair value adjustments to the seller's book value are as follows:

PURCHASE PRICE FAIR VALUE ALLOCATION ADJUSTMENTS -----	
----- (IN MILLIONS) Current	
assets.....	\$ 244
\$ 34 Property, plant and	
equipment.....	1,899 719
Goodwill.....	877 877 Current
liabilities.....	(336)
-- Deferred	
taxes.....	(76)
(76) Long-term	
debt.....	(422)
(87) Other long-term	
liabilities.....	(244) (35) ---

Total.....	\$1,942 \$1,432 =====

The following table presents selected actual financial information for 1999 and unaudited pro forma information for 1999, as if the acquisition of REPG had occurred on January 1, 1999. The pro forma results are based on assumptions deemed appropriate by the Company's management, have been prepared for informational purposes only and are not necessarily indicative of the consolidated results that would have resulted if the acquisition of REPG had occurred on January 1, 1999. Purchase related adjustments to results of operations include amortization of goodwill, interest expense and the effects on depreciation and amortization of the assessed fair value of some of REPG's net assets and liabilities.

1999 -----	ACTUAL PRO FORMA -----
(IN MILLIONS)	
Revenues.....	\$15,211 \$15,788
Net income attributable to common	
stockholders.....	1,482 1,455

(c) FLORIDA GENERATION PLANT PURCHASE

On October 6, 1999, the Company purchased a steam turbine generation plant (Indian River) with a net generating capacity of 619 MW from a Florida municipality (Municipality) for a net purchase price of \$188 million. Indian River, located near Titusville, Florida, consists of three conventional steam generation units fueled by both oil and natural gas. Under the Company's ownership, the units will sell up to 578 MW of power generation from Indian River to the Municipality through a power purchase agreement that was originally scheduled to expire in September 2003, but has been extended through September 2007. During the option period, the Municipality has the right to purchase up to 500 MW for the first two years of the option period and 300 MW for the final two years. Any excess power generated by the plant may be sold to other utilities and rural electric cooperatives within the state and other entities within the Florida wholesale market. The Company recorded the acquisition under the purchase method of accounting. The purchase price has been allocated to assets acquired and liabilities assumed based on their estimated fair market values at the date of acquisition. The Company's fair value adjustments related to the acquisition of Indian River primarily included increases in property, plant and equipment, specific intangibles related to water rights and permits, major maintenance reserves and related deferred taxes. The specific intangibles of \$112 million are being amortized over their contractual lives of 35 years. The Company finalized these fair value adjustments during

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

September 2000. There were no material adjustments made to the purchase allocation subsequent to December 31, 1999.

Net purchase price of Indian River was allocated as follows (in millions):

Current assets.....	\$ 15
Property, plant and equipment.....	93
Goodwill.....	2
Other intangibles.....	112
Major maintenance reserve.....	(3)
Other long-term liabilities.....	(31)

Total.....	\$188
	====

The Company's results of operations include Indian River's results of operations only for the period beginning with the October 6, 1999 acquisition date. Pro forma information has not been presented for Indian River for 1999. Pro forma information would not be meaningful since historical financial results of the business and the revenue generating activities underlying that period as described below are substantially different from the wholesale generation activities that Indian River has been engaged in after October 6, 1999. Prior to the Company's acquisition, the acquired Indian River generation operations were fully integrated with, and its results of operations were consolidated into, the Municipality's vertically-integrated utility operations. In addition, prior to the Company's acquisition, the electric output of these facilities was sold based on rates set by regulatory authorities and are not indicative of these assets' future operating results as a wholesale electricity provider.

(4) REGULATORY MATTERS

(a) TEXAS ELECTRIC CHOICE PLAN AND DISCONTINUANCE OF SFAS NO. 71 FOR ELECTRIC GENERATION OPERATIONS

In June 1999, the Texas legislature adopted the Texas Electric Restructuring Law, which substantially amended the regulatory structure governing electric utilities in Texas in order to allow retail electric competition. Retail pilot projects allowing competition for up to 5% of each utility's load in all customer classes began in the third quarter of 2001, and retail electric competition for all other customers began in January 2002. In preparation for competition, the Company made significant changes in the electric utility operations it conducts through its electric utility division, Reliant Energy HL&P. In addition, the Texas Utility Commission issued a number of new rules and determinations in implementing the Texas Electric Restructuring Law.

The Texas Electric Restructuring Law defined the process for competition and created a transition period during which most utility rates were frozen at rates not in excess of their then-current levels. The Texas Electric Restructuring Law provided for utilities to recover their generation related stranded costs and regulatory assets (as defined in the Texas Electric Restructuring Law).

Retail Choice. Under the Texas Electric Restructuring Law, beginning January 1, 2002, retail customers of most investor owned electric utilities in Texas became eligible to purchase their electricity from any of a number of "retail electric providers," which are certified by the Texas Utility Commission. Retail electric providers may not own or operate generation assets and their sales prices are not subject to traditional cost-of-service rate regulation. Retail electric providers that are affiliates of electric utilities may compete substantially statewide for these sales, but prices they charge within the affiliated electric utility's traditional service territory are subject to some limitations at the outset of retail choice, as described below. The Texas Utility Commission has prescribed regulations governing quality, reliability and other aspects of service from retail electric providers. Reliant Resources intends to compete in the Texas retail market and, as a result, has certified three of its subsidiaries as retail electric providers.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Unbundling. As of January 1, 2002, electric utilities in Texas such as Reliant Energy HL&P unbundled their businesses in order to separate power generation, transmission and distribution, and retail activities into different units. Pursuant to the Texas Electric Restructuring Law, the Company submitted a plan in January 2000 that was later amended and updated to accomplish the required separation (the Business Separation Plan). For additional information regarding the Business Separation Plan, see Note 4(b). The transmission and distribution business will continue to be subject to cost-of-service rate regulation and will be responsible for the delivery of electricity to retail customers. The Company plans to transfer the Texas generation facilities that were formerly part of the Reliant Energy HL&P integrated utility (Texas generation business) to an indirect wholly owned partnership (Texas Genco) in connection with the Restructuring. As a result of these changes, the Company's Texas generation operations will no longer be conducted as part of an integrated utility and will comprise a new business segment in 2002, Electric Generation. Additionally, these operations will not be part of the Company's business if they are acquired in 2004 by Reliant Resources pursuant to an option agreement as described below. At that time, Reliant Resources will be an unaffiliated company as a result of the planned Distribution.

Generation. Power generators began selling electric energy to wholesale purchasers, including retail electric providers, at unregulated prices on January 1, 2002. To facilitate a competitive market, each power generation company affiliated with a transmission and distribution utility is required to sell at auction 15% of the output of its installed generating capacity. The first auction was held in September 2001 for power delivered beginning January 1, 2002. This obligation continues until January 1, 2007 unless before that date the Texas Utility Commission determines that at least 40% of the quantity of electric power consumed in 2000 by residential and small commercial load in the electric utility's service area is being served by retail electric providers other than the affiliated retail electric provider. See Note 4(b) for information regarding the capacity auctions and the effect of the Business Separation Plan on the Company. Texas Genco plans to auction all of its remaining capacity (less approximately 10% withheld to provide for unforeseen outages) during the time period prior to Reliant Resources' exercise of the Texas Genco option discussed below. Pursuant to the Business Separation Plan, Reliant Resources is entitled to purchase, at prices established in these auctions, 50% (but no less than 50%) of the remaining capacity, energy and ancillary services auctioned by Texas Genco.

Rates. Base rates charged by Reliant Energy HL&P on September 1, 1999 were frozen until January 1, 2002. Pursuant to Texas Utility Commission regulations, effective January 1, 2002, after the cycle meter read in January 2002, retail rates charged to residential and small commercial customers by an affiliated retail electric provider were reduced by 6% from the average rates (on a bundled basis) in effect on January 1, 1999. Following adjustments for changes in fuel prices, this actually resulted in a 17% rate reduction for Reliant Resources, through its subsidiaries, as an affiliated retail provider. That reduced rate, known as the "price to beat", is being charged by the affiliated retail electric provider to residential and small commercial customers in the utility's service area who have not elected service from another retail electric provider. The affiliated retail electric provider may not offer different rates to residential or small commercial customer classes in the utility's service area until the earlier of the date the Texas Utility Commission determines that 40% of power consumed by that class in the affiliated transmission and distribution utility's service area is being served by non-affiliated retail electric providers or January 1, 2005. In addition, the affiliated retail electric provider must make the price to beat rate available to eligible consumers until January 1, 2007.

Stranded Costs. Reliant Energy HL&P will be entitled to recover its stranded costs (i.e., the excess of net book value of generation assets (as defined by the Texas Electric Restructuring Law) over the market value of those assets) and its regulatory assets related to generation. The Texas Electric Restructuring Law prescribes specific methods for determining the amount of stranded costs and the details for their recovery. During the transition period to deregulation (the Transition Period) which included 1998 and the first six months of 1999, and extending through the base rate freeze period from July 1999 through 2001, the Texas Electric Restructuring Law provided that earnings above a stated overall annual rate of return on invested

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

capital be used to recover the Electric Operations business segments' investment in generation assets (Accelerated Depreciation). In addition, during the Transition Period, the redirection of depreciation expense to generation assets that the Electric Operation business segment would otherwise apply to transmission, distribution and general plant assets was permitted for regulatory purposes (Redirected Depreciation). See discussion of the accounting treatment of Accelerated Depreciation and Redirected Depreciation for financial reporting purposes below under "Accounting." We cannot predict the amount, if any, of these costs that may not be recovered.

In accordance with the Texas Electric Restructuring Law, beginning on January 1, 2002, and ending when the true-up proceeding is completed in January 2004, any difference between market power prices received in the generation capacity auction and the Texas Utility Commission's earlier estimates of those market prices will be included in the 2004 stranded cost true-up, as further discussed below. This component of the true-up is intended to ensure that neither the customers nor the Company are disadvantaged economically as a result of the two-year transition period by providing this pricing structure.

On October 24, 2001, Reliant Energy Transition Bond Company LLC (Bond Company), a Delaware limited liability company and direct wholly owned subsidiary of Reliant Energy, issued \$749 million aggregate principal amount of its Series 2001-1 Transition Bonds pursuant to a financing order of the Texas Utility Commission. Classes of the bonds have final maturity dates of September 15, 2007, September 15, 2009, September 15, 2011 and September 15, 2015, and bear interest at rates of 3.84%, 4.76%, 5.16% and 5.63%, respectively. Scheduled payments on the bonds are from 2002 through 2013. Net proceeds to the Bond Company from the issuance were \$738 million. The Bond Company paid Reliant Energy \$738 million for the transition property. Reliant Energy used the net proceeds for general corporate purposes, including the repayment of indebtedness.

The Transition Bonds are secured primarily by the "transition property," which includes the irrevocable right to recover, through non-bypassable transition charges payable by certain retail electric customers, the qualified costs of Reliant Energy HL&P authorized by the financing order. The holders of the Bond Company's bonds have no recourse to any assets or revenues of Reliant Energy, and the creditors of Reliant Energy have no recourse to any assets or revenues (including, without limitation, the transition charges) of the Bond Company. Reliant Energy has no payment obligations with respect to the Transition Bonds except to remit collections of transition charges as set forth in a servicing agreement between Reliant Energy and the Bond Company and in an intercreditor agreement among Reliant Energy, the Bond Company and other parties.

Costs associated with nuclear decommissioning will continue to be subject to cost-of-service rate regulation and are included in a charge to transmission and distribution customers. For further discussion of the effect of the Business Separation Plan on funding of the nuclear decommissioning trust fund, see Note 4(b).

True-Up Proceeding. The Texas Electric Restructuring Law and current Texas Utility Commission implementation guidance provide for a True-up Proceeding to be initiated in January 2004. The purpose of the True-up Proceeding is to quantify and reconcile the amount of stranded costs, the capacity auction true-up, unreconciled fuel costs (see Note 2(f)), and other regulatory assets associated with Reliant Energy HL&P's electric generating operations that were not previously securitized through the Transition Bonds. The True-up Proceeding will result in either additional charges or credits being assessed on certain retail electric customers.

Accounting. Historically, Reliant Energy HL&P has applied the accounting policies established in SFAS No. 71. Effective June 30, 1999, the Company applied SFAS No. 101 to Reliant Energy HL&P's electric generation operations. Reliant Energy HL&P's transmission and distribution operations continue to meet the criteria of SFAS No. 71.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

In 1999, the Company evaluated the effects that the Texas Electric Restructuring Law would have on the recovery of its generation related regulatory assets and liabilities. The Company determined that a pre-tax accounting loss of \$282 million existed because it believes only the economic value of its generation related regulatory assets (as defined by the Texas Electric Restructuring Law) will be recovered. Therefore, the Company recorded a \$183 million after-tax extraordinary loss in the fourth quarter of 1999. Pursuant to EITF Issue No. 97-4, the remaining recoverable regulatory assets will not be written off and will become associated with the transmission and distribution portion of the Company's electric utility business. For details regarding Reliant Energy HL&P's regulatory assets, see Note 2(f).

At June 30, 1999, the Company performed an impairment test of its previously regulated electric generation assets pursuant to SFAS No. 121 on a plant specific basis. Under SFAS No. 121, an asset is considered impaired, and should be written down to fair value, if the future undiscounted net cash flows expected to be generated by the use of the asset are insufficient to recover the carrying amount of the asset. For assets that are impaired pursuant to SFAS No. 121, the Company determined the fair value for each generating plant by estimating the net present value of future cash inflows and outflows over the estimated life of each plant. The difference between fair value and net book value was recorded as a reduction in the current book value. The Company determined that \$808 million of electric generation assets were impaired in 1999. Of this amount, \$756 million related to the South Texas Project Electric Generating Station (South Texas Project) and \$52 million related to two gas-fired generation plants. The Texas Electric Restructuring Law provides for recovery of this impairment through regulated cash flows during the transition period and through charges to transmission and distribution customers. As such, a regulatory asset was recorded for an amount equal to the impairment loss and was included on the Company's Consolidated Balance Sheets as a regulatory asset. The Company recorded amortization expense related to the recoverable impaired plant costs and other assets created from discontinuing SFAS No. 71 of \$221 million in the third and fourth quarters of 1999, \$329 million in 2000 and \$258 million in 2001.

The impairment analysis requires estimates of possible future market prices, load growth, competition and many other factors over the lives of the plants. The resulting impairment loss is highly dependent on these underlying assumptions. In addition, after January 10, 2004, Reliant Energy HL&P must finalize and reconcile stranded costs (as defined by the Texas Electric Restructuring Law) in a filing with the Texas Utility Commission. Any positive difference between the regulatory net book value and the fair market value of the generation assets (as defined by the Texas Electric Restructuring Law) will be collected through future charges. Any overmitigation of stranded costs may be refunded by a reduction in future charges. This final reconciliation allows alternative methods of third party valuation of the fair market value of these assets, including outright sale, stock valuations and asset exchanges.

