

RRI ENERGY INC
Form 10-Q
July 30, 2010

Table of Contents

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

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from _____ to _____

Commission file number 1-16455

RRI Energy, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or
Organization)

76-0655566

(I.R.S. Employer Identification No.)

1000 Main Street

Houston, Texas 77002

(Address of Principal Executive Offices) (Zip Code)

(832) 357-3000

(Registrant's Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller
reporting company)

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

As of July 21, 2010, the latest practicable date for determination, RRI Energy, Inc. had 353,429,469 shares of common stock outstanding and no shares of treasury stock.

TABLE OF CONTENTS

Safe Harbor-Forward-Looking Information ii

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS 1

Consolidated Statements of Operations (unaudited) Three and Six Months Ended June 30, 2010 and 2009 1

Consolidated Balance Sheets June 30, 2010 (unaudited) and December 31, 2009 2

Consolidated Statements of Cash Flows (unaudited) Six Months Six Ended June 30, 2010 and 2009 3

Notes to Unaudited Consolidated Interim Financial Statements 4

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS 33

Business Overview 33

Recent Events 35

Consolidated Results of Operations 37

Liquidity and Capital Resources 51

Off-Balance Sheet Arrangements 52

Historical Cash Flows 53

New Accounting Pronouncements, Significant Accounting Policies and Critical Accounting Estimates 55

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK 56

Market Risks and Risk Management 56

Non-Trading Market Risks 56

Trading Market Risks 57

Fair Value Measurements 58

ITEM 4. CONTROLS AND PROCEDURES 59

<u>Evaluation of Disclosure Controls and Procedures</u>	59
<u>Changes in Internal Control Over Financial Reporting</u>	59

PART II.
OTHER INFORMATION

<u>ITEM 1. LEGAL PROCEEDINGS</u>	59
----------------------------------	----

<u>ITEM 1A. RISK FACTORS</u>	59
------------------------------	----

<u>ITEM 6. EXHIBITS</u>	60
-------------------------	----

Exhibit 31.1

Exhibit 31.2

Exhibit 32.1

EX-101 INSTANCE DOCUMENT

EX-101 SCHEMA DOCUMENT

EX-101 CALCULATION LINKBASE DOCUMENT

EX-101 LABELS LINKBASE DOCUMENT

EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

Table of Contents

SAFE HARBOR-FORWARD-LOOKING INFORMATION

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

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

- Demand and market prices for electricity, capacity, fuel and emission allowances
- The timing and extent of changes in commodity prices
- Limitations on our ability to set rates at market prices
- Legislative, regulatory and/or market developments
- Changes in environmental regulations that constrain our operations or increase our compliance costs
- Competition in the wholesale power markets
- Operating without long-term power sales agreements
- Ineffective hedging activities
- Our ability to obtain adequate fuel supply and/or transmission services
- Interruption or breakdown of our plants
- Failure of third parties to perform contractual obligations
- Failure to meet our debt service obligations or restrictive covenants
- Changes in the wholesale power market or in our evaluation of our plants
- The outcome of pending or threatened lawsuits, regulatory proceedings, tax proceedings and investigations
- Weather-related events or other events beyond our control
- Financial and economic market conditions and our access to capital and
- The successful and timely completion of the proposed merger with Mirant Corporation, which could be materially and adversely affected by, among other things, the following:
 - obtaining mutually acceptable debt financing
 - resolving any litigation brought in connection with the proposed merger
 - the timing and terms and conditions of required governmental and regulatory approvals
 - the ability to maintain relationships with employees, suppliers or customers as well as the ability to integrate the businesses and realize cost savings

Other factors that could cause our actual results to differ from our projected results are discussed or referred to in the Risk Factors sections of this report and of our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission. Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Our filings and other important information are also available on our investor page at www.rrienergy.com.

Table of Contents

PART I.
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended June		Six Months Ended June 30,	
	30,		2010	2009
	2010	2009	2010	2009
	(thousands of dollars, except per share amounts)			
Revenues:				
Revenues (including \$(56,755), \$(21,842), \$49,085 and \$(26,130) unrealized gains (losses))	\$ 400,198	\$ 389,777	\$ 1,004,908	\$ 855,961
Expenses:				
Cost of sales (including \$(8,841), \$28,486, \$12,422 and \$(10,969) unrealized gains (losses))	264,998	280,067	531,799	604,741
Operation and maintenance	183,204	156,964	343,619	314,110
General and administrative	35,470	27,645	56,188	56,659
Western states litigation and similar settlements			17,000	
Gains on sales of assets and emission and exchange allowances, net	(619)	(1,241)	(1,036)	(20,171)
Long-lived assets impairments			247,715	
Depreciation and amortization	69,148	67,646	131,468	135,504
Total operating expense	552,201	531,081	1,326,753	1,090,843
Operating Loss	(152,003)	(141,304)	(321,845)	(234,882)
Other Income (Expense):				
Debt extinguishments gains		844		844
Interest expense	(36,588)	(45,067)	(82,629)	(91,986)
Interest income	150	721	366	969
Other, net	1,063	(530)	2,623	62
Total other expense	(35,375)	(44,032)	(79,640)	(90,111)
Loss from Continuing Operations Before Income Taxes	(187,378)	(185,336)	(401,485)	(324,993)
Income tax expense (benefit)	(11,232)	(81,644)	50,852	(115,520)
Loss from Continuing Operations	(176,146)	(103,692)	(452,337)	(209,473)
Income from discontinued operations	4,029	907,258	3,514	861,626
Net Income (Loss)	\$ (172,117)	\$ 803,566	\$ (448,823)	\$ 652,153
Basic/Diluted Earnings (Loss) per Share:				

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Loss from continuing operations	\$	(0.50)	\$	(0.30)	\$	(1.28)	\$	(0.60)
Income from discontinued operations		0.01		2.59		0.01		2.46
Net income (loss)	\$	(0.49)	\$	2.29	\$	(1.27)	\$	1.86

See Notes to our Unaudited Consolidated Interim Financial Statements

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

	June 30, 2010	December 31,
	(thousands of dollars, except per share amounts)	
	(unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 563,183	\$ 943,440
Restricted cash	2,897	24,093
Accounts and notes receivable, principally customer, net	155,760	152,569
Inventory	278,382	331,584
Derivative assets	129,973	132,062
Margin deposits	149,000	198,582
Prepayments and other current assets	92,637	86,844
Current assets of discontinued operations (\$23,394 and \$55,855 of margin deposits)	55,901	108,476
Total current assets	1,427,733	1,977,650
Property, plant and equipment, gross	5,933,586	6,330,879
Accumulated depreciation	(1,652,470)	(1,728,566)
Property, Plant and Equipment, net	4,281,116	4,602,313
Other Assets:		
Other intangibles, net	293,803	305,913
Derivative assets	45,239	53,138
Prepaid lease	267,942	277,370
Other (\$27,648 and \$33,793 accounted for at fair value)	196,572	239,078
Long-term assets of discontinued operations	3,528	5,232
Total other assets	807,084	880,731
Total Assets	\$ 6,515,933	\$ 7,460,694
LIABILITIES AND EQUITY		
Current Liabilities:		
Current portion of long-term debt	\$ 106	\$ 404,505
Accounts payable, principally trade	105,053	142,787
Derivative liabilities	91,973	151,461
Margin deposits	15,064	2,860
Other	184,348	169,898
Current liabilities of discontinued operations (\$0 and \$11,000 of margin deposits)	23,620	58,452