In order to reduce potential exposure to stranded costs related to generation assets, Reliant Energy HL&P redirected \$195 million and \$99 million of depreciation in 1998 and for the six months ended June 30, 1999, respectively, from transmission and distribution related plant assets to generation assets for regulatory and financial reporting purposes (Redirected Depreciation). This redirection was in accordance with the Company's Transition Plan. Subsequent to June 30, 1999, Redirected Depreciation expense could no longer be recorded by the electric generation operations portion of Reliant Energy HL&P for financial reporting purposes as this portion of electric operations is no longer accounted for under SFAS No. 71. During the six months ended December 31, 1999 and during 2000 and 2001, \$99 million, \$218 million and \$230 million in depreciation expense, respectively, was redirected from transmission and distribution for regulatory and financial reporting purposes and was established as an embedded regulatory asset included in transmission and distribution related plant and equipment balances. As of December 31, 2000 and 2001, the cumulative amount of Redirected Depreciation for regulatory purposes was \$611 million and \$841 million, respectively, prior to the effects of the October 3, 2001 order discussed below.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Additionally, as allowed by the Texas Utility Commission, in an effort to further reduce potential exposure to stranded costs related to generation assets, Reliant Energy recorded Accelerated Depreciation of \$194 million and \$104 million in 1998 and for the six months ended June 30, 1999, respectively, for regulatory and financial reporting purposes. Accelerated Depreciation expense was recorded in accordance with the Company's Transition Plan during this period. Subsequent to June 30, 1999, Accelerated Depreciation expense could no longer be recorded by the electric generation operations portion of Reliant Energy HL&P for financial reporting purposes, as this portion of electric operations is no longer accounted for under SFAS No. 71. During the six months ended December 31, 1999 and during 2000 and 2001, \$179 million, \$385 million and \$264 million of Accelerated Depreciation was recorded for regulatory reporting purposes, reducing the regulatory book value of Reliant Energy HL&P's electric generation assets.

The Texas Utility Commission issued a final order on October 3, 2001 (October 3, 2001 Order) that established the transmission and distribution utility rates that became effective January 2002. In this Order, the Texas Utility Commission found that Reliant Energy HL&P had overmitigated its stranded costs by redirecting transmission and distribution depreciation and by accelerating depreciation of generation assets as provided under the Transition Plan and Texas Electric Restructuring Law. As a result of the October 3, 2001 Order, Reliant Energy HL&P was required to reverse the \$841 million embedded regulatory asset related to Redirected Depreciation, thereby reducing the net book value of transmission and distribution assets. Reliant Energy HL&P was required to record a regulatory liability of \$1.1 billion related to Accelerated Depreciation. The October 3, 2001 Order requires this amount to be refunded through excess mitigation credits to certain retail electric customers during a seven year period beginning in January 2002. On appeal, a Texas District court upheld the Texas Utility Commission's order. An appeal may be taken to a Texas Court of Appeal, but no further appeal has yet been filed.

As of December 31, 2001, in contemplation of the True-up Proceeding, Reliant Energy HL&P has recorded a regulatory asset of \$2.0 billion representing the estimated recovery of previously incurred stranded costs, which includes a regulatory liability of \$1.1 billion plus the reversal of previously recorded Redirected Depreciation. This estimated recovery is based upon current projections of the market value of the Reliant Energy HL&P electric generation assets to be covered by the True-up Proceeding calculations. Because generally accepted accounting principles require the Company to estimate fair market values in advance of the final reconciliation, the financial impacts of the Texas Electric Restructuring Law with respect to the final determination of stranded costs in 2004 are subject to material changes. Factors affecting such changes may include estimation risk, uncertainty of future energy and commodity prices and the economic lives of the plants. If events were to occur that made the recovery of some of the remaining generation related regulatory assets no longer probable, the Company would write off the remaining balance of such assets as a charge against earnings. For additional discussion of potential future impairment of the assets of the Company's Texas generation business, see Note 2(e).

Other Accounting Policy Changes. As a result of discontinuing SFAS No. 71, effective July 1, 1999, allowance for funds used during construction is no longer accrued on generation related construction projects. Instead, interest is being capitalized on these projects in accordance with SFAS No. 34, "Capitalization of Interest Cost."

Previously, in accordance with SFAS No. 71, Reliant Energy HL&P deferred the premiums and expenses that arose when long-term debt was redeemed and amortized these costs over the life of the new debt. If no new debt was issued, these costs would be amortized over the remaining original life of the retired debt. Effective July 1, 1999, costs resulting from the retirement of debt attributable to the generation operations of Reliant Energy HL&P will be recorded in accordance with SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt," unless these costs will be recovered through regulated cash flows. In that case, these costs will be deferred and recorded as a regulatory asset by the entity through which the source of the regulated cash flows will be derived.

(b) BUSINESS SEPARATION PLAN

Restructuring of Regulated Entities and Distribution of Reliant Resources Stock. Pursuant to the Business Separation Plan, subject to receipt of an order from the Securities and Exchange Commission (SEC) described below, Reliant Energy will become a subsidiary of a new holding company, CenterPoint Energy, which initially will own the Company's (a) electric transmission and distribution operations, (b) natural gas distribution businesses, (c) electric generating assets in Texas that were formerly operated by Reliant Energy HL&P, (d) interstate pipelines, gas gathering and pipeline services operations, (e) interests in energy companies in Latin America (see Note 19) and (f) interests in Reliant Resources. In these Notes, references to Reliant Energy in connection with events occurring or the performance of agreements after the Restructuring generally refer to CenterPoint Energy.

Upon becoming a subsidiary of CenterPoint Energy, Reliant Energy will transfer the stock of its principal operating subsidiaries to a subsidiary of CenterPoint Energy and will transfer its electric generating assets in Texas that were formerly operated by Reliant Energy HL&P to Texas Genco. In January 2004, Reliant Resources will have the right to exercise an option to acquire Texas Genco, as further discussed below. As a result of the stock and asset transfers described above, Reliant Energy will become solely a transmission and distribution utility, with its other businesses becoming indirect subsidiaries of CenterPoint Energy, which will assume all of Reliant Energy's debt other than its first mortgage bonds. The indebtedness of certain wholly owned financing subsidiaries of Reliant Energy is expected to be refinanced by the regulated holding company by the end of 2002.

The Company anticipates that, upon completion of the Restructuring and subject to approval by the Company's board of directors, market and other conditions, CenterPoint Energy will distribute all of the stock it owns in Reliant Resources to CenterPoint Energy's shareholders, affecting the separation of its operations into two publicly traded corporations. The Company has obtained a private letter ruling from the IRS providing for the tax-free treatment of the Distribution that is predicated on the completion of the Distribution by April 30, 2002. The Company has requested an extension of this deadline. While there can be no assurance that the Company will receive the extension, the Company anticipates that it will receive an extension that allows it to proceed with the Distribution after April 30, 2002.

Reliant Energy has made and will continue to make internal asset and stock transfers intended to allocate the assets and liabilities of Reliant Energy in accordance with regulatory requirements and as contemplated by the Business Separation Plan. Forms of each of the intercompany agreements described below were prepared and entered into by Reliant Energy and Reliant Resources prior to the Offering.

The Restructuring as currently planned cannot be completed unless and until the SEC issues an order granting the required approvals under the Public Utility Holding Company Act of 1935 (1935 Act). While the Company believes such an order will be received, and that both the Restructuring and Distribution will be completed during the summer of 2002, there can be no assurances that such will be the case. The Restructuring has been designed to enable the Company to meet all of the requirements of the Texas Electric Restructuring Law. The Company has not formulated an alternative restructuring plan that could be implemented were the SEC to refuse to grant the requested approvals for CenterPoint Energy.

Agreements Related to Texas Generating Assets. Pursuant to the Business Separation Plan, Reliant Energy expects to cause Texas Genco to conduct an initial public offering of approximately 20% of its capital stock by the end of 2002. If the initial public offering is not conducted, Reliant Energy may distribute approximately 20% of Texas Genco's capital stock to its stockholders in a transaction taxable both to it and its stockholders as part of the valuation of stranded costs. In connection with the separation of its unregulated businesses from its regulated businesses, Reliant Energy granted Reliant Resources an option, subject to the completion of the Distribution, to purchase all of the shares of capital stock of Texas Genco that will be owned by Reliant Energy after the initial public offering or distribution (Texas Genco Option). The Texas Genco

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Option may be exercised between January 10, 2004 and January 24, 2004. The per share exercise price under the option will be the average daily closing price on the national exchange for publicly held shares of common stock of Texas Genco for the 30 consecutive trading days with the highest average closing price during the 120 trading days immediately preceding January 10, 2004, plus a control premium, up to a maximum of 10%, to the extent a control premium is included in the valuation determination made by the Texas Utility Commission relating to the market value of Texas Genco's common stock equity. The exercise price is also subject to adjustment based on the difference between the cash dividends paid during the period there is a public ownership interest in Texas Genco and Texas Genco's earnings during that period. Reliant Resources has agreed that if it exercises the Texas Genco Option and purchases the shares of Texas Genco common stock, Reliant Resources will also purchase all notes and other receivables from Texas Genco then held by Reliant Energy, at their principal amount plus accrued interest. Similarly, if Texas Genco holds notes or receivables from the Company, Reliant Resources will assume those obligations in exchange for a payment to Reliant Resources by the Company of an amount equal to the principal plus accrued interest.

Exercise of the Texas Genco Option by Reliant Resources will be subject to various regulatory approvals, including Hart-Scott-Rodino antitrust clearance and United States Nuclear Regulatory Commission (NRC) license transfer approval. The option will be exercisable only if Reliant Energy or CenterPoint Energy distributes all of the shares of Reliant Resources common stock it owns to its shareholders.

At the time of the Restructuring, Texas Genco will become the beneficiary of the decommissioning trust that has been established to provide funding for decontamination and decommissioning of a nuclear electric generation station in which Reliant Energy owns a 30.8% interest (see Note 6). The master separation agreement provides that Reliant Energy will collect through rates or other authorized charges to its electric utility customers amounts designated for funding the decommissioning trust, and will pay the amounts to Texas Genco. Texas Genco will in turn be required to deposit these amounts received from Reliant Energy into the decommissioning trust. Upon decommissioning of the facility, in the event funds from the trust are inadequate, Reliant Energy or its successor will be required to collect through rates or other authorized charges to customers as contemplated by the Texas Utilities Code all additional amounts required to fund Texas Genco's obligations relating to the decommissioning of the facility. Following the completion of the decommissioning, if surplus funds remain in the decommissioning trust, the excess will be refunded to Reliant Energy's or its successor's ratepayers.

(c) RELIANT ENERGY HL&P REGULATORY FILINGS

As of December 31, 2000 and 2001, Reliant Energy HL&P was under-collected on fuel recovery by \$558 million and \$200 million, respectively. In two separate filings with the Texas Utility Commission in 2000, Reliant Energy HL&P received approval to implement fuel surcharges to collect the under-recovery of fuel expenses, as well as to adjust the fuel factor to compensate for significant increases in the price of natural gas. For additional information regarding this matter, see Note 2(f).

On March 15, 2001, Reliant Energy HL&P filed an application with the Texas Utility Commission to revise its fuel factor and address its undercollected fuel costs of \$389 million, which was the accumulated amount from September 2000 through February 2001, plus estimates for March and April 2001. Reliant Energy HL&P requested to revise its fixed fuel factor to be implemented with the May 2001 billing cycle and proposed to defer the collection of the \$389 million until the 2004 stranded costs True-up Proceeding. On April 16, 2001, the Texas Utility Commission issued an order approving interim rates effective with the May 2001 billing cycle.

On June 21, 2001, Reliant Energy HL&P filed an application with the Texas Utility Commission to terminate the interim factor and return to the prior fuel factor due to the forecasted decline in natural gas prices. On July 20, 2001, the Texas Utility Commission issued an order of dismissal approving Reliant Energy HL&P's request that the interim rates approved on April 16, 2001, effective with Reliant Energy HL&P's

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

May 2001 billing month, be terminated and Reliant Energy HL&P prospectively bill its customers using the prior fuel factor established in a previous order beginning with Reliant Energy HL&P's August billing month. The Texas Utility Commission also granted Reliant Energy HL&P a good cause exception in that Reliant Energy HL&P will not be required to refund amounts collected through the interim rates. Reliant Energy HL&P did not waive its right to collect any final fuel balance. The final fuel balance is subject to review, and the amount to be included in the 2004 stranded cost true-up will be determined during the final fuel reconciliation. The Texas Utility Commission currently has scheduled Reliant Energy HL&P to file its final fuel reconciliation in July 2002.

(d) ARKLA RATE CASE

On November 21, 2001, Arkla filed a rate case (Docket 01-243-U) with the Arkansas Public Service Commission seeking an increase in rates for its Arkansas customers of approximately \$47 million on an annual basis. Arkla's last rate increase was authorized in 1995. In the rate filing, Arkla maintains that its rate base has grown by \$183 million, and its operating expenses have increased from \$93 million to \$106 million on an annual basis and, therefore, Arkla's current rates for service to Arkansas customers do not provide a reasonable opportunity for Arkla to cover its operating costs and earn a fair return on its investment. A decision in the case is expected by the fourth quarter of 2002.

(5) DERIVATIVE FINANCIAL INSTRUMENTS

Effective January 1, 2001, the Company adopted SFAS No. 133, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. This statement requires that derivatives be recognized at fair value in the balance sheet and that changes in fair value be recognized either currently in earnings or deferred as a component of other comprehensive income (loss), depending on the intended use of the derivative, its resulting designation and its effectiveness. If certain conditions are met, an entity may designate a derivative instrument as hedging (a) the exposure to changes in the fair value of an asset or liability (Fair Value Hedge), (b) the exposure to variability in expected future cash flows (Cash Flow Hedge) or (c) the foreign currency exposure of a net investment in a foreign operation. For a derivative not designated as a hedging instrument, the gain or loss is recognized in earnings in the period it occurs.

Adoption of SFAS No. 133 on January 1, 2001 resulted in an after-tax increase in net income of \$61 million and a cumulative after-tax increase in accumulated other comprehensive loss of \$252 million. The adoption also increased current assets, long-term assets, current liabilities and long-term liabilities by approximately \$703 million, \$252 million, \$805 million, and \$341 million, respectively, in the Company's Consolidated Balance Sheets. During the year ended December 31, 2001, \$165 million of the initial after-tax transition adjustment recognized in other comprehensive income was recognized in net income.

The application of SFAS No. 133 is still evolving as the FASB clears issues previously submitted to the Derivatives Implementation Group for consideration. During the second quarter of 2001, an issue that applies exclusively to the electric industry and allows the normal purchases and normal sales exception for option-type contracts if certain criteria are met was approved by the FASB with an effective date of July 1, 2001. The adoption of this cleared guidance had no impact on the Company's results of operations. Certain criteria of this previously approved guidance were revised in October and December 2001 and became effective on April 1, 2002. The Company is currently in the process of determining the effect of adoption of the revised guidance.

During the third quarter of 2001, the FASB cleared an issue related to application of the normal purchases and normal sales exception to contracts that combine forward and purchased option contracts. The effective date of this guidance is April 1, 2002, and the Company is currently assessing the impact of this

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

cleared issue and does not believe it will have a material impact on the Company's consolidated financial statements.

The Company is exposed to various market risks. These risks arise from transactions entered into in the normal course of business and are inherent in the Company's consolidated financial statements. The Company utilizes derivative instruments such as futures, physical forward contracts, swaps and options (Energy Derivatives) to mitigate the impact of changes in electricity, natural gas and fuel prices on its operating results and cash flows. The Company utilizes cross-currency swaps, forward contracts and options to hedge its net investments in and cash flows of its foreign subsidiaries, interest rate swaps to mitigate the impact of changes in interest rates and other financial instruments to manage various other market risks.

Trading and marketing operations often involve risk associated with managing energy commodities and establishing open positions in the energy markets, primarily on a short-term basis. These risks fall into three different categories: price and volume volatility, credit risk of trading counterparties and adequacy of the control environment for trading. The Company routinely enters into Energy Derivatives to hedge purchase and sale commitments, fuel requirements and inventories of natural gas, coal, electricity, crude oil and products, emission allowances and other commodities and to minimize the risk of market fluctuations in its trading, marketing, power origination and risk management services operations.