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Total current liabilities	420,164	929,963
Other Liabilities:		
Derivative liabilities	38,793	61,436
Other	284,868	260,547
Long-term liabilities of discontinued operations	14,165	13,700
Total other liabilities	337,826	335,683
Long-term Debt	1,949,717	1,949,771
Commitments and Contingencies		
Temporary Equity Stock-based Compensation	6,287	6,890
Stockholders Equity:		
Preferred stock; par value \$0.001 per share (125,000,000 shares authorized; none outstanding)		
Common stock; par value \$0.001 per share (2,000,000,000 shares authorized; 353,426,741 and 352,785,985 issued)	114	114
Additional paid-in capital	6,267,849	6,259,248
Accumulated deficit	(2,421,212)	(1,972,389)
Accumulated other comprehensive loss	(44,812)	(48,586)
Total stockholders equity	3,801,939	4,238,387
Total Liabilities and Equity	\$ 6,515,933	\$ 7,460,694

See Notes to our Unaudited Consolidated Interim Financial Statements

Table of Contents

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

	Six Months Ended June 30,	
	2010	2009
	(thousands of dollars)	
Cash Flows from Operating Activities:		
Net income (loss)	\$ (448,823)	\$ 652,153
Income from discontinued operations	(3,514)	(861,626)
Loss from continuing operations	(452,337)	(209,473)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	131,468	135,504
Deferred income taxes	50,220	(115,850)
Net changes in energy derivatives	(58,911)	37,099
Gains on sales of assets and emission and exchange allowances, net	(1,036)	(20,171)
Western states litigation and similar settlements	17,000	
Long-lived assets impairments	247,715	
Amortization of deferred financing costs	3,447	3,497
Other, net	(1,051)	8,245
Changes in other assets and liabilities:		
Accounts and notes receivable, net	(843)	126,059
Inventory	50,419	12,610
Margin deposits, net	61,786	(50,402)
Net derivative assets and liabilities	(629)	(21,965)
Accounts payable	(19,416)	(7,453)
Other current assets	(4,448)	2,529
Other assets	2,373	9,073
Taxes payable/receivable	(2,101)	(4,936)
Other current liabilities	1,171	(4,207)
Other liabilities	2,015	3,322
Net cash provided by (used in) continuing operations from operating activities	26,842	(96,519)
Net cash provided by discontinued operations from operating activities	26,131	508,602
Net cash provided by operating activities	52,973	412,083
Cash Flows from Investing Activities:		
Capital expenditures	(49,898)	(114,964)
Proceeds from sales of assets, net	7,193	35,931
Proceeds from sales of emission and exchange allowances	123	19,175
Purchases of emission allowances		(5,662)
Restricted cash	4,546	(57)
Other, net	3,300	1,500
Net cash used in continuing operations from investing activities	(34,736)	(64,077)
Net cash provided by (used in) discontinued operations from investing activities	(4,402)	299,004

Net cash provided by (used in) in investing activities	(39,138)	234,927
Cash Flows from Financing Activities:		
Payments of long-term debt	(399,809)	(44,780)
Proceeds from issuances of stock	1,890	2,309
Net cash used in continuing operations from financing activities	(397,919)	(42,471)
Net cash used in discontinued operations from financing activities		(225,300)
Net cash used in financing activities	(397,919)	(267,771)
Net Change in Cash and Cash Equivalents, Total Operations	(384,084)	379,239
Less: Net Change in Cash and Cash Equivalents, Discontinued Operations	(3,827)	(103,359)
Cash and Cash Equivalents at Beginning of Period, Continuing Operations	943,440	1,004,367
Cash and Cash Equivalents at End of Period, Continuing Operations	\$ 563,183	\$ 1,486,965
Supplemental Disclosure of Cash Flow Information:		
Cash Payments:		
Interest paid (net of amounts capitalized) for continuing operations	\$ 98,000	\$ 95,105
Income taxes paid (net of income tax refunds received) for continuing operations	2,754	3,582
See Notes to our Unaudited Consolidated Interim Financial Statements		

Table of Contents

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

(1) Background and Basis of Presentation

(a) Background.

RRI Energy refers to RRI Energy, Inc. and we, us and our refer to RRI Energy, Inc. and its consolidated subsidiaries. We provide energy, capacity, ancillary and other energy services to wholesale customers in competitive energy markets in the United States through our ownership and operation of and contracting for power generation capacity. Our business consists of four reportable segments. See note 17. Our consolidated interim financial statements and notes (interim financial statements) are unaudited, omit certain disclosures and should be read in conjunction with our audited consolidated financial statements and notes in our Form 10-K. See note 2 for discussion of our proposed merger with Mirant Corporation (Mirant).

(b) Basis of Presentation.

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

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

Actual results could differ from those estimates.

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

Adjustments and Reclassifications. The interim financial statements reflect all normal recurring adjustments necessary, in management's opinion, to present fairly our financial position and results of operations for the reported periods. Amounts reported for interim periods, however, may not be indicative of a full year period because of seasonal fluctuations in demand for electricity and energy services, changes in commodity prices, and changes in regulations, timing of maintenance and other expenditures, dispositions, changes in interest expense and other factors.

Inventory. We value fuel inventories at the lower of average cost or market. We reduce these inventories as they are used in the production of electricity or sold. We recorded \$1 million and \$35 million during the three months ended June 30, 2010 and 2009, respectively, for lower of average cost or market valuation adjustments in cost of sales and recorded \$3 million and \$59 million during the six months ended June 30, 2010 and 2009, respectively.

New Accounting Pronouncement – Improving Disclosures about Fair Value Measurements. Effective for the first quarter of 2010, this guidance requires disclosures of significant transfers in and out of Levels 1 and 2. In addition, it clarifies existing disclosure requirements regarding inputs and valuation techniques as well as the appropriate level of disaggregation for fair value measurements disclosures. See note 4. Effective for the first quarter of 2011 financial statements, this guidance requires separate presentation of purchases, sales, issuances and settlements within the Level 3 reconciliation.

(2) Proposed Merger with Mirant

On April 11, 2010, we entered into an Agreement and Plan of Merger with Mirant. We have formed a new wholly-owned subsidiary that will merge with and into Mirant upon closing. As a result, Mirant will be a wholly-owned subsidiary of RRI Energy.

Upon closing the merger, each issued and outstanding share of Mirant common stock, including restricted shares held in reserve under the Chapter 11 plan of reorganization for Mirant, will convert into the right to receive 2.835 shares of common stock of RRI Energy, including the preferred share purchase rights granted under the Rights Agreement dated January 15, 2001, between RRI Energy and The Chase Manhattan Bank as Rights Agent. Mirant stock options and other equity awards will convert upon completion of the merger into vested stock options and equity awards with respect to RRI Energy common stock, after giving effect to the exchange ratio. The exchange ratio is fixed but subject to adjustment for a proposed reverse stock split.

Table of Contents

The merger is intended to qualify as a tax-free reorganization under the Internal Revenue Code of 1986, as amended, so that none of RRI Energy, Mirant or any of the Mirant stockholders generally will recognize any gain or loss in the transaction, except that Mirant stockholders will recognize gain with respect to cash received in lieu of fractional shares of RRI Energy common stock.

Completion of the merger is contingent upon, among other things, (a) approvals by stockholders of both companies, (b) effectiveness of a registration statement on Form S-4 and approval of the New York Stock Exchange listing for the RRI Energy common stock to be issued in the merger, (c) expiration or termination of the applicable Hart-Scott-Rodino Act waiting period, (d) required regulatory approvals from the FERC and the New York Public Service Commission and (e) mutually acceptable debt financing in an amount sufficient to fund the refinancing transactions contemplated by the merger agreement.