Energy Derivatives primarily used by the Company are described below:

- Future contracts are exchange-traded standardized commitments to purchase or sell an energy commodity or financial instrument, or to make a cash settlement, at a specific price and future date.
- Physical forward contracts are commitments to purchase or sell energy commodities in the future.
- Swap agreements require payments to or from counterparties based upon the differential between a fixed price and variable index price (fixed price swap) or two variable index prices (variable price swap) for a predetermined contractual notional amount. The respective index may be an exchange quotation or an industry pricing publication.
- Option contracts convey the right to buy or sell an energy commodity, financial instrument at a predetermined price or settlement of the differential between a fixed price and a variable index price or two variable index prices.

(a) ENERGY TRADING, MARKETING, POWER ORIGINATION AND PRICE RISK MANAGEMENT ACTIVITIES

The Company offers energy price risk management services primarily related to natural gas, electric power and other energy related commodities. These activities also include the establishing of open positions in the energy markets, primarily on a short-term basis, and transactions intended to optimize the Company's power generation portfolio, but which do not qualify for hedge accounting. The Company provides these services by utilizing a variety of derivative instruments (Trading Energy Derivatives).

The Company applies mark-to-market accounting for all of its energy trading, marketing, power origination and price risk management services operations in North America and Europe, as well as to retail contracted sales to large commercial, industrial and institutional customers. Accordingly, these Trading Energy Derivatives are recorded at fair value with net realized and unrealized gains (losses) recorded as a

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

component of revenues. The recognized, unrealized balances are recorded as trading and marketing assets/liabilities.

FAIR VALUE -----	ASSETS	LIABILITIES -----
----- (IN MILLIONS) December 31, 2000 Natural		
gas.....		\$3,823
	\$3,818	
Electricity.....		
	974 946 Oil and	
other.....		39 39
-----	\$4,836 \$4,803 =====	===== December 31,
	2001 Natural	
gas.....		\$1,389
	\$1,303	
Electricity.....		
	648 517 Oil and	
other.....		21 20
-----	\$2,058 \$1,840 =====	=====

All of the fair values shown in the table above at December 31, 2000 and 2001 have been recognized in income. The fair values as of December 31, 2000 and 2001, are estimated using quoted prices where available, other valuation techniques when market data is not available, for example in illiquid markets, and other factors such as time value and volatility factor for the underlying commitment. The Company's alternative pricing methodologies include, but are not limited to, extrapolation of forward pricing curves using historically reported data from illiquid pricing points. These same pricing techniques are used to evaluate a contract prior to taking the position.

The fair values in the above table are subject to significant changes based on fluctuating market prices and conditions. Changes in the assets and liabilities from trading, power origination, marketing and price risk management services result primarily from changes in the valuation of the portfolio of contracts, newly originated transactions and the timing of settlements. The most significant estimates include natural gas and power forward market prices, volatility and credit risk. For the contracted retail electric sales to large commercial, industrial and institutional customers, significant variables affecting contract values also include the variability in electricity consumption patterns due to weather and operational uncertainties (within contract parameters). Market prices assume a normal functioning market with an adequate number of buyers and sellers providing market liquidity. Insufficient market liquidity could significantly affect the values that could be obtained for these contracts, as well as the costs at which these contracts could be hedged.

The weighted-average term of the trading portfolio, based on volumes, is less than one year. The maximum term of the trading portfolio is 17 years. These maximum and average terms are not indicative of likely future cash flows, as these positions may be changed by new transactions in the trading portfolio at any time in response to changing market conditions, market liquidity and the Company's risk management portfolio needs and strategies. Terms regarding cash settlements of these contracts vary with respect to the actual timing of cash receipts and payments.

(b) NON-TRADING ACTIVITIES

Cash Flow Hedges. To reduce the risk from market fluctuations in revenues and the resulting cash flows derived from the sale of electric power, natural gas and other commodities, the Company may enter into Energy Derivatives in order to hedge exposure to variability in cash flows (Non-trading Energy Derivatives).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The Non-trading Energy Derivative portfolios are managed to complement the physical transaction portfolio, reducing overall risks within authorized limits.

The Company applies hedge accounting for its Non-trading Energy Derivatives utilized in non-trading activities only if there is a high correlation between price movements in the derivative and the item designated as being hedged. This correlation, a measure of hedge effectiveness, is measured both at the inception of the hedge and on an ongoing basis, with an acceptable level of correlation of at least 80% to 120% for hedge designation. If and when correlation ceases to exist at an acceptable level, hedge accounting ceases and mark-to-market accounting is applied. During 2001, the amount of hedge ineffectiveness recognized in earnings from derivatives that are designated and qualify as Cash Flow Hedges was a gain of \$8 million. No component of the derivative instruments' gain or loss was excluded from the assessment of effectiveness. If it becomes probable that an anticipated transaction will not occur, the Company realizes in net income the deferred gains and losses recognized in accumulated other comprehensive income (loss). During the year ended December 31, 2001, there was a \$3.6 million deferred loss recognized in earnings as a result of the discontinuance of cash flow hedges because it was no longer probable that the forecasted transaction would occur due to credit problems of a customer. Once the anticipated transaction occurs, the accumulated deferred gain or loss recognized in accumulated other comprehensive income (loss) is reclassified and included in the Company's Statements of Consolidated Income under the captions (a) fuel expenses, in the case of natural gas transactions, (b) purchased power, in the case of electric power purchase transactions and (c) revenues, in the case of electric power sales transactions. Cash flows resulting from these transactions in Non-trading Energy Derivatives are included in the Statements of Consolidated Cash Flows in the same category as the item being hedged. As of December 31, 2001, the Company's current non-trading derivative assets and liabilities and corresponding amounts in accumulated other comprehensive loss were expected to be reclassified into net income during the next twelve months.

The maximum length of time the Company is hedging its exposure to the variability in future cash flows for forecasted transactions excluding the payment of variable interest on existing financial instruments is eleven years.

In addition, as of December 31, 2001, the European Energy business segment had entered into transactions to purchase \$271 million at fixed exchange rates in order to hedge future fuel purchases payable in U.S. dollars.

Interest Rate Swaps. During 2001, the Company entered into interest rate swaps with an aggregate notional amount of \$1.8 billion to fix the interest rate applicable to floating rate short-term debt and interest rate swaps with a notional amount of \$425 million to fix the interest rate applicable to floating rate long-term debt. At December 31, 2001, \$225 million of the swaps relating to long-term debt had expired. The swaps relating to short-term debt do not qualify as cash flow hedges under SFAS No. 133, and are marked to market on the Consolidated Balance Sheets with changes reflected in interest expense in the Statements of Consolidated Income. The swaps relating to long-term debt qualify for hedge accounting under SFAS No. 133 and the periodic settlements are recognized as an adjustment to interest expense in the Statements of Consolidated Income over the term of the swap agreement. During 2001, the Company entered into forward-starting interest rate swaps having an aggregate notional amount of \$500 million to hedge the interest rate on a portion of a future offering of five-year notes. These swaps qualify as cash flow hedges under SFAS No. 133. Should the expected issuance of the debt no longer be probable, any deferred amount will be recognized immediately into income. The maximum length of time the Company is hedging its exposure to the payment of variable interest rates is four years.

Hedge of the Foreign Currency Exposure of Net Investment in Foreign Subsidiaries. The Company has substantially hedged the foreign currency exposure of its net investment in its European subsidiaries through a combination of Euro-denominated borrowings, foreign currency swaps and foreign currency forward contracts to reduce the Company's exposure to changes in foreign currency rates. During the normal course of business,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

the Company reviews its currency hedging strategies and determines the hedging approach deemed appropriate based upon the circumstances of each situation.

The Company records the changes in the value of the foreign currency hedging instruments and Euro-denominated borrowings as foreign currency translation adjustments included as a component of accumulated other comprehensive loss. The effectiveness of the hedging instruments can be measured by the net change in foreign currency translation adjustments attributed to the Company's net investment in its European subsidiaries. These amounts generally offset amounts recorded in stockholders' equity as adjustments resulting from translation of the hedged investment into U.S. dollars. During 2001, the derivative and non-derivative instruments designated as hedging the net investment in the Company's European subsidiaries resulted in a gain of \$31 million, which is included in the balance of the cumulative translation adjustment.

Other Derivatives. In December 2000, the Dutch parliament adopted legislation allocating to the Dutch generation sector, including REPGb, financial responsibility for various stranded costs contracts and other liabilities. The legislation became effective in all material respects on January 1, 2001. In particular, the legislation allocated to the Dutch generation sectors, including REPGb, financial responsibility to purchase electricity and gas under gas supply and electricity contracts. These contracts are derivatives pursuant to SFAS No. 133. As of December 31, 2001, the Company had recognized \$369 million in short-term and long-term non-trading derivative liabilities for REPGb's portion of these stranded costs contracts. Future changes in the valuation of these stranded cost import contracts which remain an obligation of REPGb will be recorded as adjustments to the Company's Statements of Consolidated Income. The valuation of the contracts could be affected by, among other things, changes in the price of electric power, coal, low sulfur fuel oil and the value of the United States dollar and British pound relative to the Euro. For additional information regarding REPGb's stranded costs and the related indemnification by former shareholders of these stranded costs during 2001, see Note 14(h).

During 2001, Reliant Resources entered into two structured transactions which were recorded on the Consolidated Balance Sheets in non-trading derivative assets and liabilities involving a series of forward contracts to buy and sell an energy commodity in 2001 and to buy and sell an energy commodity in 2002 or 2003. The change in fair value of these derivative assets and liabilities must be recorded in the Statements of Consolidated Income for each reporting period. During 2001, \$117 million of net non-trading derivative liabilities were settled related to these transactions, and a \$1 million pre-tax unrealized gain was recognized. As of December 31, 2001, Reliant Resources has recognized \$221 million of non-trading derivative assets and \$103 million of non-trading derivative liabilities related to these transactions.

(c) CREDIT RISKS

In addition to the risk associated with price movements, credit risk is inherent in the Company's risk management activities and hedging activities. Credit risk relates to the risk of loss resulting from non-performance of contractual obligations by a counterparty. The Company has off-balance sheet risk to the extent that the counterparties to these transactions may fail to perform as required by the terms of each contract. The Company enters into derivative instruments primarily with counterparties having at least a minimum investment grade credit rating (i.e. a minimum credit rating for such entity's senior unsecured debt of BBB- for Standard & Poor's and Fitch or Baa3 for Moody's). In addition, the Company seeks to enter into netting agreements that permit it to offset receivables and payables with a given counterparty. The Company also attempts to enter into agreements that enable the Company to obtain collateral from a counterparty or to terminate upon the occurrence of credit-related events. For long-term arrangements, the Company periodically reviews the financial condition of these counterparties in addition to monitoring the effectiveness of these financial contracts in achieving the Company's objectives. If the counterparties to these arrangements fail to perform, the Company would seek to compel performance at law or otherwise obtain compensatory damages. The Company might be forced to acquire alternative hedging arrangements or be required to replace the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

underlying commitment at then-current market prices. In this event, the Company might incur additional losses to the extent of amounts, if any, already paid to the counterparties. For information regarding the provision related to energy sales in California, see Note 14(g). For information regarding the net provision recorded in 2001 related to energy sales to Enron, see Note 21.

The following tables show the composition of the trading and marketing assets of the Company as of December 31, 2000 and 2001 and the non-trading derivative assets as of December 31, 2001.

DECEMBER 31, 2000	DECEMBER 31, 2001	-----	-----
----- INVESTMENT			
INVESTMENT TRADING AND MARKETING ASSETS			
GRADE(2) TOTAL	GRADE(2) TOTAL	-	-----

- (IN MILLIONS) Energy			
marketers.....			
\$2,291	\$2,481	\$ 683	\$ 757
institutions.....	1,099		
1,228	495	495	Gas and electric
utilities.....	472	542	538
	544	Oil and gas	
producers.....	474	566	
135	176	Commercial, industrial and	institutional
customers.....			
73	85	119	184
Total.....			
\$4,409	4,902	\$1,970	2,156
		====	====
		Credit and other	
reserves.....	(66)	(98)	---
		Trading and marketing	
assets.....	\$4,836	\$2,058	
	====	====	

DECEMBER 31, 2001	-----	INVESTMENT NON-
TRADING DERIVATIVE ASSETS	GRADE(1)(2) TOTAL	-----
----- (IN MILLIONS) Energy		
marketers.....	\$371	
	\$408	Financial
institutions.....	76	76
		Gas and electric
utilities.....	89	90
gas producers.....	8	76
		Commercial, industrial and institutional
customers.....	7	8
Others.....		
	5	14
Total.....		
	\$556	672
	====	----
		Credit and other
reserves.....	(16)	----
trading derivative assets.....		
	\$656	====

(1) "Investment Grade" is primarily determined using publicly available credit ratings along with the consideration of credit support (such as parent company guarantees) and collateral, which encompass cash and standby letters of credit.

(2) For unrated counterparties, the Company performs financial statement analysis, considering contractual rights and restrictions, and collateral, to create a synthetic credit rating.

(d) TRADING AND NON-TRADING -- GENERAL POLICY

The Company has established a Risk Oversight Committee comprised of corporate and business segment officers that oversees all commodity price, foreign currency and credit risk activities, including the Company's trading, marketing, power origination, risk management services and hedging activities. The committee's duties are to approve the Company's commodity risk policies, allocate risk capital within limits established by

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

the Company's board of directors, approve trading of new products and commodities, monitor risk positions and monitor compliance with the Company's risk management policies and procedures and trading limits established by the Company's board of directors.

The Company's policies prohibit the use of leveraged financial instruments. A leveraged financial instrument, for this purpose, is a transaction involving a derivative whose financial impact will be based on an amount other than the notional amount or volume of the instrument.

(6) JOINTLY OWNED ELECTRIC UTILITY PLANT

The Company has a 30.8% interest in the South Texas Project, which consists of two 1,250 MW nuclear generating units and bears a corresponding 30.8% share of capital and operating costs associated with the project. The South Texas Project is owned as a tenancy in common among its four co-owners, with each owner retaining its undivided ownership interest in the two nuclear-fueled generating units and the electrical output from those units. The four co-owners have delegated management and operating responsibility for the South Texas Project to the South Texas Project Nuclear Operating Company (STPNOC). STPNOC is managed by a board of directors comprised of one director from each of the four owners, along with the chief executive officer of STPNOC. As of December 31, 2001, the total utility plant in service and construction work in progress for the total South Texas Project was \$5.8 billion and \$120 million, respectively. The Company's investment in the South Texas Project was \$316 million (net of \$2.2 billion accumulated depreciation which includes an impairment loss recorded in 1999 of \$756 million). For additional information regarding the impairment loss, see Note 4(a). The Company's investment in nuclear fuel was \$35 million (net of \$286 million amortization) as of December 31, 2001.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(8) INDEXED DEBT SECURITIES (ACES AND ZENS) AND AOL TIME WARNER SECURITIES

(a) ORIGINAL INVESTMENT IN TIME WARNER SECURITIES

On July 6, 1999, the Company converted its 11 million shares of Time Warner Inc. (TW) convertible preferred stock (TW Preferred) into 45.8 million shares of Time Warner common stock (TW Common). Prior to the conversion, the Company's investment in the TW Preferred was accounted for under the cost method at a value of \$990 million in the Company's Consolidated Balance Sheets. The TW Preferred which was redeemable after July 6, 2000, had an aggregate liquidation preference of \$100 per share (plus accrued and unpaid dividends), was entitled to annual dividends of \$3.75 per share until July 6, 1999 and was convertible by the Company. The Company recorded pre-tax dividend income with respect to the TW Preferred of \$21 million in 1999 prior to the conversion. Effective on the conversion date, the shares of TW Common were classified as trading securities under SFAS No. 115 and an unrealized gain was recorded in the amount of \$2.4 billion (\$1.5 billion after-tax) to reflect the cumulative appreciation in the fair value of the Company's investment in Time Warner securities. Unrealized gains and losses resulting from changes in the market value of the TW Common (now AOL TW Common) are recorded in the Company's Statements of Consolidated Income.