Each of RRI Energy and Mirant is also subject to restrictions on its ability to solicit alternative acquisition proposals, provide information and engage in discussion with third parties, except under limited circumstances to permit RRI Energy's or Mirant's board of directors to comply with its fiduciary duties. The merger agreement contains termination rights for both RRI Energy and Mirant and further provides that, upon termination of the merger agreement under specified circumstances, RRI Energy or Mirant may be required to pay the other party a termination fee of either \$37 million or \$58 million depending on the nature of the termination.

We anticipate completing the merger before the end of 2010. Except for specific references to the pending merger, the disclosures contained in this report on Form 10-Q relate solely to RRI Energy. Information concerning the proposed merger is included in the joint proxy statement/prospectus contained in the registration statement on Form S-4, as amended and filed with the Securities and Exchange Commission in connection with the merger.

(3) Stock-based Compensation

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

	Three Months Ended June		Six Months Ended June 30,	
	2010	30, 2009	2010	2009
	(in millions)			
Stock-based incentive plans compensation expense (pre-tax) ⁽¹⁾	\$ 5 ⁽²⁾	\$ 1	\$ 7 ⁽²⁾	\$ 4

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

(2) During the three and six months ended June 30, 2010, we

recorded
\$2 million of
expense related
to the
modification of
our outstanding
time-based stock
options in
contemplation of
the merger. See
note 2 for
discussion of the
merger.

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

No tax benefits related to stock-based compensation were realized during the three and six months ended June 30, 2010 and 2009 because of our net operating loss carryforwards.

Table of Contents**(4) Fair Value Measurements**

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

- Level 1:** Level 1 represents unadjusted quoted market prices in active markets for identical assets or liabilities that are accessible at the measurement date. This category primarily includes our energy derivative instruments that are exchange-traded or that are cleared and settled through the exchange. Our cash equivalents and available-for-sale and trading securities are also valued using Level 1 inputs.
- Level 2:** Level 2 represents quoted market prices for similar assets or liabilities in active markets, quoted market prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data. This category includes emission allowances futures that are exchange-traded and over-the-counter (OTC) derivative instruments such as generic swaps, forwards and options.
- Level 3:** This category includes our energy derivative instruments whose fair value is estimated based on internally developed models and methodologies utilizing significant inputs that are generally less readily observable from objective sources (such as implied volatilities and correlations). Our OTC, complex or structured derivative instruments that are transacted in less liquid markets with limited pricing information are included in Level 3. Examples are coal contracts, longer term natural gas contracts and options valued using implied or internally developed inputs.

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

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

We value some of our OTC, complex or structured derivative instruments using a variety of valuation models, which utilize inputs that may not be corroborated by market data and vary in complexity depending on the contractual terms of, and inherent risks in, the instrument being valued. We use both industry-standard models as well as internally developed proprietary valuation models that consider various assumptions, such as market prices for power and fuel, price shapes, volatilities and correlations as well as other relevant factors. When such inputs are significant to the fair value measurement, the derivative assets or liabilities are classified as Level 3 when we do not have corroborating market evidence to support significant valuation model inputs and cannot verify the model to market transactions. We

think the transaction price is the best estimate of fair value at inception under the exit price methodology. Accordingly, when a pricing model is used to value such an instrument, the resulting value is adjusted so the model value at inception equals the transaction price. Valuation models are typically impacted by Level 1 or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Subsequent to initial recognition, we update Level 1 and Level 2 inputs to reflect observable market changes. Level 3 inputs are updated when corroborated by available market evidence. In the absence of such evidence, management's best estimate is used. See note 7 for discussion of our fair value measurements for some non-financial assets.

Table of Contents

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

	June 30, 2010				Total Fair Value
	Level 1⁽¹⁾	Level 2⁽¹⁾	Level 3 (in millions)	Reclassifications⁽²⁾	
Derivative assets:					
Power	\$ 39	\$ 38	\$ 2	\$	\$ 79
Power basis		1	2		3
Capacity energy			4		4
Natural gas	54		1		55
Natural gas basis	23				23
Coal			9		9
Other				2	2
Total derivative assets	\$ 116	\$ 39	\$ 18	\$ 2	\$ 175
Derivative liabilities:					
Power	\$ 6	\$ 98	\$ 1	\$	\$ 105
Power basis		1			1
Natural gas			3		3
Natural gas basis	14				14
Coal			4		4
Emissions		2			2
Other				2	2
Total derivative liabilities	\$ 20	\$ 101	\$ 8	\$ 2	\$ 131
Cash equivalents ⁽³⁾	\$ 563	\$	\$	\$	\$ 563
Other assets ⁽⁴⁾	\$ 28	\$	\$	\$	\$ 28

(1) Transfers between Level 1 and Level 2 are recognized as of the beginning of the reporting period. There were no significant transfers during the six months ended June 30, 2010.

- (2) Reclassifications are required to reconcile to our consolidated balance sheet presentation.
- (3) Represent investments in money market funds and are included in cash and cash equivalents in our consolidated balance sheet.
- (4) Include \$11 million in available-for-sale securities (shares in a public exchange) and \$17 million in trading securities (rabbi trust investments (which are comprised of mutual funds) associated with our non-qualified deferred compensation plans for key and highly compensated employees).

	December 31, 2009				Total Fair Value
	Level 1	Level 2	Level 3 (in millions)	Reclassifications ⁽¹⁾	
Total derivative assets	\$ 137	\$ 46	\$ 4	\$ (2)	\$ 185
Total derivative liabilities	49	134	32	(2)	213
Cash equivalents ⁽²⁾	965				965
Other assets ⁽³⁾	34				34

- (1) Reclassifications are required to reconcile to our consolidated balance sheet presentation.
- (2) Represent investments in money market funds and are included in cash and cash equivalents and restricted cash in our consolidated balance sheet. We had \$943 million of cash equivalents included in cash and cash equivalents and \$22 million of cash equivalents included in restricted cash.
- (3) Include \$13 million in available-for-sale securities (shares in a public exchange) and \$21 million in trading securities (rabbi trust investments (which are comprised of mutual funds) associated with our non-qualified deferred compensation plans for key and highly compensated employees).

Table of Contents

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

	Three Months Ended		Six Months Ended June 30,	
	June 30,		2010	
	2010	2009	2010	2009
	Net Derivatives (Level 3)		Net Derivatives (Level 3)	
	(in millions)			
Balance, beginning of period (net asset (liability))	\$ 16	\$ (153)	\$ (28)	\$ (114)
Total gains (losses) realized/unrealized included in earnings ⁽¹⁾	(3)	(12)	41	(79)
Purchases, issuances and settlements (net)	(3)	48	(3)	76
Transfers into Level 3 ⁽²⁾				
Transfers out of Level 3 ⁽²⁾				
Balance, end of period (net asset (liability))	\$ 10	\$ (117)	\$ 10	\$ (117)
Changes in unrealized gains (losses) relating to derivative assets and liabilities still held as of June 30, 2010 and 2009:				
Revenues	\$ (4)	\$	\$ 9	\$ (2)
Cost of sales	1	(5)	18	(54)
Total	\$ (3)	\$ (5)	\$ 27	\$ (56)

(1) Recorded in revenues and cost of sales.

(2) Recognized as of the beginning of the reporting period.

Nonperformance Risk. Derivative assets are discounted for credit risk using a yield curve representative of the counterparty's probability of default. The counterparty's default probability is based on a modified version of published default rates, taking 20-year historical default rates from Standard & Poor's and Moody's and adjusting them to reflect a rolling five-year average. Fair value measurement of our derivative liabilities reflects the nonperformance risk related to that liability, which is our own credit risk. We derive our nonperformance risk by applying our credit default swap spread against the respective derivative liability.