(b) ACES

In July 1997, in order to monetize a portion of the cash value of its investment in TW Preferred, the Company issued 22.9 million of its unsecured 7% Automatic Common Exchange Securities (ACES) having an original principal amount of \$1.052 billion and maturing July 1, 2000. The market value of ACES was indexed to the market value of TW Common. On the July 1, 2000 maturity date, the Company tendered 37.9 million shares of TW Common to fully settle its obligations in connection with its unsecured 7% ACES having a value of \$2.9 billion.

(c) ZENS

On September 21, 1999, the Company issued approximately 17.2 million of its 2.0% Zero-Premium Exchangeable Subordinated Notes due 2029 (ZENS) having an original principal amount of \$1.0 billion. The original principal amount per ZENS will increase each quarter to the extent that the sum of the quarterly cash dividends and the interest paid during a quarter on the reference shares attributable to one ZENS is less than \$.045, so that the annual yield to investors from the date the Company issued the ZENS to the date of computation of the contingent principal amount is not less than 2.309%. At December 31, 2001, the principal amount of the ZENS had increased \$3 million as the reference shares no longer pay dividends. At maturity the holders of the ZENS will receive in cash the higher of the original principal amount of the ZENS (subject to adjustment as discussed above) or an amount based on the then-current market value of AOL TW

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Common, or other securities distributed with respect to AOL TW Common (1.5 shares of AOL TW Common and such other securities, if any, are referred to as reference shares). Each ZENS has an original principal amount of \$58.25, and is exchangeable at any time at the option of the holder for cash equal to 95% (100% in some cases) of the market value of the reference shares attributable to one ZENS. The Company pays interest on each ZENS at an annual rate of 2% plus the amount of any quarterly cash dividends paid in respect of the quarterly interest period on the reference shares attributable to each ZENS. Subject to some conditions, the Company has the right to defer interest payments from time to time on the ZENS for up to 20 consecutive quarterly periods. As of December 31, 2001, no interest payments on the ZENS had been deferred.

The Company used \$537 million of the net proceeds from the offering of the ZENS to purchase 9.2 million shares of TW Common (now 13.8 million shares of AOL TW Common), which are classified as trading securities under SFAS No. 115. Prior to the purchase of additional shares of TW Common on September 21, 1999, the Company owned approximately 8 million shares of TW Common (now 12 million shares of AOL TW Common). The Company now holds 25.8 million shares of AOL TW Common that are expected to be held to facilitate the Company's ability to meet its obligation under the ZENS.

Prior to January 1, 2001, an increase above \$58.25 (subject to some adjustments) in the market value per share of TW Common resulted in an increase in the Company's liability for the ZENS. However, as the market value per share of TW Common declined below \$58.25 (subject to some adjustments), the liability for the ZENS did not decline below the original principal amount. The market value per share of TW Common was \$52.24 as of December 31, 2000 and the market value per share of AOL TW Common was \$32.10 as of December 31, 2001. Upon adoption of SFAS No. 133 effective January 1, 2001, the ZENS obligation was bifurcated into a debt component and a derivative component (the holder's option to receive the appreciated value of AOL TW Common at maturity). The derivative component was valued at fair value and determined the initial carrying value assigned to the debt component (\$121 million) as the difference between the original principal amount of the ZENS (\$1.0 billion) and the fair value of the derivative component at issuance (\$879 million). Effective January 1, 2001 the debt component was recorded at its accreted amount of \$122 million and the derivative component is recorded at its current fair value of \$788 million, as a current liability, resulting in a transition adjustment pre-tax gain of \$90 million (\$58 million net of tax). The transition adjustment gain was reported in the first quarter of 2001 as the effect of a change in accounting principle. Subsequently, the debt component will accrete through interest charges at 17.5% up to the minimum amount payable upon maturity of the ZENS in 2029, approximately \$1.1 billion, and changes in the fair value of the derivative component will be recorded in the Company's Statements of Consolidated Income. During 2001, the Company recorded a \$70 million loss on the Company's investment in AOL TW Common. During 2001, the Company recorded a \$58 million gain associated with the fair value of the derivative component of the ZENS obligation. Changes in the fair value of the AOL TW Common held by the Company are expected to substantially offset changes in the fair value of the derivative component of the ZENS.

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The following table sets forth summarized financial information regarding the Company's investment in AOL TW securities and the Company's ACES and ZENS obligations (in millions).

DEBT DERIVATIVE AOL TW			
COMPONENT OF COMPONENT			
INVESTMENT ACES ZENS OF ZENS			

--	-----	Balance at	
		December 31,	
1998.....	\$ 990	\$	
2,350	\$ --	\$ --	Issuance of
			indexed debt securities.....
--	--	1,000	Purchase of TW
			Common.....
537	--	--	Loss on indexed
			debt securities.....
	388	241	-- Gain on TW
			Common.....
2,452	--	--	-----
		-----	Balance at
		December 31,	
1999.....	3,979	2,738	
	1,241	--	Loss (gain) on
			indexed debt securities... --
	139	(241)	-- Loss on TW
			Common.....
(205)	--	--	Settlement of
			ACES.....
(2,877)	(2,877)	--	-----
		-----	Balance
		at December 31,	
2000.....	897	--	
	1,000	--	Transition
			adjustment from adoption of
			SFAS No.
133.....			
--	--	(90)	-- Bifurcation of
			ZENS obligation..... --
--	(788)	788	Accretion of
			debt component of ZENS.....
--	--	1	-- Gain on indexed
			debt securities..... --
--	--	(58)	Loss on AOL TW
			Common.....
(70)	--	--	-----
		-----	Balance at
		December 31,	
2001.....	\$ 827	\$ --	
	\$ 123	\$730	=====
			=====
			=====

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(10) LONG-TERM DEBT AND SHORT-TERM BORROWINGS

DECEMBER 31, 2000	DECEMBER 31, 2001	-----
----- LONG- LONG- TERM CURRENT(1) TERM		
CURRENT(1) ----- (IN		
MILLIONS) Short-term borrowings: Commercial		
paper.....	\$3,675	
	\$2,502	Lines of
credit.....	853	290
		Receivables
facility.....	350	346
Other(2).....	126	297
	----- Total short-term	
borrowings.....	\$5,004	\$3,435
	----- Long-term debt: Reliant Energy	
ZENS(3).....		
\$ -- \$1,000 \$ -- \$ 123	Debentures 7.88% to 9.38% due	
2002.....	100	250
	--- 100 First	
	mortgage bonds 4.90% to 9.15% due 2002 to 2027.....	
1,261 -- 1,161	100 Pollution control bonds 4.70% to 5.95%	
	due 2011 to 2030... 1,046 -- 1,046 -- Series 2001-1	
	Transition Bonds 3.84% to 5.63% due 2002 to	
2013.....		
	--- 736 13	
Other.....		
12 1 11 1	Financing Subsidiaries (directly or indirectly	
	owned by Reliant Energy) Debentures 7.40% due	
2002.....	300	225
	--- 300	
	Reliant Energy Power Generation, Inc. Notes payable	
	various market rates due 2002 to 2024..... 260 -- 295 2	
	REPG(2) Debentures 6.00% to 8.94% due 2002 to	
2006.....	66	1 38 22
	Reliant Energy Capital	
	Europe(2) Notes payable various market rates due	
2003.....	565	-- 534 -- RERC Corp.(4)
	Convertible debentures 6.00% due	
2012.....	93	-- 82 -- Debentures 6.38% to
	8.90% due 2003 to 2011..... 1,285 -- 1,833 --	
	Notes payable 8.77% to 9.23% paid	
2001.....	-- 146	-- -- Unamortized
	discount and premium..... 8 -- 6 -	
	----- Total long-term	
debt.....	4,996	1,623
	5,742	661
	----- Total	
borrowings.....	\$4,996	
	\$6,627	\$5,742 \$4,096 =====

(1) Includes amounts due or exchangeable within one year of the date noted.

(2) Includes borrowings at December 31, 2000 and 2001 which are denominated in Euros. As of December 31, 2000 and 2001, the assumed exchange rate was 1.06 Euros and 1.12 Euros per U.S. dollar, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

- (3) Upon adoption of SFAS No. 133 effective January 1, 2001, the Company's ZENS obligation was bifurcated into a debt component and an embedded derivative component. For additional information regarding ZENS, see Note 8(b). As ZENS are exchangeable for cash at any time at the option of the holders, these notes are classified as a current portion of long-term debt.
- (4) Debt acquired in business acquisitions is adjusted to fair market value as of the acquisition date. Included in long term debt is additional unamortized premium related to fair value adjustments of long-term debt of \$12 million and \$9 million at December 31, 2000 and 2001, respectively, which is being amortized over the respective remaining term of the related long-term debt.

(a) SHORT-TERM BORROWINGS

As of December 31, 2001, the Company had credit facilities, which included the facilities of various financing subsidiaries, Reliant Resources, REPG and RERC Corp., with financial institutions which provide for an aggregate of \$11.0 billion in committed credit. The facilities expire as follows: \$6.6 billion in 2002, \$3.6 billion in 2003 and \$0.8 billion in 2004. As of December 31, 2001, borrowings of \$4.6 billion were outstanding or supported under these credit facilities of which \$0.8 billion were classified as long-term debt, based on availability of committed credit with expiration dates exceeding one year and management's intention to maintain these borrowings in excess of one year. The remaining unused credit facilities totaled \$6.4 billion. Various credit facilities aggregating \$2.4 billion may be used for letters of credit of which \$0.4 billion were outstanding as of December 31, 2001. Interest rates on borrowings are based on the London Interbank Offered Rate (LIBOR) plus a margin, Euro interbank deposits plus a margin, a base rate or a rate determined through a bidding process. Credit facilities aggregating \$5.4 billion are unsecured. The credit facilities contain covenants and requirements that must be met to borrow funds and obtain letters of credit, as applicable. Such covenants are not anticipated to materially restrict the borrowers from borrowing funds or obtaining letters of credit, as applicable, under such facilities. As of December 31, 2001, the borrowers are in compliance with the covenants under all of these credit agreements.

The Company sells commercial paper to provide financing for general corporate purposes. As of December 31, 2001, \$2.5 billion of commercial paper was outstanding. The commercial paper borrowings are supported by various credit facilities discussed above, including \$4.7 billion in credit facilities expiring in 2002 and a \$350 million revolving credit facility expiring in 2003.

RERC Corp. has a receivables facility under which it sells its customer accounts receivable. Advances under this facility are reflected in the Consolidated Balance Sheets as short-term debt. At December 31, 2000 and 2001, the amount of the receivables facility was \$350 million and RERC Corp. had received advances of \$350 million and \$346 million, respectively. Fees and interest expense related to this facility for 1999, 2000 and 2001 aggregated \$19 million, \$24 million and \$15 million, respectively. The size of the receivables facility was increased from \$300 million to \$350 million in August 1999. For information on the reduction in the size of the facility in 2002, see Note 22(b).

The weighted average interest rate on short-term borrowings as of December 31, 1999, 2000 and 2001 was 5.84%, 7.43% and 3.29%, respectively.

The Company's revolving credit agreements are broadly-syndicated committed facilities which contain "material adverse change" clauses that could impact its ability to borrow under these facilities. The "material adverse change" clauses generally relate to the Company's ability to perform its obligations under the agreements.

(b) LONG-TERM DEBT

Maturities. The Company's maturities of long-term debt and sinking fund requirements, excluding the ZENS obligation, are \$538 million in 2002, \$1.2 billion in 2003, \$90 million in 2004, \$390 million in 2005 and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

\$218 million in 2006. The 2002 and 2003 amounts are net of sinking fund payments that can be satisfied with bonds that had been acquired and retired as of December 31, 2001.

Liens. At December 31, 2001, substantially all physical assets used in the conduct of the business and operations of the Electric Operations business segment are subject to liens securing the First Mortgage Bonds. After the Restructuring, only the assets of the transmission and distribution utility are expected to be subject to liens securing the First Mortgage Bonds. Sinking fund requirements on the First Mortgage Bonds may be satisfied by certification of property additions at 100% of the requirements as defined by the Mortgage and Deed of Trust. Sinking or improvement/replacement fund requirements for 1999, 2000 and 2001 have been satisfied by certification of property additions. The replacement fund requirement to be satisfied in 2002 is \$334 million.

RERC Corp. Debt Issuance. In February 2001, RERC Corp. issued \$550 million of unsecured notes that bear interest at 7.75% per year and mature in February 2011. Net proceeds to RERC Corp. were \$545 million. RERC Corp. used the net proceeds from the sale of the notes to pay a \$400 million dividend to Reliant Energy, and for general corporate purposes. Reliant Energy used the \$400 million proceeds from the dividend for general corporate purposes, including the repayment of short-term borrowings.

Securitization. For a discussion of the securitization financing completed in October 2001, see Note 4(a).

Purchase of Convertible Debentures. At December 31, 2000 and 2001, RERC Corp. had issued and outstanding \$98 million and \$86 million, respectively, aggregate principal amount (\$93 million and \$82 million, respectively, carrying amount) of its 6% Convertible Subordinated Debentures due 2012 (Subordinated Debentures). The holders of the Subordinated Debentures receive interest quarterly and have the right at any time on or before the maturity date thereof to convert each Subordinated Debenture into 0.65 shares of Reliant Energy common stock and \$14.24 in cash. After the Restructuring, each Subordinated Debenture will be convertible into 0.65 shares of CenterPoint Energy common stock and \$14.24 in cash. After the Distribution, each Subordinated Debenture will be convertible into an increased number of CenterPoint Energy shares based on a formula as provided in the relevant indenture and \$14.24 in cash. During 2001, RERC Corp. purchased \$11 million aggregate principal amount of its Subordinated Debentures.

TERM Notes. RERC Corp.'s \$500 million aggregate principal amount of 6 3/8% Term Enhanced ReMarketable Securities (TERM Notes) provide an investment bank with a call option, which gives it the right to have the TERM Notes redeemed from the investors on November 1, 2003 and then remarketed if it chooses to exercise the option. The TERM Notes are unsecured obligations of RERC Corp. which bear interest at an annual rate of 6 3/8% through November 1, 2003. On November 1, 2003, the holders of the TERM Notes are required to tender their notes at 100% of their principal amount. The portion of the proceeds attributable to the call option premium will be amortized over the stated term of the securities. If the option is not exercised by the investment bank, RERC Corp. will repurchase the TERM Notes at 100% of their principal amount on November 1, 2003. If the option is exercised, the TERM Notes will be remarketed on a date, selected by RERC Corp., within the 52-week period beginning November 1, 2003. During this period and prior to remarketing, the TERM Notes will bear interest at rates, adjusted weekly, based on an index selected by RERC Corp. If the TERM Notes are remarketed, the final maturity date of the TERM Notes will be November 1, 2013, subject to adjustment, and the effective interest rate on the remarketed TERM Notes will be 5.66% plus RERC Corp.'s applicable credit spread at the time of such remarketing.

Extinguishments of Debt. During the second quarter of 2000, REPGB negotiated the repurchase of \$272 million aggregate principal amount of its long-term debt for a total cost of \$286 million, including \$14 million in expenses. The book value of the debt repurchased was \$293 million, resulting in an extraordinary gain on the early extinguishment of long-term debt of \$7 million. Borrowings under a short-term

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

banking facility and proceeds from the sale of trading securities by REPGb were used to finance the debt repurchase.