Fair Value of Other Financial Instruments. The fair values of cash, accounts receivable and payable and margin deposits approximate their carrying amounts. Values of our debt for continuing operations (see note 9) are:

June 30, 2010		December 31, 2009	
Carrying Value	Fair Value⁽¹⁾	Carrying Value	Fair Value⁽¹⁾

(in millions)

Fixed rate debt	\$	1,950	\$	1,912	\$	2,355	\$	2,333
Total debt	\$	1,950	\$	1,912	\$	2,355	\$	2,333

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

See note 5.

(5) Derivative Instruments and Hedging Activities

Changes in commodity prices prior to the energy delivery period are inherent in our business. Accordingly, we may enter selective hedges, including originated transactions, to (a) seek potential value greater than what is available in the spot or day-ahead markets, (b) address operational requirements or (c) seek a specific financial objective. For our risk management activities, we use derivative and non-derivative contracts that provide for settlement in cash or by delivery of a commodity. We use derivative instruments such as futures, forwards, swaps and options to execute our hedge strategy. We may also enter into derivatives to manage our exposure to changes in prices of emission and exchange allowances.

Table of Contents

We account for our derivatives under one of three accounting methods (mark-to-market, accrual (under the normal purchase/normal sale exception to fair value accounting) or cash flow hedge accounting) based on facts and circumstances. See note 4 for discussion on fair value measurements.

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

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

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

Instrument	Primary Risk Exposure	Purpose for Holding or Issuing Instrument ⁽¹⁾	Transactions that Physically Flow/Settle ⁽²⁾	Transactions that Financially Settle ⁽³⁾
Power futures, forward, swap and option contracts	Price risk	Power sales to customers	Revenues	Revenues
		Power purchases related to operations	Cost of sales	Revenues
		Power purchases/sales related to legacy trading and non-core asset management positions ⁽⁴⁾	Revenues	Revenues
Natural gas and fuel futures, forward, swap and option contracts	Price risk	Natural gas and fuel sales related to operations	Revenues/Cost of sales	Cost of sales
		Natural gas sales related to power generation ⁽⁵⁾	N/A ⁽⁶⁾	Revenues
		Natural gas and fuel purchases related to operations	Cost of sales	Cost of sales
		Natural gas and fuel purchases/sales related to legacy trading and non-core asset management positions ⁽⁴⁾	Cost of sales	Cost of sales
Emission and exchange allowances futures ⁽⁷⁾	Price risk	Purchases/sales of emission and exchange allowances	N/A ⁽⁶⁾	Revenues/Cost of sales

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

- (2) Includes classification of unrealized gains and losses for derivative transactions reclassified to inventory or intangibles upon settlement.
- (3) Includes classification for mark-to-market derivatives and amounts reclassified from accumulated other comprehensive income/loss related to cash flow hedges.
- (4) See discussion below regarding trading activities.
- (5) Natural gas financial swaps and options transacted to economically hedge generation in the PJM region (in our East Coal and East Gas segments).
- (6) N/A is not applicable.
- (7) Includes emission and exchange allowances futures for

sulfur dioxide
(SO₂), nitrogen
oxide (NOx)
and carbon
dioxide (CO₂).

In addition to price risk, we are exposed to credit and operational risk. We have a risk control framework to manage these risks, which include: (a) measuring and monitoring these risks, (b) review and approval of new transactions relative to these risks, (c) transaction validation and (d) portfolio valuation and reporting. We use mark-to-market valuation, value-at-risk and other metrics in monitoring and measuring risk. Our risk control framework includes a variety of separate but complementary processes, which involve commercial and senior management and our Board of Directors. See note 6 for further discussion of our credit policy.

Earnings Volatility from Derivative Instruments. We procure power, natural gas, coal, oil, natural gas transportation and storage capacity and other energy-related commodities to support our business. We may experience volatility in our earnings resulting from contracts receiving accrual accounting treatment while related derivative instruments are marked to market through earnings. As discussed in note 1(b), our financial statements include estimates and assumptions made by management throughout the reporting periods and as of the balance sheet dates. It is reasonable that subsequent to the balance sheet date of June 30, 2010, changes, some of which could be significant, have occurred in the inputs to our various fair value measures, particularly relating to commodity price movements.

Table of Contents

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

Cash Flow Hedges. During the first quarter of 2007, we de-designated our remaining cash flow hedges; therefore, as of June 30, 2010 and December 31, 2009, we do not have any designated cash flow hedges. The fair value of our de-designated cash flow hedges are deferred in accumulated other comprehensive loss, net of tax, to the extent the contracts have been effective as hedges, until the forecasted transactions affect earnings. At the time the forecasted transactions affect earnings, we reclassify the amounts in accumulated other comprehensive loss into earnings.

Amounts included in accumulated other comprehensive loss are:

	June 30, 2010	
	Expected to be Reclassified into Results of	
	At the End of the Period	Operations in Next 12 Months
	(in millions)	
De-designated cash flow hedges, net of tax ⁽¹⁾⁽²⁾	\$ 26	\$ 13

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

(2) During the three and six months ended June 30, 2010 and 2009, \$0 was recognized in our results of operations as a result of the discontinuance of cash flow hedges because it was probable that the forecasted transaction

would not occur.

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

As of June 30, 2010, our commodity derivative assets and liabilities include amounts for non-trading and trading activities as follows:

	Derivative Assets		Derivative Liabilities		Net Derivative Assets (Liabilities)
	Current	Long-Term	Current (in millions)	Long-Term	
Non-trading	\$ 106	\$ 45	\$ (75)	\$ (39)	\$ 37
Trading	24		(17)		7
Total derivatives	\$ 130	\$ 45	\$ (92)	\$ (39)	\$ 44

We have the following derivative commodity contracts outstanding as of June 30, 2010:

Commodity	Unit ⁽¹⁾	Notional Volumes ⁽²⁾	
		Current (in millions)	Long-term
Power	MWh	(6)	(3)
Capacity energy	MWh	(1)	(1)
Natural gas ⁽³⁾	MMBtu	14	12
Natural gas basis	MMBtu	(1)	
Coal	MMBtu	83	133

(1) MWh is megawatt hours and MMBtu is million British thermal units.

(2) Negative amounts indicate net forward sales.

(3) Includes current and long-term volumes related to purchases of put options.

Table of Contents

The income (loss) associated with our energy derivatives during the three and six months ended June 30, 2010 and 2009 is:

Derivatives Not Designated as Hedging Instruments	Three Months Ended June 30,			
	2010		2009	
	Revenues	Cost of Sales	Revenues	Cost of Sales
	(in millions)			
Non-Trading Commodity Contracts:				
Unrealized ⁽¹⁾	\$ (57)	\$ (2)	\$ (22)	\$ 31
Realized ⁽²⁾⁽³⁾⁽⁴⁾	62	(44)	81	(66)
Total non-trading	\$ 5	\$ (46)	\$ 59	\$ (35)
Trading Commodity Contracts:				
Unrealized ⁽¹⁾	\$	\$ (7)	\$	\$ (2)
Realized ⁽²⁾		(8)		1
Total trading	\$	\$ (15)	\$	\$ (1)

Derivatives Not Designated as Hedging Instruments	Six Months Ended June 30,			
	2010		2009	
	Revenues	Cost of Sales	Revenues	Cost of Sales
	(in millions)			
Non-Trading Commodity Contracts:				
Unrealized ⁽¹⁾	\$ 49	\$ 24	\$ (26)	\$ (9)
Realized ⁽²⁾⁽³⁾⁽⁴⁾	149	(112)	187	(74)
Total non-trading	\$ 198	\$ (88)	\$ 161	\$ (83)
Trading Commodity Contracts:				
Unrealized ⁽¹⁾	\$	\$ (12)	\$	\$ (2)
Realized ⁽²⁾		(3)		20
Total trading	\$	\$ (15)	\$	\$ 18

(1) As discussed above, during 2007, we de-designated our remaining cash flow hedges; during

the three and six months ended June 30, 2010 and 2009, previously measured ineffectiveness gains/losses in revenues reversing related to settlement of the derivative contracts were insignificant.