During 1999, the Company's regulated operations recorded losses from the extinguishment of debt of \$22 million. There were no losses recorded from the early extinguishment of debt in 2000 and 2001. As these costs will be recovered through regulated cash flows, these costs have been deferred and a regulatory asset has been recorded. For further discussion regarding the accounting, see Note 4(a).

(c) OFF-BALANCE SHEET FINANCINGS

For information regarding off-balance sheet financings and REMA sale-leaseback transactions related to Reliant Resources, see Notes 14(b) and 14(l).

(11) TRUST PREFERRED SECURITIES

In February 1997, two Delaware statutory business trusts created by Reliant Energy (HL&P Capital Trust I and HL&P Capital Trust II) issued to the public (a) \$250 million aggregate amount of preferred securities and (b) \$100 million aggregate amount of capital securities, respectively. In February 1999, a Delaware statutory business trust created by Reliant Energy (REI Trust I) issued \$375 million aggregate amount of preferred securities to the public. Reliant Energy accounts for REI Trust I, HL&P Capital Trust I and HL&P Capital Trust II as wholly owned consolidated subsidiaries. Each of the trusts used the proceeds of the offerings to purchase junior subordinated debentures issued by Reliant Energy having interest rates and maturity dates that correspond to the distribution rates and the mandatory redemption dates for each series of preferred securities or capital securities.

The junior subordinated debentures are the trusts' sole assets and their entire operations. Reliant Energy considers its obligations under the Amended and Restated Declaration of Trust, Indenture, Guaranty Agreement and, where applicable, Agreement as to Expenses and Liabilities, relating to each series of preferred securities or capital securities, taken together, to constitute a full and unconditional guarantee by Reliant Energy of each trust's obligations with respect to the respective series of preferred securities or capital securities.

The preferred securities and capital securities are mandatorily redeemable upon the repayment of the related series of junior subordinated debentures at their stated maturity or earlier redemption. Subject to some limitations, Reliant Energy has the option of deferring payments of interest on the junior subordinated debentures. During any deferral or event of default, Reliant Energy may not pay dividends on its capital stock. As of December 31, 2001, no interest payments on the junior subordinated debentures had been deferred.

In June 1996, a Delaware statutory business trust created by RERC Corp. (RERC Trust) issued \$173 million aggregate amount of convertible preferred securities to the public. RERC Corp. accounts for RERC Trust as a wholly owned consolidated subsidiary. RERC Trust used the proceeds of the offering to purchase convertible junior subordinated debentures issued by RERC Corp. having an interest rate and maturity date that correspond to the distribution rate and mandatory redemption date of the convertible preferred securities. The convertible junior subordinated debentures represent RERC Trust's sole assets and its entire operations. RERC Corp. considers its obligation under the Amended and Restated Declaration of Trust, Indenture and Guaranty Agreement relating to the convertible preferred securities, taken together, to constitute a full and unconditional guarantee by RERC Corp. of RERC Trust's obligations with respect to the convertible preferred securities.

The convertible preferred securities are mandatorily redeemable upon the repayment of the convertible junior subordinated debentures at their stated maturity or earlier redemption. Each convertible preferred security is convertible at the option of the holder into \$33.62 of cash and 1.55 shares of Reliant Energy common stock. During 2000 and 2001, convertible preferred securities of \$0.3 million and \$0.04 million,

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

respectively, were converted. As of December 31, 2000 and 2001, \$0.4 million liquidation amount of convertible preferred securities were outstanding. Subject to some limitations, RERC Corp. has the option of deferring payments of interest on the convertible junior subordinated debentures. During any deferral or event of default, RERC Corp. may not pay dividends on its common stock to Reliant Energy. As of December 31, 2001, no interest payments on the convertible junior subordinated debentures had been deferred.

The outstanding aggregate liquidation amount, distribution rate and mandatory redemption date of each series of the preferred securities, convertible preferred securities or capital securities of the trusts and the identity and similar terms of each related series of junior subordinated debentures are as follows:

AGGREGATE
LIQUIDATION AMOUNTS
AS OF MANDATORY
DECEMBER 31,
DISTRIBUTION
REDEMPTION TRUST
2000 AND 2001
RATE/INTEREST RATE
DATE/MATURITY DATE
JUNIOR SUBORDINATED
DEBENTURES - -----

- (IN MILLIONS) REI

Trust I.....
\$375 7.20% March
2048 7.20% Junior
Subordinated
Debentures due 2048
HL&P Capital Trust
I... \$250 8.125%
March 2046 8.125%
Junior Subordinated
Deferrable Interest
Debentures Series A
HL&P Capital Trust
\$100 8.257% February
2037 8.257% Junior
Subordinated

II.....
Deferrable Interest
Debentures Series B
RERC
Trust..... \$
1 6.25% June 2026
6.25% Convertible
Junior Subordinated
Debentures due 2026

RELIANT ENERGY, INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(14) COMMITMENTS AND CONTINGENCIES

(a) COMMITMENTS AND GUARANTEES

The following information is presented separately for the Company's regulated and unregulated businesses:

RELIANT ENERGY (TO BECOME CENTERPOINT ENERGY SUBSEQUENT TO THE RESTRUCTURING)

Capital and Environmental Commitments. Reliant Energy anticipates investing up to \$397 million in capital and other special project expenditures between 2002 and 2006 for environmental compliance. Reliant Energy anticipates expenditures to be as follows (in millions):

2002.....	\$234
2003.....	132
2004.....	28
2005.....	3
2006.....	--

Total.....	\$397
	====

Fuel and Purchased Power. Fuel commitments include several long-term coal, lignite and natural gas contracts related to Texas power generation operations, which have various quantity requirements and durations that are not classified as non-trading derivatives assets and liabilities or trading and marketing assets and liabilities in the Company's Consolidated Balance Sheets as of December 31, 2001 as these contracts meet the SFAS No. 133 exception to be classified as "normal purchases contracts" (see Note 5) or do not meet the definition of a derivative. Minimum payment obligations for coal and transportation agreements that extend through 2009 are approximately \$199 million in 2002, \$129 million in 2003, \$133 million in 2004, \$137 million in 2005 and \$141 million in 2006. Purchase commitments related to lignite mining and lease agreements, natural gas purchases and storage contracts, and purchased power are not material to Reliant Energy's operations. Prior to January 1, 2002, the Electric Operations business segment was allowed recovery of these costs through rates for electric service. As of December 31, 2001, some of these contracts are above market. Reliant Energy anticipates that stranded costs associated with these obligations will be recoverable through the stranded cost recovery mechanisms contained in the Texas Electric Restructuring Law. For information regarding the Texas Electric Restructuring Law, see Note 4(a).

Reliant Energy's other long-term fuel supply commitments which have various quantity requirements and durations are not considered material either individually or in the aggregate to its results of operations or cash flows.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

RELIANT RESOURCES -- UNREGULATED BUSINESSES

As of December 31, 2001, the Wholesale Energy business segment had entered into commitments associated with various non-rate regulated electric generating projects, including commitments for the purchase of combustion turbines, aggregating \$440 million. In addition, the Wholesale Energy business segment has options to purchase additional generating equipment for a total estimated cost of \$42 million for future generation projects. Reliant Resources is actively attempting to remarket this equipment.

Reliant Resources is a party to several fuel supply contracts, commodity transportation contracts, and purchase power and electric capacity contracts, that have various quantity requirements and durations that are not classified as non-trading derivatives assets and liabilities or trading and marketing assets and liabilities in the Consolidated Balance Sheets as of December 31, 2001 as these contracts meet the SFAS No. 133 exception to be classified as "normal purchases contracts" (see Note 5) or do not meet the definition of a derivative. The maximum duration of any of these commitments is 21 years. Minimum purchase commitment obligations under these agreements are as follows for the next five years, as of December 31, 2001 (in millions):

	PURCHASED POWER AND ELECTRIC AND TRANSPORTATION GAS CAPACITY FUEL COMMITMENTS	COMMITMENTS	COMMITMENTS	---
	-----	-----	-----	-----
2002.....	\$105	\$ 45	\$315	
2003.....	39	84	119	
2004.....	45	101	61	
2005.....	45	101	61	
2006.....	45	101	61	----
Total.....	\$279	\$432	\$617	====

The maximum duration under any individual fuel supply contract and transportation contract is 18 years and 21 years, respectively.

Reliant Resources' aggregate electric capacity commitments, including capacity auction products, are for 7,496 MW, 1,800 MW, 1,000 MW, 1,000 MW and 1,000 MW for 2002, 2003, 2004, 2005 and 2006, respectively. The maximum duration under any individual commitment is five years. Included in the above purchase power and electric capacity commitments are amounts to be acquired from Texas Genco in 2002 and 2003 of \$213 million and \$57 million, respectively.

As of December 31, 2001, Reliant Resources has commitments, including electric energy and capacity sale contracts and district heating contracts (see Note 14(h)) which are not classified as non-trading derivative assets and liabilities or trading and marketing assets and liabilities in the Consolidated Balance Sheets as these contracts meet the SFAS No. 133 exception to be classified as "normal sales contracts" or do not meet the definition of a derivative. The estimated minimum sale commitments under these contracts are \$450 million, \$211 million, \$194 million, \$174 million and \$159 million in 2002, 2003, 2004, 2005 and 2006, respectively.

In addition, in January 2002, Reliant Resources began providing retail electric services to approximately 1.5 million residential and small commercial customers previously served by Reliant Energy's electric utility division. Within Reliant Energy's electric utility division's territory, prices that may be charged to residential and small commercial customers by this retail electric service provider are subject to a fixed, specified price (price to beat) at the outset of retail competition. The Texas Utility Commission's regulations allow this retail electric provider to adjust its price to beat fuel factor based on a percentage change in the price of natural gas. In addition, the retail electric provider may also request an adjustment as a result of changes in its price of purchased energy. The retail electric provider may request that its price to beat be adjusted twice a year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Reliant Resources will not be permitted to sell electricity to residential and small commercial customers in the incumbent's traditional service territory at a price other than the price to beat until January 1, 2005, unless before that date the Texas Utility Commission determines that 40% or more of the amount of electric power that was consumed in 2000 by the relevant class of customers is committed to be served by other retail electric providers.

Reliant Resources guarantees the performance of certain of its subsidiaries' trading and hedging obligations. As of December 31, 2001, the fixed maximum amount of such guarantees was \$4.7 billion. In addition, Reliant Resources has issued letters of credit totaling \$51 million in connection with its trading activities. Reliant Resources does not consider it likely that it would be required to perform or otherwise incur any losses associated with these guarantees.

In addition to the above discussions, Reliant Resources' other commitments have various quantity requirements and durations and are not considered material either individually or in the aggregate to its results of operations or cash flows.

(b) LEASE COMMITMENTS

In August 2000, the Company, entered into separate sale-leaseback transactions with each of three owner-lessors covering the subsidiaries' respective 16.45%, 16.67% and 100% interests in the Conemaugh, Keystone and Shawville generating stations, respectively, acquired in the REMA acquisition. As lessee, the Company leases an interest in each facility from each owner-lessor under a facility lease agreement. The equity interests in all the subsidiaries of REMA are pledged as collateral for REMA's lease obligations. In addition, the subsidiaries have guaranteed the lease obligations. The lease documents contain restrictive covenants that restrict REMA's ability to, among other things, make dividend distributions unless REMA satisfies various conditions. The covenant restricting dividends would be suspended if the direct or indirect parent of REMA, meeting specified criteria, including having a rating on REMA's long-term unsecured senior debt of at least BBB from Standard and Poor's and Baa2 from Moody's, guarantees the lease obligations. The Company will make lease payments through 2029. The lease term expires in 2034. As of December 31, 2001, REMA had \$167 million of restricted funds that are available for REMA's working capital needs and to make future lease payments, including a lease payment of \$55 million which was made in January 2002.

In the first quarter of 2001, Reliant Resources entered into tolling arrangements with a third party to purchase the rights to utilize and dispatch electric generating capacity of approximately 1,100 MW extending through 2012. This electricity will be generated by two gas-fired, simple-cycle peaking plants, with fuel oil backup which are being constructed by a tolling partner. Reliant Resources anticipates construction to be completed by the summer of 2002, at which time Reliant Resources will commence tolling payments. The tolling arrangements qualify as operating leases.

In February 2001, the Company entered into a lease for office space for Reliant Resources in a building under construction. The lease agreement was assigned by the Company to Reliant Resources by an assignment and assumption agreement in June 2001. The lease term, which commences in the second quarter 2003, is 15 years with two five-year renewal options. Reliant Resources has the right to name the building.

The following table sets forth information concerning the Company's obligations under non-cancelable long-term operating leases at December 31, 2001, which primarily relate to the REMA leases mentioned above. Other non-cancelable, long-term operating leases for Reliant Energy and Reliant Resources principally

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

consist of tolling arrangements, as discussed above, rental agreements for building space, data processing equipment and vehicles, including major work equipment.

	REMA SALE-LEASE	RELIANT RESOURCES	RELIANT ENERGY	OTHER	OTHER	TOTAL	--
	OBLIGATION	OTHER	OTHER	TOTAL	--		

(IN MILLIONS)							
2002.....	\$ 136	\$ 52	\$ 14	\$ 202			
2003.....	77	72	12	161			
2004.....	84	87	7	178			
2005.....	75	89	6	170			
2006.....	64	90	5	159	2007 and beyond.....	1,124	
	469	66	1,659	-----	-----	-----	

Total.....	\$1,560	\$859	\$110	\$2,529	=====		
	=====	=====	=====	=====			

Total lease expense for all operating leases was \$39 million, \$62 million and \$112 million during 1999, 2000 and 2001, respectively. During 2001, the Company made lease payments related to the REMA lease of \$259 million. As of December 31, 2001, the Company had recorded a prepaid lease obligation related to the REMA sale-leaseback of \$59 million and \$122 million in other current assets and other long-term assets, respectively.

(c) CROSS BORDER LEASES

During the period from 1994 through 1997, under cross border lease transactions, REPGb leased several of its power plants and related equipment and turbines to non-Netherlands based investors (the head leases) and concurrently leased the facilities back under sublease arrangements with remaining terms as of December 31, 2001 of 1 to 23 years. REPGb utilized proceeds from the head lease transactions to prepay its sublease obligations and to provide a source for payment of end of term purchase options and other financial undertakings. The initial sublease obligations totaled \$2.4 billion of which \$1.6 billion remained outstanding as of December 31, 2001. These transactions involve REPGb providing to a foreign investor an ownership right in (but not necessarily title to) an asset, with a leaseback of that asset. The net proceeds to REPGb of the transactions were recorded as a deferred gain and are currently being amortized to income over the lease terms. At December 31, 2000 and 2001, the unamortized deferred gain on these transactions totaled \$77 million and \$68 million, respectively. The power plants, related equipment and turbines remain on the financial statements of REPGb and continue to be depreciated.

REPGb is required to maintain minimum insurance coverages, perform minimum annual maintenance and, in specified situations, post letters of credit. REPGb's shareholder is subject to some restrictions with respect to the liquidation of REPGb's shares. In the case of early termination of these contracts, REPGb would be contingently liable for some payments to the sublessors, which at December 31, 2001, are estimated to be \$272 million. Starting in March 2000, REPGb was required by some of the lease agreements to obtain standby letters of credit in favor of the sublessors in the event of early termination. The amount of the required letters of credit was \$272 million as of December 31, 2001. Commitments for these letters of credit have been obtained as of December 31, 2001.

(d) NAMING RIGHTS TO HOUSTON SPORTS COMPLEX

In October 2000, Reliant Resources acquired the naming rights for the new football stadium for the Houston Texans, the National Football League's newest franchise. In addition, the naming rights cover the entertainment and convention facilities included in the stadium complex. The agreement extends for 32 years. In addition to naming rights, the agreement provides Reliant Resources with significant sponsorship rights.