- (2) Does not include realized gains or losses associated with cash month transactions, non-derivative transactions or derivative transactions that qualify for the normal purchase/normal sale exception.
- (3) Excludes settlement value of fuel contracts classified as inventory upon settlement.
- (4) Includes gains or losses from de-designated cash flow hedges reclassified from accumulated other comprehensive loss related to settlement of the derivative contracts. See note 8.

Trading Activities. Prior to March 2003, we engaged in proprietary trading activities. Trading positions entered into prior to our decision to exit this business are being closed on economical terms or are being retained and settled over

the contract terms. In addition, we have current transactions relating to non-core asset management, such as gas storage and transportation contracts not tied to generation assets, which are classified as trading activities. The income (loss) associated with these transactions is:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(in millions)			
Revenues	\$	\$	\$	\$
Cost of sales		5	1	16
Total ⁽¹⁾	\$	\$ 5	\$ 1	\$ 16

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

Table of Contents**(6) Credit Risk**

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

Our credit exposure is based on (a) derivative assets and accounts receivable from our counterparties (each included in our consolidated balance sheet) and (b) contracts classified as normal purchase/normal sale and non-derivative contractual commitments (each not included in our consolidated balance sheet except for any related accounts receivable), all after taking into consideration netting within each contract and any master netting contracts with counterparties. We think this represents the maximum potential loss we could incur if our counterparties to the contracts discussed above failed to perform according to their contract terms.

As of June 30, 2010, our credit exposure is summarized as follows:

Credit Rating Equivalent	Exposure Before Collateral⁽¹⁾	Credit Collateral Held⁽²⁾	Exposure Net of Collateral (dollars in millions)	Number of Counterparties >10%	Net Exposure of Counterparties >10%
Investment grade	\$ 260	\$ 10	\$ 250	3 ⁽³⁾	\$ 169
Non-investment grade	3		3		
No external ratings:					
Internally rated Investment grade	30		30	1 ⁽⁴⁾	29
Internally rated Non-investment grade	15	12	3		
Total	\$ 308	\$ 22	\$ 286	4	\$ 198

(1) The table includes amounts related to certain contracts classified as discontinued operations in our consolidated balance sheets. These contracts settle through the expiration date in 2013.

(2)

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

(3) These counterparties are two utility companies and a power grid operator.

(4) This counterparty is a financial institution.

As of December 31, 2009, three investment grade counterparties (a power grid operator, a utility company and a financial institution) represented 56% (\$138 million) of our credit exposure net of collateral held. As of December 31, 2009, we had \$45 million of collateral held.

Based on our current credit ratings, any additional collateral postings that would be required from us as a result of a credit downgrade would be immaterial.

We have cash collateral posted and letters of credit issued as follows:

	June 30, 2010		December 31, 2009	
	Cash	Letters of Credit (1)	Cash	Letters of Credit (1)
	(in millions)			
Commodity contracts ⁽²⁾	\$ 123	\$ 53	\$ 207	\$ 52
Derivative contracts receiving mark-to-market accounting treatment ⁽²⁾⁽³⁾	\$ 48	\$ 3	\$ 97	\$ 5
Other ⁽⁴⁾	\$ 34	\$	\$ 47	\$

(1) See note 9.

(2) Includes activity for both continuing and discontinued operations.

(3) These amounts are included in the amounts above for commodity contracts.

- (4) Represents cash posted under surety bonds related to environmental obligations to the Pennsylvania Department of Environmental Protection.

Table of Contents**(7) Long-Lived Assets Impairments**

We periodically evaluate the recoverability of our long-lived assets (property, plant and equipment and intangible assets), which involves significant judgment and estimates, when there are certain indicators that the carrying value of these assets may not be recoverable. As of June 30, 2010, we had \$4.6 billion of long-lived assets. This estimate affects all segments, which hold 99% of our total net property, plant and equipment and net intangible assets. Our East Coal segment holds the largest portion of our net property, plant and equipment and net intangible assets at 58% of our consolidated total. We did not evaluate the recoverability of our long-lived assets (property, plant and equipment and intangible assets) during the three months ended June 30, 2010 as there were no additional events or changes in circumstances from March 31, 2010 that indicated that the carrying value of such assets may not be recoverable. See notes 2(g), 4 and 5 to our consolidated financial statements in our Form 10-K for further discussion.

Based on the further decline of commodity prices, our asset recoverability review was updated from December 31, 2009 to March 31, 2010. Our asset recoverability review as of March 31, 2010 indicated that two plants, our Elrama plant and our Niles plant (each in our East Coal segment), needed to be measured at fair value to determine if impairments existed.

As of March 31, 2010, following our current methodology (as described below), we had three additional plants and related intangible assets with a combined carrying value of \$344 million, where the undiscounted cash flows were close to the carrying values. If market conditions or environmental and regulatory assumptions change negatively in the future, it is likely that these three plants (and possibly others) could be impaired.

Key Assumptions. The following summarizes some of the most significant estimates and assumptions used in evaluating our plant level undiscounted cash flows as of March 31, 2010. The ranges for the fundamental view assumptions are to account for variability by year and region.

March 31, 2010

Undiscounted Cash Flow Scenarios Weightings:

5-year market forecast with escalation ⁽¹⁾⁽²⁾	50%
5-year market forecast with fundamental view ⁽¹⁾	50%
Range of Assumptions in Fundamental View:	
Demand for power growth per year	1%-2%
After-tax rate of return on new construction ⁽³⁾	6.5%-9.5%
Spread between natural gas and coal prices, \$/MMBtu ⁽⁴⁾	\$3-\$5

(1) For each scenario, the first five years of cash flows are the same.

(2) We assumed an annual 2.5% escalation percentage beyond year five.

(3) The low to mid part of the range represents

natural gas-fired plants required returns and the mid to high part of the range represents coal-fired and nuclear plants required returns.

- (4) Natural gas and coal prices are prior to transportation costs.

We estimate the undiscounted cash flows of our plants based on a number of subjective factors, including:

(a) appropriate weighting of undiscounted cash flow scenarios, as shown in the table above, (b) forecasts of future power generation margins, (c) estimates of our future cost structure, (d) environmental assumptions, (e) time horizon of cash flow forecasts and (f) estimates of terminal values of plants, if necessary, from the eventual disposition of the assets. We did not include the cash flows associated with our economic hedges in our PJM region (East Coal and East Gas segments) as these cash flows are not specific to any one plant.

Under the 5-year market forecast with escalation scenario, we use the following data: (a) forward market curves for commodity prices as of March 16, 2010 for the first five years, (b) cash flow projections through the plant's estimated remaining useful life and (c) escalation factor of cash flows of 2.5% per year after year five.