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The aggregate cost of the naming rights will be approximately \$300 million. During the fourth quarter of 2000, Reliant Resources incurred an obligation to pay \$12 million in order to secure the long-term commitment and for the initial advertising of which \$10 million was expensed in the Statement of Consolidated Income in 2000. Starting in 2002, when the new stadium is operational, Reliant Resources will pay \$10 million each year through 2032 for annual advertising under this agreement.

(e) TRANSPORTATION AGREEMENT

A subsidiary of RERC Corp. had an agreement (ANR Agreement) with ANR Pipeline Company (ANR) that contemplated that this subsidiary would transfer to ANR an interest in some of RERC Corp.'s pipeline and related assets. As of December 31, 2000 and 2001, the Company had recorded \$41 million in other long-term liabilities in the Company's Consolidated Balance Sheets to reflect the Company's obligation to ANR for the use of 130 million cubic feet (Mmcf)/day of capacity in some of the Company's transportation facilities. The level of transportation will decline to 100 Mmcf/day in the year 2003 with a refund of \$5 million to ANR. The ANR Agreement will terminate in 2005 with a refund of \$36 million.

(f) LEGAL, ENVIRONMENTAL AND OTHER REGULATORY MATTERS

Legal Matters

Reliant Energy HL&P Municipal Franchise Fee Lawsuits. In February 1996, the cities of Wharton, Galveston and Pasadena filed suit, for themselves and a proposed class of all similarly situated cities in Reliant Energy HL&P's service area, against Reliant Energy and Houston Industries Finance, Inc. (formerly a wholly owned subsidiary of Reliant Energy) alleging underpayment of municipal franchise fees. Plaintiffs claim that they are entitled to 4% of all receipts of any kind for business conducted within these cities over the previous four decades. Because the franchise ordinances at issue affecting Reliant Energy HL&P expressly impose fees only on its own receipts and only from sales of electricity for consumption within a city, the Company regards all of plaintiffs' allegations as spurious and is vigorously contesting the case. The plaintiffs' pleadings asserted that their damages exceeded \$250 million. The 269th Judicial District Court for Harris County granted partial summary judgment in favor of Reliant Energy dismissing all claims for franchise fees based on sales tax collections. Other motions for partial summary judgment were denied. A six-week jury trial of the original claimant cities (but not the class of cities) ended on April 4, 2000 (Three Cities case). Although the jury found for Reliant Energy on many issues, they found in favor of the original claimant cities on three issues, and assessed a total of \$4 million in actual and \$30 million in punitive damages. However, the jury also found in favor of Reliant Energy on the affirmative defense of laches, a defense similar to a statute of limitations defense, due to the original claimant cities having unreasonably delayed bringing their claims during the 43 years since the alleged wrongs began.

The trial court in the Three Cities case granted most of Reliant Energy's motions to disregard the jury's findings. The trial court's rulings reduced the judgment to \$1.7 million, including interest, plus an award of \$13.7 million in legal fees. In addition, the trial court granted Reliant Energy's motion to decertify the class and vacated its prior orders certifying a class. Following this ruling, 45 cities filed individual suits against Reliant Energy in the District Court of Harris County.

The Three Cities case has been appealed. The Company believes that the \$1.7 million damage award resulted from serious errors of law and that it will be set aside by the Texas appellate courts. In addition, the Company believes that because of an agreement between the parties limiting fees to a percentage of the damages, reversal of the award of \$13.7 million in attorneys' fees in the Three Cities case is probable.

The extent to which issues in the Three Cities case may affect the claims of the other cities served by Reliant Energy HL&P cannot be assessed until judgments are final and no longer subject to appeal. However, the trial court's rulings disregarding most of the jury's findings are consistent with Texas Supreme Court

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

opinions over the past decade. The Company estimates the range of possible outcomes for the plaintiffs to be between zero and \$18 million inclusive of interest and attorneys' fees.

California Wholesale Market. Reliant Energy, Reliant Energy Services, REPG and several other subsidiaries of Reliant Resources, as well as three officers of some of these companies, have been named as defendants in class action lawsuits and other lawsuits filed against a number of companies that own generation plants in California and other sellers of electricity in California markets. Pursuant to the terms of the master separation agreement between Reliant Energy and Reliant Resources (see Note 4(c)), Reliant Resources has agreed to indemnify Reliant Energy for any damages arising under these lawsuits and may elect to defend these lawsuits at its own expense. Three of these lawsuits were filed in the Superior Court of the State of California, San Diego County; two were filed in the Superior Court in San Francisco County; and one was filed in the Superior Court of Los Angeles County. While the plaintiffs allege various violations by the defendants of state antitrust laws and state laws against unfair and unlawful business practices, each of the lawsuits is grounded on the central allegation that defendants conspired to drive up the wholesale price of electricity. In addition to injunctive relief, the plaintiffs in these lawsuits seek treble the amount of damages alleged, restitution of alleged overpayments, disgorgement of alleged unlawful profits for sales of electricity, costs of suit and attorneys' fees. The cases were initially removed to federal court and were then assigned to Judge Robert H. Whaley, United States District Judge, pursuant to the federal procedures for multi-district litigation. On July 30, 2000, Judge Whaley remanded the cases to state court. Upon remand to state court, the cases were assigned to Superior Court Judge Janis L. Sammartino pursuant to the California state coordination procedures. On March 4, 2002, Judge Sammartino adopted a schedule proposed by the parties that would result in a trial beginning on March 1, 2004. On March 8, 2002, the plaintiffs filed a single, consolidated complaint naming numerous defendants, including Reliant Energy Services and other Reliant Resources' subsidiaries, that restated the allegations described above and alleged that damages against all defendants could be as much as \$1 billion.

Plaintiffs have voluntarily dismissed Reliant Energy from two of the three class actions in which it was named as a defendant. The ultimate outcome of the lawsuits cannot be predicted with any degree of certainty at this time. However, the Company believes, based on its analysis to date of the claims asserted in these lawsuits and the underlying facts, that resolution of these lawsuits will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

On March 11, 2002, the California Attorney General filed a civil lawsuit in San Francisco Superior Court naming Reliant Energy, Reliant Resources, Reliant Energy Services, REPG, and several other subsidiaries of Reliant Resources as defendants. Pursuant to the terms of the master separation agreement between Reliant Energy and Reliant Resources (see Note 4(c)), Reliant Resources has agreed to indemnify Reliant Energy for any damages arising under these lawsuits and may elect to defend these lawsuits at its own expense. The Attorney General alleges various violations by the defendants of state laws against unfair and unlawful business practices arising out of transactions in the markets for ancillary services run by the California Independent System Operator (Cal ISO). In addition to injunctive relief, the Attorney General seeks restitution and disgorgement of alleged unlawful profits for sales of electricity, and civil penalties. The ultimate outcome of this lawsuit cannot be predicted with any degree of certainty at this time.

On March 19, 2002, the California Attorney General filed a complaint with the FERC naming Reliant Energy Services and "all other public utility sellers" in California as defendants. The complaint alleges that sellers with market-based rates have violated their tariffs by not filing with the FERC transaction-specific information about all of their sales and purchases at market-based rates. The California Attorney General argues that, as a result, all past sales should be subject to refund if found to be above just and reasonable levels. The ultimate outcome of this complaint proceeding cannot be predicted with any degree of certainty at this time. However, the Company believes, based on its analysis to date of the claims asserted in the complaint, the underlying facts, and the relevant statutory and regulatory provisions, that resolution of this

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

lawsuit will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

Natural Gas Measurement Lawsuits. In 1997, a suit was filed under the Federal False Claim Act against RERC and certain of its subsidiaries alleging mismeasurement of natural gas produced from federal and Indian lands. The suit seeks undisclosed damages, along with statutory penalties, interest, costs, and fees. The complaint is part of a larger series of complaints filed against 77 natural gas pipelines and their subsidiaries and affiliates. An earlier single action making substantially similar allegations against the pipelines was dismissed by the U.S. District Court for the District of Columbia on grounds of improper joinder and lack of jurisdiction. As a result, the various individual complaints were filed in numerous courts throughout the country. This case was consolidated, together with the other similar False Claim Act cases filed and transferred to the District of Wyoming. Motions to dismiss were denied. The defendants intend to vigorously contest this case.

In addition, RERC, REGT, REFS and MRT have been named as defendants in a class action filed in May 1999 against approximately 245 pipeline companies and their affiliates. The plaintiffs in the case purport to represent a class of natural gas producers and fee royalty owners who allege that they have been subject to systematic gas mismeasurement by the defendants, including certain Reliant Energy entities, for more than 25 years. The plaintiffs seek compensatory damages, along with statutory penalties, treble damages, interest, costs and fees. The action is currently pending in state court in Stevens County, Kansas. Plaintiffs initially sued Reliant Energy Services, but that company was dismissed without prejudice on June 8, 2001. Other Reliant Energy entities that were misnamed or duplicative have also been dismissed. MRT and REFS have filed motions to dismiss for lack of personal jurisdiction and are currently responding to discovery on personal jurisdiction. All four Reliant Energy defendants have joined in a motion to dismiss.

The defendants plan to raise significant affirmative defenses based on the terms of the applicable contracts, as well as on the broad waivers and releases in take or pay settlements that were granted by the producer-sellers of natural gas who are putative class members.

Environmental Matters

Clean Air Standards. The Company has participated in a lawsuit against the Texas Natural Resource Conservation Commission (TNRCC) regarding the limitation of the emission of oxides of nitrogen (NOx) in the Houston area. A settlement of the lawsuit was reached with the TNRCC in the second quarter of 2001 and revised emissions limitations were adopted by the TNRCC in the third quarter of 2001. The revised limitations provide for an increase in allowable NOx emissions, compared to the original TNRCC requirements, through 2004. Further emission reduction requirements may or may not be required through 2007, depending upon the outcome of further investigations of regional air quality issues. To achieve the TNRCC NOx reduction requirements, the Company anticipates investing up to \$721 million in capital and other special project expenditures by 2004, including costs incurred through December 31, 2001, and potentially up to an additional \$88 million between 2004 and 2007. The Texas Electric Restructuring Law provides for stranded cost recovery for expenditures incurred before May 1, 2003 to achieve the NOx reduction requirements.

Hydrocarbon Contamination. On August 24, 2001, 37 plaintiffs filed suit against Reliant Energy Gas Transmission Company, Inc., Reliant Energy Pipeline Services, Inc., RERC, Reliant Energy Services, Inc., other Reliant Energy entities and third parties (Docket No. 460, 916-Div. "B"), in the 1st Judicial District Court, Caddo Parish, Louisiana. The petition has now been supplemented five times. As of March 11, 2002, there were 628 plaintiffs, a majority of whom are Louisiana residents who live near the Wilcox Aquifer. In addition to the Reliant Energy entities, the plaintiffs have sued the State of Louisiana through its Department of Environmental Quality, several individuals, some of whom are present employees of the State of Louisiana, the Bayou South Gas Gathering Company, L.L.C., Martin Timber Company, Inc., and several trusts.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The suit alleges that, at some unspecified date prior to 1985, the defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer which lies beneath property owned or leased by the defendants and which is the sole or primary drinking water aquifer in the area. The primary source of the contamination is alleged by the plaintiffs to be a gas processing facility in Haughton, Bossier Parish, Louisiana known as the "Sligo Facility." This facility was purportedly used for gathering natural gas from surrounding wells, separating gasoline and hydrocarbons from the natural gas for marketing, and transmission of natural gas for distribution. This site was originally leased and operated by predecessors of Reliant Energy Gas Transmission Company in the late 1940s and was operated until Arkansas Louisiana Gas Company ceased operations of the plant in the late 1970s.

Beginning about 1985, the predecessors of certain Reliant Energy defendants engaged in a voluntary remediation of any subsurface contamination of the groundwater below the property they own or lease. This work has been done in conjunction with and under the direction of the Louisiana Department of Environmental Quality. The plaintiffs seek monetary damages for alleged damage to the aquifer underlying their property, unspecified alleged personal injuries, alleged fear of cancer, alleged property damage or diminution of value of their property, and in addition seek damages for trespass, punitive, and exemplary damages. The quantity of monetary damages sought is unspecified. As of December 31, 2001, the Company is unable to estimate the monetary damages, if any, that the plaintiffs may be awarded in this matter.

Manufactured Gas Plant Sites. RERC and its predecessors operated a manufactured gas plant (MGP) until 1960 adjacent to the Mississippi River in Minnesota, formerly known as Minneapolis Gas Works (MGW). RERC has substantially completed remediation of the main site other than ongoing water monitoring and treatment. The manufactured gas was stored in separate holders. RERC is negotiating clean-up of one such holder. There are six other former MGP sites in the Minnesota service territory. Remediation has been completed on one site. Of the remaining five sites, RERC believes that two were neither owned nor operated by RERC. RERC believes it has no liability with respect to the sites it neither owned nor operated.

At December 31, 2000 and 2001, RERC had accrued \$18 million and \$23 million, respectively, for remediation of the Minnesota sites. At December 31, 2001, the estimated range of possible remediation costs was \$11 million to \$49 million. The cost estimates of the MGW site are based on studies of that site. The remediation costs for the other sites are based on industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites remediated, the participation of other potentially responsible parties (PRP), if any, and the remediation methods used.

Issues relating to the identification and remediation of MGPs are common in the natural gas distribution industry. The Company has received notices from the United States Environmental Protection Agency and others regarding its status as a PRP for other sites. Based on current information, the Company has not been able to quantify a range of environmental expenditures for potential remediation expenditures with respect to other MGP sites.

Other Minnesota Matters. At December 31, 2000 and 2001, RERC had recorded accruals of \$4 million and \$5 million, respectively for other environmental matters in Minnesota for which remediation may be required. At December 31, 2001 the estimated range of possible remediation costs was \$4 million to \$8 million.

Mercury Contamination. The Company's pipeline and distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area with elemental mercury. This type of contamination has been found by the Company at some sites in the past, and the Company has conducted remediation at sites found to be contaminated. Although the Company is not aware of additional specific sites, it is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

amount of these costs cannot be known at this time, based on experience by the Company and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, the Company believes that the costs of any remediation of these sites will not be material to the Company's financial position, results of operations or cash flows.

REMA Ash Disposal Site Closures and Site Contaminations. Under the agreement to acquire REMA (see Note 3(a)), the Company became responsible for liabilities associated with ash disposal site closures and site contamination at the acquired facilities in Pennsylvania and New Jersey prior to a plant closing, except for the first \$6 million of remediation costs at the Seward Generating Station. A prior owner retained liabilities associated with the disposal of hazardous substances to off-site locations prior to November 24, 1999. As of December 31, 2000 and 2001, REMA has liabilities associated with six future ash disposal site closures and six current site investigations and environmental remediations. The Company has recorded its estimate of these environmental liabilities in the amount of \$36 million as of December 31, 2000 and 2001. The Company expects approximately \$16 million will be paid over the next five years.

REPGB Asbestos Abatement and Soil Remediation. Prior to the Company's acquisition of REPGB (see Note 3(b)), REPGB had a \$25 million obligation primarily related to asbestos abatement, as required by Dutch law, and soil remediation at six sites. During 2000, the Company initiated a review of potential environmental matters associated with REPGB's properties. REPGB began remediation in 2000 of the properties identified to have exposed asbestos and soil contamination, as required by Dutch law and the terms of some leasehold agreements with municipalities in which the contaminated properties are located. All remediation efforts are to be fully completed by 2005. As of December 31, 2000 and 2001, the recorded estimated undiscounted liability for this asbestos abatement and soil remediation was \$24 million and \$18 million, respectively.