Under the 5-year market forecast with fundamental view scenario, we model all of our plants and those of others in the regions in which we operate using these assumptions: (a) forward market curves for commodity prices as of March 16, 2010 for the first five years; (b) ranges shown in the table above used in developing our fundamental view beyond five years; (c) the markets in which we operate will continue to be deregulated and earn margins based on forward or projected market prices; (d) projected market prices for energy and capacity will be set by the forecasted available supply and level of forecasted demand; new supply will enter markets when market prices and associated returns, including any assumed subsidies for renewable energy, are sufficient to achieve minimum return requirements; (e) minimum return requirements on future construction of new generation facilities, as shown in the table above, will likely be driven or influenced by utilities, which we expect will have a lower cost of capital than merchant generators; (f) various ranges of environmental regulations, including those for SO₂, NO_x and greenhouse gas emissions; and (g) cash flow projections through the plant's estimated remaining useful life.

Fair Value. Generally, fair value will be determined using an income approach or a market-based approach. Under the income approach, the future cash flows are estimated as described above and then discounted using a risk-adjusted rate. Under a market-based approach, we may also consider prices of similar assets, consult with brokers or employ other valuation techniques.

Table of Contents

The following are key assumptions used in our fair value analyses as of March 31, 2010 for our two plants for which the undiscounted cash flows did not exceed the net book value of the long-lived assets.

	Elrama	Niles
Valuation approach weightings:		
Income approach	100%	100%
Market-based approach	0%	0%
Risk-adjusted discount rate for the estimated cash flows	15%	15%

We only used the income approach as we think no relevant market data exists for these two plants for which we were required to estimate fair value. The discount rates reflect the uncertainty of the plants' cash flows and their inability to support meaningful amounts of debt, and was determined considering factors such as the potential for future capacity revenues and regulatory, commodity and macroeconomic conditions.

We determined that our Elrama plant, which consists of property, plant and equipment, was impaired by \$193 million as of March 31, 2010. We determined that our Niles plant, which consists of property, plant and equipment, was impaired by \$55 million as of March 31, 2010. These impairments were primarily as a result of the further decline in commodity prices. We think the remaining net book values of \$68 million for Elrama and \$26 million for Niles represent our best estimates of fair values as of March 31, 2010.

Certain disclosures are required about nonfinancial assets and liabilities measured at fair value on a nonrecurring basis. This applies to our long-lived assets for which we were required to determine fair value. A fair value hierarchy exists for inputs used in measuring fair value that maximizes the use of observable inputs (Level 1 or Level 2) and minimizes the use of unobservable inputs (Level 3) by requiring that the observable inputs be used when available. See note 4 for further discussion about the three levels. These assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment and affects the valuation of fair value and the assets' placement within the fair value hierarchy levels.

	Level 1	March 31, 2010		Q1 2010	
		Level 2	Level 3	Impairment	
		(in millions)			Charges
Elrama property, plant and equipment ⁽¹⁾	\$	\$	\$ 68	\$ 193	
Niles property, plant and equipment ⁽²⁾			26	55	
Total	\$	\$	\$ 94	\$ 248	

(1) Elrama is in our East Coal segment.

(2) Niles is in our East Coal segment.

Effect if Different Assumptions Used. The estimates and assumptions used to determine whether long-lived assets are recoverable or whether impairment exists are subject to a high degree of uncertainty. Different assumptions as to power prices, fuel costs, our future cost structure, environmental assumptions and remaining useful lives and ultimate disposition values of our plants would result in estimated future cash flows that could be materially different than

those considered in the recoverability assessments as of March 31, 2010 and could result in having to estimate the fair value of other plants.

Use of a different risk-adjusted discount rate would result in fair value estimates for the two plants for which we recorded an impairment during the three months ended March 31, 2010 that could be materially greater than or less than the fair value estimates as of March 31, 2010. Any future fair value estimates for our Elrama and Niles long-lived assets that are greater than the fair value estimates as of March 31, 2010 will not result in reversal of the first quarter 2010 impairment charges.

Table of Contents**(8) Comprehensive Income (Loss)**

The components of total comprehensive income (loss) are:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in millions)			
Net income (loss)	\$ (172)	\$ 803	\$ (449)	\$ 652
Other comprehensive income (loss), net of tax:				
Deferred benefits	(4)	1	(3)	1
Reclassification of net deferred loss from cash flow hedges into net income/loss	3	3	8	8
Unrealized gains (losses) on available-for-sale securities		2	(1)	3
Comprehensive income (loss)	\$ (173)	\$ 809	\$ (445)	\$ 664

(9) Debt

Outstanding debt:

	Weighted Average Stated Interest Rate ⁽¹⁾	June 30, 2010		December 31, 2009	
		Long-term	Current	Long-term	Current
(in millions, except interest rates)					
Facilities, Bonds and Notes:					
RRI Energy:					
Senior secured revolver due 2012	2.28%	\$	\$	1.98%	\$
Senior secured notes due 2014	6.75	279		279	
Senior unsecured notes due 2014	7.625	575		575	
Senior unsecured notes due 2017	7.875	725		725	
Subsidiary Obligations:					
Orion Power Holdings, Inc. senior notes due 2010 (unsecured) ⁽²⁾				12.00	400
PEDFA ⁽³⁾ fixed-rate bonds due 2036	6.75	371		371	
Total facilities, bonds and notes		1,950		1,950	400
Other:					
					5
Table of Contents					40

Adjustment to fair value of
debt⁽⁴⁾

Total other debt					5
Total debt	\$	1,950	\$	\$	1,950 \$ 405

(1) The weighted average stated interest rates are as of March 31, 2010 or December 31, 2009.

(2) We paid off this debt in May 2010.

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

(4) Debt acquired in the Orion Power acquisition was adjusted to fair value as of the acquisition date. Included in interest expense is amortization of \$1 million and \$3 million for valuation adjustments for debt during the three months ended June 30, 2010 and 2009, respectively, and \$5 million

and \$6 million during the six months ended June 30, 2010 an 2009, respectively.

Amounts borrowed and available for borrowing under our revolving credit agreements as of June 30, 2010 are:

	Total Committed Credit	Drawn Amount	Letters of Credit	Unused Amount
	(in millions)			
RRI Energy senior secured revolver due 2012	\$ 500	\$	\$	\$ 500
RRI Energy letter of credit facility due 2014	250		88	162
Total	\$ 750	\$	\$ 88	\$ 662

Table of Contents**(10) Earnings (Loss) Per Share**

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

	Three Months Ended June		Six Months Ended June 30,	
	2010	2009	2010	2009
	30,			
	(in millions)			
Loss from continuing operations (basic and diluted)	\$ (177)	\$ (103)	\$ (453)	\$ (209)

	Three Months Ended		Six Months Ended June 30,	
	2010	2009	2010	2009
	June 30,		2010	
	2009		2009	
	(shares in thousands)			
Weighted average shares outstanding (basic and diluted)	353,473	350,665	353,390	350,577

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

	Three Months Ended June		Six Months Ended June	
	2010	2009	2010	2009
	30,		30,	
	(shares in thousands)			
Shares excluded from the calculation of diluted earnings/loss per share	230 ⁽¹⁾	438 ⁽¹⁾	189 ⁽¹⁾	442 ⁽¹⁾
Shares excluded from the calculation of diluted earnings/loss per share because the exercise price exceeded the average market price	6,168 ⁽²⁾	6,217 ⁽²⁾	4,787 ⁽²⁾	7,086 ⁽²⁾

(1) Potential shares include stock options and restricted stock.

(2) Includes stock options.

(11) Income Taxes**(a) Tax Rate Reconciliation.**

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

	Three Months Ended June		Six Months Ended June	
	2010	2009	2010	2009
	30,		30,	
Federal statutory rate	(35)%	(35)%	(35)%	(35)%

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Additions (reductions) resulting from:				
Federal valuation allowance	26 ⁽¹⁾	(8) ⁽²⁾	40 ⁽³⁾	
State income taxes, net of federal income taxes	(1) ⁽⁴⁾	(1) ⁽⁵⁾	5 ⁽⁶⁾	(1) ⁽⁷⁾
Other	4		3	
Effective rate	(6)%	(44)%	13%	(36)%

(1) Of this percentage, \$47 million (26%) relates to additional valuation allowance.

(2) Of this percentage, \$(16) million (8%) relates to a reduction in valuation allowance.

(3) Of this percentage, \$159 million (40%) relates to additional valuation allowance.

(4) Of this percentage, \$6 million (3%) relates to additional valuation allowance.

(5) Of this percentage, \$9 million (5%) relates to additional valuation allowance.

(6) Of this percentage,

\$38 million
(9%) relates to
additional
valuation
allowance.

(7) Of this
percentage,
\$15 million
(5%) relates to
additional
valuation
allowance.

Table of Contents**(b) Valuation Allowances.**

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

	Federal	State
	(in millions)	
As of December 31, 2009	\$ 129	\$ 135
Changes in valuation allowances	112	32
As of March 31, 2010	241	167
Changes in valuation allowance	47	6
As of June 30, 2010	\$ 288	\$ 173

(c) Income Tax Uncertainties.

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

Our unrecognized federal and state tax benefits changed during the six months ended June 30, 2010 as follows (in millions):

Balance, December 31, 2009	\$	3
Increases related to prior years		12
Decreases related to prior years		(11)
Increases related to current year		
Settlements		
Lapses in the statute of limitations		
Balance, June 30, 2010	\$	4

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

We expect to continue discussions with taxing authorities regarding tax positions related to the following, and think it is reasonably possible some of these matters could be resolved in the next 12 months; however, we cannot estimate the range of changes that might occur: (a) the \$351 million charge during 2005 to settle certain civil litigation and claims relating to the Western states energy crisis; and (b) the timing of tax deductions as a result of negotiations with respect to California-related revenue, depreciation and emission allowances.

We are in ongoing discussions with the Internal Revenue Service (IRS) regarding the timing of revenue recognition and tax deductions with respect to certain California-related items in our 2002 short taxable period return (subsequent to our separation from CenterPoint Energy, Inc. (CenterPoint)). The IRS has informed us it expects to issue a notice of denial of our administrative claim for refund involving these California-related items and we expect to institute refund litigation with respect to this claim in the U.S. District Court or U.S. Court of Federal Claims. In order to set a jurisdictional prerequisite to institute such a refund suit, we expect to make a payment of approximately \$60 million to

\$65 million (which includes an asserted tax liability of \$38 million plus interest) sometime during the next twelve months and record a related receivable. If the IRS were to ultimately prevail in this matter, there would be an increase to our income tax expense. The payment will be refunded with interest if we are successful in the litigation.

Table of Contents**(12) Guarantees and Indemnifications**

We have guaranteed some non-qualified benefits of CenterPoint's existing retirees at September 20, 2002. The estimated maximum potential amount of future payments under the guarantee is approximately \$52 million as of June 30, 2010 and no liability is recorded in our consolidated balance sheet for this item.

We also guarantee the PEDFA fixed-rate bonds, which are included in our consolidated balance sheet as outstanding debt (\$371 million are in our consolidated balance sheets as of June 30, 2010 and December 31, 2009). Our guarantees are secured by the same collateral as our senior secured 6.75% notes. The guarantees require us to comply with covenants similar to those in the senior secured 6.75% notes indenture. The PEDFA bonds will become secured by certain assets of our Seward power plant if the collateral supporting both the senior secured 6.75% notes and our guarantees are released. Our maximum potential obligation under the guarantees is for payment of the principal and related interest charges at a fixed rate of 6.75%. During 2009, we purchased \$129 million (\$92 million of which was classified as discontinued operations) of the PEDFA bonds and are the holder of these repurchased bonds. Therefore, the net amount payable by us would not exceed the amount of PEDFA bonds outstanding, excluding the PEDFA bonds we hold. See note 9.

We guaranteed payments to a third party relating to energy sales during December 2000 from El Dorado Energy, LLC, a former investment. In April 2010, the third party agreed to settle litigation arising from the 2000-2001 energy crises. Based on estimates from the third party and as a result, we recorded a \$17 million charge during the three months ended March 31, 2010, which is included in Western states litigation and similar settlements in our statement of operations and other current liabilities in our consolidated balance sheet as of June 30, 2010. The third party's settlement has not yet been filed with nor approved by the FERC. We currently expect to make this payment during 2010 or early 2011. This estimate is subject to change.

In connection with the sale of our Northeast C&I contracts in December 2008, we guaranteed some former customers performance to the buyer. We estimate the most probable maximum potential amount of future payments under the guarantee is \$9 million as of June 30, 2010. As of June 30, 2010 and December 31, 2009, we have recorded an insignificant amount in our consolidated balance sheets associated with this guarantee.

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

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

(13) Contingencies

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

(a) Pending Natural Gas Litigation.

We are party to seven lawsuits, several of which are class action lawsuits, in state and federal courts in Kansas, Missouri, Nevada and Wisconsin. These lawsuits relate to alleged conduct to increase natural gas prices in violation of antitrust and similar laws. The lawsuits seek treble or punitive damages, restitution and/or expenses. The lawsuits also name a number of unaffiliated energy companies as parties. In April 2010, in a related lawsuit, the Tennessee Supreme Court reversed the Court of Appeals and dismissed all claims.

(b) Environmental Matters.

New Source Review Matters. The United States Environmental Protection Agency (EPA) and various states are investigating compliance of coal-fueled electric generating plants with the pre-construction permitting requirements of the Clean Air Act known as New Source Review. In 2000 and 2001, we responded to the EPA's information requests related to five of our plants, and in December 2007, we received supplemental requests for two of those plants. In September 2008, we received an EPA request for information related to two additional plants and in October 2009, we received supplemental requests for those two plants. The EPA agreed to share information relating to its investigations with state environmental agencies. In January 2009, we received a Notice of Violation (NOV) from the EPA alleging

that past work at our Shawville, Portland and Keystone plants violated the agency's regulations regarding New Source Review.

Table of Contents

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

We think that the projects listed by the EPA and the projects subject to the NJDEP suit were conducted in compliance with applicable regulations. However, any final finding that we violated the New Source Review requirements could result in significant capital expenditures associated with the implementation of emissions reductions on an accelerated basis and possible penalties. Most of these work projects were undertaken before our ownership of those facilities. We think we are indemnified by or have the right to seek indemnification from the prior owners for certain losses and expenses that we may incur from activities occurring prior to our ownership.

Ash Disposal Landfill Closures. We are responsible for environmental costs related to the future closures of seven ash disposal landfills. We recorded the estimated discounted costs (\$19 million and \$18 million as of June 30, 2010 and December 31, 2009, respectively) associated with these environmental liabilities as part of our asset retirement obligations. See note 2(m) to our consolidated financial statements in our Form 10-K.

Remediation Obligations. We are responsible for environmental costs related to site contamination investigations and remediation requirements at four power plants in New Jersey. We recorded the estimated long-term liability for the remediation costs of \$8 million as of June 30, 2010 and December 31, 2009.