Other. From time to time the Company has received notices from regulatory authorities or others regarding its status as a PRP in connection with sites found to require remediation due to the presence of environmental contaminants. The Company has from time to time received notices from regulatory authorities regarding alleged noncompliance with environmental regulatory requirements. In addition, the Company has been named as a defendant in litigation related to allegedly contaminated sites and in recent years has been named, along with numerous others, as a defendant in several lawsuits filed by a large number of individuals who claim injury due to exposure to asbestos while working at sites along the Texas Gulf Coast. Most of these claimants have been workers who participated in construction of various industrial facilities, including power plants, and some of the claimants have worked at locations owned by the Company. The Company anticipates that additional claims like those received may be asserted in the future and intends to continue vigorously contesting claims which it does not consider to have merit. Although their ultimate outcome cannot be predicted at this time, the Company does not believe, based on its experience to date, that these matters, either individually or in the aggregate, will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Other Matters

The Company is involved in other legal, environmental, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business. Some of these proceedings involve substantial amounts. The Company's management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. The Company's management believes that the disposition of these matters will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

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(g) CALIFORNIA WHOLESALE MARKET UNCERTAINTY.

Receivables. During portions of 2000 and 2001, prices for wholesale electricity in California increased dramatically as a result of a combination of factors, including higher natural gas prices and emission allowance costs, reduction in available hydroelectric generation resources, increased demand, decreased net electric imports and limitations on supply as a result of maintenance and other outages. The resulting supply and demand imbalance disproportionately impacted California utilities that relied too heavily on short-term power markets to meet their load requirements. Although wholesale prices increased, California's deregulation legislation kept retail rates frozen at 10% below 1996 levels for two of California's public utilities, Pacific Gas and Electric (PG&E) and Southern California Edison Company (SCE), until rates were raised by the California Public Utilities Commission (CPUC) early in 2001.

Due to the disparity between wholesale and retail rates, the credit ratings of PG&E and SCE fell below investment grade. Additionally, PG&E filed for protection under the bankruptcy laws on April 6, 2001. As a result, PG&E and SCE are no longer considered creditworthy and since January 17, 2001 have not directly purchased power from third-party suppliers through the Cal ISO to serve their net short load. Pursuant to emergency legislation enacted by the California Legislature, the California Department of Water Resources (CDWR) has negotiated and purchased power through short and long-term contracts on behalf of PG&E and SCE to meet their net short loads. In December 2001, the CDWR began making payments to the Cal ISO for real-time transactions. The CDWR has now made payment through the Cal ISO for most real-time energy deliveries subsequent to January 17, 2001.

In addition, certain contracts intended to serve as collateral for sales to the California Power Exchange (Cal PX) were seized by California Governor Gray Davis in February 2001. The Ninth Circuit Court of Appeals subsequently ruled that Governor Davis' seizure of these contracts was wrongful. The Company has filed a lawsuit, currently pending in California, to require the state of California to compensate it for the seizure of these contracts. Although SCE made a payment on March 1, 2002 to the Cal PX that included amounts it owed to the Company under these contracts, the Company is still seeking to recover the market value of the contracts at the time they were seized by Governor Davis, which was significantly higher than the contract value, and to collect amounts owed as a result of payment defaults by PG&E under the contracts. The timing and ultimate resolution of these claims is uncertain at this time.

On September 20, 2001, PG&E filed a Plan of Reorganization and an accompanying disclosure statement with the bankruptcy court. Under this plan, PG&E would pay all allowed creditor claims in full, through a combination of cash and long-term notes. Components of the plan will require the approval of the FERC, the SEC and the Nuclear Energy Regulatory Commission, in addition to the bankruptcy court. PG&E has stated it seeks to have this plan confirmed by December 31, 2002. A number of parties are contesting PG&E's reorganization plan, including a number of California parties and agencies. The bankruptcy judge in the PG&E case has ordered that the CPUC may file a competing plan. The details of the CPUC's proposal are unknown at this time. The ability of PG&E to have its reorganization plan confirmed, including the provision providing for the payment in full of unsecured creditors, is uncertain at this time.

On October 5, 2001, a federal district court in California entered a stipulated judgment approving a settlement between SCE and the CPUC in an action brought by SCE regarding the recovery of its wholesale power costs under the filed rate doctrine. Under the stipulated judgment, a rate increase approved earlier in 2001 will remain in place until the earlier of SCE recovering \$3.3 billion or December 31, 2002. After that date, the CPUC will review the sufficiency of retail rates through December 31, 2005. A consumer organization has appealed the judgment to the Ninth Circuit Court of Appeals, and no hearing has been held to date. Under the stipulated judgment, any settlement with SCE's creditors that is entered into after March 1, 2002 must be approved by the CPUC. The Company has appealed this provision of the judgment. On March 1, 2002, SCE made a payment to the Cal PX that included amounts it owed the Company. The Company has made a filing with FERC seeking an order providing for the disbursement of the funds owed to

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the suppliers. The FERC and the bankruptcy court governing the Cal PX bankruptcy proceedings are considering how to dispense this money and it remains uncertain when those funds will be paid over to the Company.

As of December 31, 2000, the Company was owed a total of \$282 million by the Cal PX and the Cal ISO. As of December 31, 2001, the Company was owed a total of \$302 million by the Cal ISO, the Cal PX, the CDWR, and California Energy Resources Scheduling for energy sales in the California wholesale market during the fourth quarter of 2000 through December 31, 2001. From January 1, 2002 through March 26, 2002, the Company has collected \$45 million of these receivable balances. As of December 31, 2001, the Company had a pre-tax provision of \$68 million against receivable balances related to energy sales in the California market, including \$39 million recorded in 2000 and \$29 million recorded in 2001. Management will continue to assess the collectability of these receivables based on further developments affecting the California electricity market and the market participants described herein.

FERC Market Mitigation. In response to the filing of a number of complaints challenging the level of wholesale prices, the FERC initiated a staff investigation and issued a number of orders implementing a series of wholesale market reforms. Under these orders, and subject to review and adjustment based on the pending refund proceeding described below, the Company may face an as yet undetermined amount of refund liability. See "-- FERC Refunds" below. Under these orders, for the period January 1, 2001 through June 19, 2001, approximately \$20 million of the \$149 million charged by the Company for sales in California to the Cal ISO and the Cal PX were identified as being subject to possible refunds. During the second quarter of 2001, the Company accrued refunds of \$15 million, \$3 million of which had been previously expensed during the first quarter of 2001.

On April 26, 2001, the FERC issued an order replacing the previous price review procedures and establishing a market monitoring and mitigation plan, effective May 29, 2001, for the California markets. The plan establishes a cap on prices during periods when power reserves fall below 7% in the Cal ISO (reserve deficiency periods). The Cal ISO is instructed to use data submitted confidentially by gas-fired generators in California and daily indices of natural gas and emissions allowance costs to establish the market-clearing price in real-time based on the marginal cost of the highest-cost generator called to run. The plan also requires generators in California to offer all their available capacity for sale in the real-time market, and conditions sellers' market-based rate authority such that sellers engaging in certain bidding practices will be subject to increased scrutiny by the FERC, potential refunds and even revocation of their market-based rate authority.

On June 19, 2001, the FERC issued an order modifying the market monitoring and mitigation plan adopted in its April 26 order, to apply price controls to all hours, instead of just hours of low operating reserve, and to extend the mitigation measures to other Western states in addition to California, including Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming. The FERC set July 2, 2001 as the refund effective date for sales subject to the price mitigation plan throughout the West region. This means that transactions after that date may be subject to refund if found to be unjust or unreasonable. The proxy market clearing price calculated by the Cal ISO will apply during periods of reserve deficiency to all sales in the Cal ISO and Western spot markets. In non-reserve deficiency hours in California, the maximum price in California and the other Western states will be capped at 85% of the highest Cal ISO hourly market clearing price established during the most recent reserve deficiency period. Sellers other than marketers will be allowed to bid higher than the maximum prices, but such bids are subject to justification and potential refund. Justification of higher prices is limited to establishing higher actual gas costs than the proxy calculation averages and making a showing that conditions in natural gas markets changed significantly. The modified monitoring and mitigation plan went into effect June 20, 2001, and will terminate on September 30, 2002, covering two summer peak seasons, or approximately 16 months.

On December 19, 2001, the FERC issued a series of orders on price mitigation in California and the West region. These orders largely maintained existing mitigation mechanisms, but did make a temporary modifica-

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tion to the way that mitigated market clearing prices will be set during the winter months, allowing the maximum prices to rise if gas prices rise. The FERC removed the requirement that non-reserve deficiency prices be limited to 85% of the most recent reserve deficiency prices, allowing prices to rise to a mitigated clearing price of \$108/MWh (above which price transactions must be justified as described above). In addition, the FERC determined that if gas prices in California rise by 10%, the mitigated price may be revised to take that change into account. The formula will then track subsequent cumulative changes of at least 10%, but may not fall below a maximum price of \$108/MWh. This modification is effective December 20, 2001 through April 30, 2002, at which point the previous mitigation formula is reinstated.

Also, the December 19 orders affirm the June 19 order's requirement that generators must offer all available capacity for sale in the real-time market. As a result of this requirement, the Company's opportunity to sell ancillary services in the West region in the future may be reduced. During 2001, the Company recorded \$42 million in revenues related to ancillary services in the West region.

In addition to the impact on ancillary services sales, certain aspects of the December 19, 2001 orders may have retroactive application that may affect prices charged in the West region since June 21, 2001. Because the precise application of the December 19, 2001 order is not known at this time, the Company cannot anticipate the resulting impact on earnings.

The Company believes that while the mitigation plan will reduce volatility in the market, the Company will nevertheless be able to profitably operate its facilities in the West. Additionally, as noted above, the mitigation plan allows sellers, such as the Company, to justify prices above the proxy price. However, previous efforts by the Company to justify prices above the proxy price have been rejected by the FERC and there is no certainty that the FERC will allow for the recovery of costs above the proxy price. Finally, any adverse impacts of the mitigation plan on the Company's operations would be mitigated, in part, by the Company's forward hedging activities.

FERC Refunds. The FERC issued an order on July 25, 2001 adopting a refund methodology and initiating a hearing schedule to determine (1) revised mitigated prices for each hour from October 2, 2000 through June 20, 2001; (2) the amount owed in refunds by each supplier according to the methodology (these amounts may be in addition to or in place of the refund amounts previously determined by the FERC); and (3) the amount currently owed to each supplier. The amounts of any refunds will be determined by the FERC after the conclusion of the hearing process. On December 19, 2001, the FERC issued an order modifying the methodology to be used to determine refund amounts. The schedule currently anticipates that the Administrative Law Judge will make his refund amount recommendations to the FERC in October 2002. However, the Company does not know when the FERC will issue its final decision. The Company has not reserved any amounts for potential future refund liability resulting from the FERC refund hearing, nor can it currently predict the amount of these potential refunds, if any, because the methodology used to calculate these refunds is not final and will depend on information that is still subject to review and challenge in the hearing process. Any refunds that are determined in the FERC proceeding will likely be offset against unpaid amounts owed, if any, to the Company for its prior sales.

On November 20, 2001, the FERC instituted an investigation under Section 206 of the Federal Power Act regarding the tariffs of all sellers with market-based rates authority, including the Company. In this proceeding, the FERC conditions the market-based rate authority of all sellers on their not engaging in anti-competitive behavior. Such condition will apply upon a further order from FERC establishing a refund effective date. This condition allows the FERC, if it determines that a seller has engaged in anti-competitive behavior subsequent to the start of the refund effective period, to order refunds back to the date of such behavior. The FERC invited comments regarding this proposal, and the Company has filed comments in opposition to the proposal. On March 11, 2002, the FERC's Staff held a conference with market participants to discuss the comments FERC has received, and possible modification of the proposed conditions to address concerns raised in the comments while protecting consumers against anticompetitive behavior. The timing of

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further action by FERC is uncertain. If the FERC does not modify or reject its proposed approach for dealing with anti-competitive behavior, the Company's future earnings may be affected by the open-ended refund obligation.

On February 13, 2002, the FERC issued an order initiating a staff investigation into potential manipulation of electric and natural gas prices in the Western region for the period January 1, 2000 forward. While this order does not propose any action against the Company, if the investigation results in findings that markets were dysfunctional during this period, those findings may be used in support of existing or future claims by the FERC or others that prices in the Company's long-term contracts entered into after January 1, 2000 for sales in the West region should be altered.

Other Investigations. In addition to the FERC investigation discussed above, several state and other federal regulatory investigations and complaints have commenced in connection with the wholesale electricity prices in California and other neighboring Western states to determine the causes of the high prices and potentially to recommend remedial action. In California, the California State Senate and the California Office of the Attorney General have separate ongoing investigations into the high prices and their causes. Although these investigations have not been completed and no findings have been made in connection with either of them, the California Attorney General has filed a civil lawsuit in San Francisco Superior Court alleging that the Company has violated state laws against unfair and unlawful business practices and a complaint with the FERC alleging the Company violated the terms of its tariff with the FERC (see Note 14(f)). Adverse findings or rulings could result in punitive legislation, sanctions, fines or even criminal charges against the Company or its employees. The Company is cooperating with both investigations and has produced a substantial amount of information requested in subpoenas issued by each body. The Washington and Oregon attorneys general have also begun similar investigations.

Legislative Efforts. Since the inception of the California energy crisis, various pieces of legislation, including tax proposals, have been introduced in the U.S. Congress and the California Legislature addressing several issues related to the increase in wholesale power prices in 2000 and 2001. For example, a bill was introduced in the California legislature that would have created a "windfall profits" tax on wholesale electricity sales and would subject exempt wholesale generators, such as the Company's subsidiaries that own generation facilities in California, to regulation by the CPUC as "public utilities." To date, only a few energy-related bills have passed and the Company does not believe that the legislation that has been enacted to date on these issues will have a material adverse effect on the Company. However, it is possible that legislation could be enacted on either the state or federal level that could have a material adverse effect on the Company's financial condition, results of operations and cash flows.

(h) INDEMNIFICATION OF STRANDED COSTS

Background. In January 2001, the Dutch Electricity Production Sector Transitional Arrangements Act (Transition Act) became effective and, among other things, allocated to REPG and the three other large-scale Dutch generation companies, a share of the assets, liabilities and stranded cost commitments of NEA. Prior to the enactment of the Transition Act, NEA acted as the national electricity pooling and coordinating body for the generation output of REPG and the three other large-scale national Dutch generation companies. REPG and the three other large-scale Dutch generation companies are shareholders of NEA.

The Transition Act and related agreements specify that REPG has a 22.5% share of NEA's assets, liabilities and stranded cost commitments. NEA's stranded cost commitments consisted primarily of various uneconomical or stranded cost investments and commitments, including a gas supply and three power contracts entered into prior to the liberalization of the Dutch wholesale electricity market. REPG's stranded cost obligations also include uneconomical district heating contracts which were previously administered by NEA prior to deregulation of the Dutch power market.

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The gas supply contract expires in 2016 and provides for gas imports aggregating 2.283 billion cubic meters per year. Prior to December 31, 2001, one of the stranded cost power contracts was settled. The two remaining stranded cost power contracts have the following capacities and terms: (a) 300 MW through 2005, and (b) 600 MW through March 2002 and 750 MW through 2009. Under the Transition Act, REPGb can either assume its 22.5% allocated interest in the contracts or, subject to the terms of the contracts, sell its interests to third parties. The district heating obligations relate to three heating water supply contracts entered into with various municipalities and expire from 2013 through 2015. Under the district heating contracts, the municipal districts are required to take annually a combined minimum of 5,549 terajoules (TJ) increasing annually to 7,955 TJ over the life of the contracts.