Conemaugh Actions. In April 2007, PennEnvironment and the Sierra Club filed a citizens suit against us in the United States District Court, Western District of Pennsylvania to enforce provisions of the water discharge permit for the Conemaugh plant, of which we are the operator and have a 16.45% interest. PennEnvironment and the Sierra Club seek civil penalties, remediation and an injunction against further violations. We are confident that the Conemaugh plant has operated and will continue to operate in material compliance with its water discharge permit, its consent order agreement with the Pennsylvania Department of Environmental Protection, and related state and federal laws. In December 2009, the District Court ordered that the case be dismissed. PennEnvironment and the Sierra Club have requested that the court reconsider its ruling. If PennEnvironment and the Sierra Club are ultimately successful, we could incur additional capital expenditures associated with the implementation of discharge reductions and penalties, which we do not think would be material.

Global Warming. In February 2008, the Native Village of Kivalina and the City of Kivalina, Alaska filed a suit in the United States District Court for the Northern District of California against us and 23 other electric generating and oil and gas companies. The lawsuit seeks damages of up to \$400 million for the cost of relocating the village allegedly because of global warming caused by the greenhouse gas emissions of the defendants. In late 2009, the District Court ordered that the case be dismissed and the plaintiffs appealed. We are also a party to *Comer v. Murphy Oil*, where a group of Mississippi residents and landowners allege the defendants' greenhouse gas emissions contributed to the force of Hurricane Katrina. The plaintiffs have not specified the amount of damages they are seeking. In May 2010, the United States Court of Appeals for the Fifth Circuit ordered that the case be dismissed with prejudice. While we think claims such as these lack legal merit, it is possible that this trend of climate change litigation may continue.

(c) Other.

Excess Mitigation Credits. From January 2002 to April 2005, CenterPoint applied excess mitigation credits (EMCs) to its monthly charges to retail energy providers. The PUCT imposed these credits to facilitate the transition to competition in Texas, which had the effect of lowering the retail energy providers' monthly charges payable to CenterPoint. CenterPoint represents that the portion of those EMCs credited to our former Texas retail business totaled \$385 million. In its stranded cost case, CenterPoint sought recovery of all EMCs credited to all retail electric providers, including our former Texas retail business, and the PUCT ordered that relief. On appeal, the Texas Third Court of Appeals ruled that CenterPoint's stranded cost recovery should exclude EMCs credited to our former Texas retail business for price-to-beat customers. The case is now before the Texas Supreme Court. In November 2008, CenterPoint asked us to agree to suspend any limitations periods that might exist for possible claims against us or our former Texas retail business if it is ultimately not allowed to include in its stranded cost calculation EMCs credited to

our former Texas retail business. We agreed to suspend only unexpired deadlines, if any, that may apply to a CenterPoint claim relating to EMCs credited to our former Texas retail business.

Table of Contents

CenterPoint Indemnity. We have agreed to indemnify CenterPoint against certain losses relating to the lawsuits described in note 13(a) under Pending Natural Gas Litigation.

Texas Franchise Audit. The state of Texas has issued assessment orders indicating an estimated tax liability of approximately \$59 million (including interest and penalties of \$21 million) relating primarily to the sourcing of receipts for 2000 through 2006. We are contesting the audit assessments related to this issue.

Refund Contingency Related to Transportation Rates. In September 2008, Kern River Gas Transmission Company (Kern), a natural gas pipeline company, and certain of its shippers entered into a settlement agreement regarding Kern's transportation rates to which we were a party. The agreement resulted in a refund to us of \$30 million during 2008 (recorded as a current liability). In 2009, the Federal Energy Regulatory Commission (FERC) rejected the settlement agreement and directed Kern to recalculate the refunds. We do not expect any adjustments to be material.

(d) Proposed Merger with Mirant.

In April 2010, RRI Energy together with Mirant and Mirant's board of directors were named defendants in four purported class action lawsuits filed in the Superior Court of Fulton County, Georgia, brought on behalf of proposed classes consisting of holders of Mirant common stock, excluding defendants and their affiliates. RRI Energy Holdings, Inc., a wholly-owned subsidiary of RRI Energy formed for the purpose of effecting the merger, was also named a defendant in three of the lawsuits. In three of the actions, amended complaints have been filed adding allegations that the defendants breached their fiduciary duties by failing to disclose certain information in the preliminary joint proxy statement/prospectus of RRI Energy and Mirant, which is a part of the Registration Statement of RRI Energy that was filed with the Securities and Exchange Commission. The complaints allege, among other things, that the merger agreement was the product of breaches of fiduciary duties by the individual defendants, in that it allegedly does not provide for the best value reasonable under the circumstances for Mirant's public stockholders, and that the other defendants aided and abetted the individual defendants' breaches of fiduciary duties. The complaints seek, among other things, (a) a declaration that the merger agreement was entered into in breach of the defendants' duties, (b) to enjoin defendants from consummating the merger, (c) rescission of the merger if it is consummated and/or (d) granting the class members any profits or benefits allegedly improperly received by defendants. Motions to dismiss each of the four complaints for failure to state a claim have been filed on behalf of all of the defendants. We think that the allegations of the complaints are without merit and that we have substantial meritorious defenses to the claims made in these actions.

(14) Pension and Postretirement Benefits

We sponsor multiple defined benefit pension plans. We provide subsidized postretirement benefits to some bargaining employees but generally do not provide them to non-bargaining employees. See note 11 to our consolidated financial statements in our Form 10-K for additional information about pension and postretirement benefits.

	Pension		Postretirement	
	Three months ended June 30,		Three months ended June 30,	
	2010	2009	2010	2009
	(in millions)			
Service cost	\$ 1	\$ 2	\$	\$ 1
Interest cost	1	1	1	
Expected return on plan assets	(2)	(1)		
Net amortization ⁽¹⁾	1	1		1
Net periodic benefit costs	\$ 1	\$ 3	\$ 1	\$ 2

Table of Contents

	Pension		Postretirement	
	Six months ended June 30, 2010	2009	Six months ended June 30, 2010	2009
	(in millions)			
Service cost	\$ 2	\$ 3	\$	\$ 1
Interest cost	3	3	2	2
Expected return on plan assets	(3)	(2)		
Net amortization ⁽¹⁾	1	2		1
Net periodic benefit costs	\$ 3	\$ 6	\$ 2	\$ 4

(1) Net amortization amount includes prior service costs and actuarial gains and losses.

(15) Collective Bargaining Agreements

As of June 30, 2010, approximately 45% of our employees are subject to collective bargaining agreements. Less than five percent of our employees are subject to collective bargaining agreements that will expire by June 30, 2011.

(16) Supplemental Guarantor Information

Our wholly-owned subsidiaries are either (a) full and unconditional guarantors, jointly and severally, or (b) non-guarantors of the senior secured notes. Orion Power Holdings, Inc. and its consolidated subsidiaries became guarantors in June 2010 as a result of the pay off of its senior notes in May 2010. We have reclassified 2009 disclosures to be comparable to 2010.

Table of Contents*Condensed Consolidating Statements of Operations.*

	Three Months Ended June 30, 2010					
	RRI Energy	Guarantors	Non-Guarantors (in millions)	Adjustments (1)	Consolidated	
Revenues	\$	\$ 404	\$	146	\$ (150)	\$ 400
Cost of sales		346		69	(150)	265
Operation and maintenance		100		84		184
General and administrative		21		14		35
Gains on sales of assets and emission and exchange allowances, net		(1)				(1)
Depreciation and amortization		55		14		69
Total		521		181	(150)	552
Operating loss		(117)		(35)		(152)
Loss of equity investments of consolidated subsidiaries						