The Transition Act also authorized the government to purchase from NEA at least a majority of the shares in the Dutch national transmission grid company which was sold to the Dutch government on October 25, 2001 for approximately NLG 2.6 billion (approximately \$1.05 billion based on an exchange rate of 2.48 NLG per U.S. dollar as of December 31, 2001).

Prior to December 31, 2001, the former shareholders agreed pursuant to a share purchase agreement to indemnify REPGb for up to NLG 1.9 billion in stranded cost liabilities (approximately \$766 million). The indemnity obligation of the former shareholders and various provincial and municipal entities (including the city of Amsterdam), was secured by a NLG 900 million escrow account (approximately \$363 million).

The Transition Act provided that, subject to the approval of the European Commission, the Dutch government will provide financial compensation to the Dutch generation companies, including REPGb, for liabilities associated with (a) long-term district heating contracts and (b) an experimental coal facility. In July 2001, the European Commission ruled that under certain conditions the Dutch government can provide financial compensation to the generation companies for the district heating contracts. To the extent that this compensation is not ultimately provided to the generation companies by the Dutch government, REPGb was to collect its compensation directly from the former shareholders as further discussed below.

In January 2001, the Company recognized an out-of-market, net stranded cost liability for its gas and electric contracts and district heating commitments. At such time, the Company recorded a corresponding asset of equal amount for the indemnification of this obligation from REPGb's former shareholders and the Dutch government, as applicable. Pursuant to SFAS No. 133, the gas and electric contracts are marked-to-market (see Note 5). As of December 31, 2001, the Company has recorded a liability of \$369 million for its stranded cost gas and electric commitments in non-trading derivative liabilities and a liability of \$206 million for its district heating commitments in current and non-current other liabilities. As of December 31, 2001, the Company has recorded an indemnification receivable from the Dutch government for the district heating stranded cost liability of \$206 million. The settlement of the indemnification related to gas and electric contract commitments in December 2001 is discussed below.

Settlement of Stranded Cost Indemnification. In December 2001, REPGb and its former shareholders entered into a settlement agreement immediately resolving the former shareholders of their stranded cost indemnity obligations related to the gas supply and power contracts under the original share purchase agreement, and provides conditional terms for the possible settlement of their stranded cost indemnity obligation related to district heating obligations under certain conditions. The settlement agreement was approved in December 2001 by the Ministry of Economic Affairs of the Netherlands.

Under the settlement agreement, the former shareholders paid to REPGb NLG 500 million (\$202 million) in January and February 2002. The payment represents a settlement of the obligations of the former shareholders to indemnify REPGb for all stranded cost liabilities other than those relating to the district heating contracts. The full amount of this payment was placed into an escrow account in the name of REPGb to fund its stranded cost obligations related to the gas and electric import contracts. Any remaining escrow funds as of January 1, 2004 will be distributed to REPGb.

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Under the settlement agreement, the former shareholders will continue to indemnify REPGb for the stranded cost liabilities relating to district heating contracts. The terms of the indemnity are as follows:

- The settlement agreement acknowledges that the Netherlands is finalizing regulations for compensation of stranded cost associated with district heating projects. Within 21 days after the date these compensation rules take effect, REPGb can elect to receive one of two forms of indemnification under the settlement agreement.
- If the compensation to be paid by the Netherlands under these rules is at least as much as the compensation to be paid under the original indemnification agreement, REPGb can elect to receive a one-time payment of NLG 60 million (\$24 million). In addition, unless the decree implementing the new compensation rules provides for compensation for the lifetime of the district heating projects, REPGb can receive an additional cash payment of NLG 15 million (\$6 million).
- If the compensation rules do not provide for compensation at least equal to that provided under the original indemnification agreement, REPGb can claim indemnification for stranded cost losses up to a maximum of NLG 700 million (\$282 million) less the amount of compensation provided by the new compensation rules and certain proceeds received from arbitrations.
- If no new compensation rules have taken effect on or prior to December 31, 2003, REPGb is entitled, but not obligated, to elect to receive indemnification under the formula described above.

Under the terms of the original indemnification agreement, the former shareholders were entitled to receive any and all distributions and dividends above NLG 125 million (\$51 million) paid by NEA. Under the settlement agreement, the former shareholders waived all rights under the original indemnification agreement to claim distributions of NEA.

Reliant Resources recognized a net gain of \$37 million for the difference between the sum of (a) the cash settlement payment of \$202 million and the additional rights to claim distributions of Reliant Resources' NEA investment recognized of \$248 million and (b) the amount recorded as stranded cost indemnity receivable related to the stranded cost gas and electric commitments of \$369 million and claims receivable related to stranded cost incurred in 2001 of \$44 million both previously recorded in the Consolidated Balance Sheets.

Investment in NEA. During the second quarter of 2001, Reliant Resources recorded a \$51 million pre-tax gain (NLG 125 million) recorded as equity income for the preacquisition gain contingency related to the acquisition of REPGb for the value of its equity investment in NEA. This gain was based on Reliant Resources' evaluation of NEA's financial position and fair value. The fair value of Reliant Resources' investment in NEA is dependent upon the ultimate resolution of its existing contingencies and proceeds received from liquidating its remaining net assets. Prior to the settlement agreement discussed above, pursuant to the purchase agreement of REPGb, as amended, REPGb was entitled to a NLG 125 million dividend from NEA with any remainder owing to the former shareholders. As mentioned above, REPGb entered into an agreement with its former shareholders to settle the original indemnification agreement and the former shareholders waived all rights to distributions of NEA. Accordingly, as a component of the net gain recognized from the settlement of the stranded cost indemnity, Reliant Resources recorded a \$248 million increase in its investment in NEA. As of December 31, 2001, Reliant Resources has recorded \$299 million in equity investments of unconsolidated subsidiaries for its investment in NEA.

(i) OPERATIONS AGREEMENT WITH CITY OF SAN ANTONIO

As part of the 1996 settlement of certain litigation claims asserted by the City of San Antonio with respect to the South Texas Project, the Company entered into a 10-year joint operations agreement under which the Company and the City of San Antonio, acting through the City Public Service Board of San Antonio (CPS), share savings resulting from the joint dispatching of their respective generating assets in

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

order to take advantage of each system's lower cost resources. In January 2000, the contract term was extended for three years and is expected to terminate in 2009. Under the terms of the joint operations agreement entered into between CPS and Electric Operations, the Company has guaranteed CPS minimum annual savings of \$10 million up to a total cumulative savings of \$150 million over the term of the agreement. The cumulative obligation was met in the first quarter of 2001. In 1999, 2000 and 2001, savings generated for CPS' account were \$14 million, \$60 million and \$65 million, respectively. Through December 31, 2001, cumulative savings generated for CPS' account were \$189 million.

(j) NUCLEAR INSURANCE

The Company and the other owners of the South Texas Project maintain nuclear property and nuclear liability insurance coverage as required by law and periodically review available limits and coverage for additional protection. The owners of the South Texas Project currently maintain \$2.75 billion in property damage insurance coverage, which is above the legally required minimum, but is less than the total amount of insurance currently available for such losses.

Pursuant to the Price Anderson Act, the maximum liability to the public of owners of nuclear power plants was \$9.3 billion as of December 31, 2001. Owners are required under the Price Anderson Act to insure their liability for nuclear incidents and protective evacuations. The Company and the other owners of the South Texas Project currently maintain the required nuclear liability insurance and participate in the industry retrospective rating plan.

There can be no assurance that all potential losses or liabilities will be insurable, or that the amount of insurance will be sufficient to cover them. Any substantial losses not covered by insurance would have a material effect on the Company's financial condition, results of operations and cash flows.

(k) NUCLEAR DECOMMISSIONING

The Company contributed \$14.8 million per year in 1999, 2000 and 2001 to a trust established to fund its share of the decommissioning costs for the South Texas Project. Pursuant to the October 3, 2001 Order, beginning in 2002, the Company will contribute \$2.9 million per year to this trust. There are various investment restrictions imposed upon the Company by the Texas Utility Commission and the NRC relating to the Company's nuclear decommissioning trust. Additionally, the Company's board of directors has appointed the Nuclear Decommissioning Trust Investment Committee to establish the investment policy of the trust and oversee the investment of the trusts' assets. The securities held by the trust for decommissioning costs had an estimated fair value of \$169 million as of December 31, 2001, of which approximately 46% were fixed-rate debt securities and the remaining 54% were equity securities. For a discussion of the accounting treatment for the securities held in the Company's nuclear decommissioning trust, see Note 2(1). In July 1999, an outside consultant estimated the Company's portion of decommissioning costs to be approximately \$363 million. While the current funding levels currently exceed minimum NRC requirements, no assurance can be given that the amounts held in trust will be adequate to cover the actual decommissioning costs of the South Texas Project. Such costs may vary because of changes in the assumed date of decommissioning and changes in regulatory requirements, technology and costs of labor, materials and equipment. Pursuant to the Texas Electric Restructuring Law, costs associated with nuclear decommissioning that have not been recovered as of January 1, 2002, will continue to be subject to cost-of-service rate regulation and will be included in a charge to transmission and distribution customers. For information regarding the effect of the Business Separation Plan on funding of the nuclear decommissioning trust fund, see Note 4(b).

(l) CONSTRUCTION AGENCY AGREEMENT AND EQUIPMENT FINANCING STRUCTURE

In 2001, Reliant Resources, through several of its subsidiaries, entered into operative documents with special purpose entities to facilitate the development, construction, financing and leasing of several power

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

generation projects. The special purpose entities are not consolidated by the Company. The special purpose entities have an aggregate financing commitment from equity and debt participants (Investors) of \$2.5 billion of which the last \$1.1 billion is currently available only if the cash is collateralized. The availability of the commitment is subject to satisfaction of various conditions, including the obligation to provide cash collateral for the loans and letters of credit outstanding on November 27, 2004. Reliant Resources, through several of its subsidiaries, acts as construction agent for the special purpose entities and is responsible for completing construction of these projects by December 31, 2004, but Reliant Resources has generally limited its risk during construction to an amount not in excess of 89.9% of costs incurred to date, except in certain events. Upon completion of an individual project and exercise of the lease option, Reliant Resources' subsidiaries will be required to make lease payments in an amount sufficient to provide a return to the Investors. If Reliant Resources does not exercise its option to lease any project upon its completion, Reliant Resources must purchase the project or remarket the project on behalf of the special purpose entities. Reliant Resources' ability to exercise the lease option is subject to certain conditions. Reliant Resources must guarantee that the Investors will receive an amount at least equal to 89.9% of their investment in the case of a remarketing sale at the end of construction. At the end of an individual project's initial operating lease term (approximately five years from construction completion), Reliant Resources' subsidiary lessees have the option to extend the lease with the approval of Investors, purchase the project at a fixed amount equal to the original construction cost, or act as a remarketing agent and sell the project to an independent third party. If the lessees elect the remarketing option, they may be required to make a payment of an amount not to exceed 85% of the project cost, if the proceeds from remarketing are not sufficient to repay the Investors. Reliant Resources has guaranteed the performance and payment of its subsidiaries' obligations during the construction periods and, if the lease option is exercised, each lessee's obligations during the lease period. At any time during the construction period or during the lease, Reliant Resources may purchase a facility by paying an amount approximately equal to the outstanding balance plus costs.

Reliant Resources, through its subsidiary, REPG, has entered into an agreement with a bank whereby the bank, as owner, entered or will enter into contracts for the purchase and construction of power generation equipment and REPG, or its subagent, acts as the bank's agent in connection with administering the contracts for such equipment. Under the agreement, the bank has agreed to provide up to a maximum aggregate amount of \$650 million. REPG and its subagents must cash collateralize their obligation to administer the contracts. This cash collateral is approximately equivalent to the total payments by the bank for the equipment, interest and other fees. As of December 31, 2001, the bank had assumed contracts for the purchase of eleven turbines, two heat recovery steam generators and one air-cooled condenser with an aggregate cost of \$398 million. REPG, or its designee, has the option at any time to purchase, or, at equipment completion, subject to certain conditions, including the agreement of the bank to extend financing, to lease the equipment, or to assist in the remarketing of the equipment under terms specified in the agreement. All costs, including the purchase commitment on the turbines, are the responsibility of the bank. The cash collateral is deposited by REPG or an affiliate into a collateral account with the bank and earns interest at LIBOR less 0.15%. Under certain circumstances, the collateral deposit or a portion of it, will be returned to REPG or its designee. Otherwise, it will be retained by the bank. At December 31, 2001, REPG and its subsidiary had deposited \$230 million into the collateral account. The bank's payments for equipment under the contracts totaled \$227 million as of December 31, 2001. In January 2002, the bank sold to the parties to the construction agency agreements discussed above, equipment contracts with a total contractual obligation of \$258 million, under which payments and interest during construction totaled \$142 million. Accordingly, \$142 million of Reliant Resources' collateral deposits were returned to Reliant Resources. As of December 31, 2001, there were equipment contracts with a total contractual obligation of \$140 million under which payments during construction totaled \$83 million. Currently this equipment is not designated for current planned power generation construction projects. Therefore, the Company anticipates that it will either purchase the equipment, assist in the remarketing of the equipment or negotiate to cancel the related contracts.

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(21) BANKRUPTCY OF ENRON CORP. AND ITS AFFILIATES

During the fourth quarter of 2001, Enron filed a voluntary petition for bankruptcy. Accordingly, the Company recorded an \$85 million provision, comprised of provisions against 100% of receivables of \$88 million and net non-trading derivative balances of \$52 million, offset by the Company's net trading and marketing liabilities to Enron of \$55 million.

The non-trading derivatives with Enron were designated as Cash Flow Hedges (see Note 5). The net gain on these derivative instruments previously reported in other comprehensive income will remain in accumulated other comprehensive loss and will be reclassified into earnings during the period in which the originally designated hedged transactions occur.

(22) SUBSEQUENT EVENTS

(a) ORION POWER HOLDINGS, INC.

In February 2002, Reliant Resources acquired all of the outstanding shares of Orion Power for \$26.80 per share in cash for an aggregate purchase price of \$2.9 billion. Reliant Resources funded the Orion Power acquisition with a term loan supported by a \$2.9 billion credit facility and \$41 million of cash on hand. Interest rates on the term loan are based on LIBOR plus a margin or a base rate. The term loan must be repaid within one year from the date on which it was funded. As a result of the acquisition, Reliant Resources' consolidated net debt obligations also increased by the amount of Orion Power's net debt obligations. As of February 19, 2002, Orion Power's debt obligations were \$2.4 billion (\$2.1 billion net of cash acquired some of which is restricted pursuant to debt covenants). Orion Power is an independent electric power generating company formed in March 1998 to acquire, develop, own and operate power-generating facilities in certain deregulated wholesale markets throughout North America. As of February 28, 2002, Orion Power had 81 power plants in operation with a total generating capacity of 5,644 MW and an additional 804 MW in construction or in various stages of development.

(b) FACTORING AGREEMENT

In the first quarter of 2002, RERC reduced its trade receivables facility from \$350 million to \$150 million. Borrowings under the receivables facility aggregating \$196 million were repaid in January 2002 with proceeds from the issuance of commercial paper under RERC's \$350 million revolving credit facility and from the liquidation of short-term investments.

(c) INTEREST RATE SWAPS

In the first quarter of 2002, the Company entered into interest rate swaps with an aggregate notional amount of \$1.25 billion. Swaps with a notional amount of \$250 million were entered into for the purpose of fixing rates on short-term debt subject to interest rate fluctuations and do not qualify as cash flow hedges under SFAS No. 133. The swaps with a notional amount of \$1 billion were entered into to hedge the interest rate on a future offering of five-year fixed rate notes. These swaps qualify as cash flow hedges under SFAS No. 133.