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)

Region	Number of Generation Facilities(1)	Total Net Generating 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)

Region	Number of Generation Facilities	Total Net Generating 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(l) 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 Counsel (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(l) 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(l) 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. 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
Total Power (MMWh)(1)	82	172	300
Total Gas (Bcf)(2)	1,564	2,423	3,508

(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 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 REPGB, 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), NOx, 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 16,958 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)

Name	Age	Officer 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 2. *Properties*

Character of Ownership

We own or lease our principal properties in fee, including our corporate office space and various real property and facilities relating to our generation assets and development activities. Most of our electric lines and gas mains are located, pursuant to easements and other rights, on public roads or on land owned by others.

Substantially all of the real estate, electric distribution system properties, buildings and franchises owned directly by Reliant Energy (excluding real estate and other properties of subsidiaries of Reliant Energy) are subject to a lien created under a Mortgage and Deed of Trust dated as of November 1, 1944 (as supplemented, Mortgage) between Reliant Energy and South Texas Commercial National Bank of Houston (JP Morgan Chase Bank, as Successor Trustee). The lien of the Mortgage excludes cash, stock in subsidiaries and certain other assets. Additionally, properties owned by subsidiaries of Reliant Energy are subject to liens of creditors of the respective subsidiaries. We believe we have satisfactory title to our facilities in accordance with standards generally accepted in the electric power industry, subject to exceptions which, in our opinion, would not have a material adverse effect on the use or value of the facilities.

Electric Operations

For information regarding the properties of our Electric Operations business segment, please read "Electric Operations" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

Natural Gas Distribution

For information regarding the properties of our Natural Gas Distribution business segment, please read "Natural Gas Distribution" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

Pipelines and Gathering

For information regarding the properties of our Pipelines and Gathering business segment, please read "Pipelines and Gathering" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

Wholesale Energy

For information regarding the properties of our Wholesale Energy business segment, please read "Wholesale Energy" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

European Energy

For information regarding the properties of our European Energy business segment, please read "European Energy" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

Retail Energy

For information regarding the properties of our Retail Energy business segment, please read "Retail Energy" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

Latin America

For information regarding the properties of our Latin America business segment, please read "Latin America" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

Other Operations

For information regarding the properties of our Other Operations business segment, please read "Other Operations" in Item 1 of this Form 10-K, which information is incorporated herein by reference.

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

A special meeting of our shareholders was held on December 17, 2001. At the meeting, our shareholders were asked to approve an Agreement and Plan of Merger, dated as of October 19, 2001, pursuant to which CenterPoint Energy would become the parent company of Reliant Energy and each outstanding share of Reliant Energy common stock would be automatically converted into one share of CenterPoint Energy common stock. The proposal to approve the Agreement and Plan of Merger was approved with 167,344,153 votes for, 56,529,357 votes against and 3,019,520 abstentions.

PART II

Item 5. ***Market for Common Stock and Related Stockholder Matters***

As of April 8, 2002, our common stock was held of record by approximately 71,212 shareholders. Our common stock is listed on the New York and Chicago Stock Exchanges and is traded under the symbol "REI."

The following table sets forth the high and low sales prices of our common stock on the New York Stock Exchange composite tape during the periods indicated, as reported by *Bloomberg*, and the cash dividends declared in these periods. Cash dividends paid aggregated $1.50 per share in 2000 and 2001.

	Market Price		Dividend Declared Per Share
	High	Low	
2000			
First Quarter			$0.375
March 7		$19.88	
March 16	$24.38		
Second Quarter			$0.375
April 7		$22.56	
June 23	$29.81		
Third Quarter			$0.375
July 3		$29.81	
September 29	$46.50		
Fourth Quarter			$0.375
October 2	$48.19		
December 6		$38.06	
2001			
First Quarter			$0.375
January 11		$32.44	
March 30	$45.25		
Second Quarter			$0.375
May 1	$50.02		
June 26		$30.50	
Third Quarter			$0.375
July 10	$32.70		
September 27		$26.07	
Fourth Quarter			(1)
October 16	$28.88		
December 17		$23.64	

(1) The quarterly dividend of $0.375 per share normally declared in the fourth quarter for payment in the following first quarter was declared on February 8, 2002 and paid in March 2002.

The closing market price of our common stock on December 31, 2001 was $26.52 per share.

The amount of future cash dividends will be subject to determination based upon our results of operations and financial condition, our future business prospects, any applicable contractual restrictions and other factors that our board of directors considers relevant and will be declared at the discretion of the board of directors. No dividends are currently being paid to Reliant Energy by Reliant Resources, which may affect the ability of Reliant Energy to maintain its existing dividend levels pending completion of the Distribution.

After the consummation of the Restructuring, the declaration and payment of dividends by CenterPoint Energy will be at the discretion of its board of directors. CenterPoint Energy will not directly conduct any business operations from which it will derive revenues. Therefore, the payment and rate of future dividends on CenterPoint Energy common stock will depend primarily upon the earnings, financial condition and capital requirements of its subsidiaries. Following the Distribution, CenterPoint Energy will not be as large a company as Reliant Energy is today, and the earnings of the subsidiaries and assets that were transferred to Reliant Resources will not be available for the payment of dividends on the CenterPoint Energy common stock. As a result, the cash dividend per share of CenterPoint Energy common stock is expected to be reduced to a level that is consistent with both its earnings profile and the level of cash dividends of other predominately regulated utility businesses.

Subject to the availability of earnings, the needs of its businesses, and other applicable restrictions, upon becoming subsidiaries of CenterPoint Energy following the Restructuring, the T&D Utility and Texas Genco intend to make regular cash payments to CenterPoint Energy in the form of dividends or distributions on their stock or membership interests in amounts which would be sufficient to pay cash dividends on CenterPoint Energy common stock as described above and to pay operating expenses of CenterPoint Energy and for other purposes as the board of directors of CenterPoint Energy may determine. CenterPoint Energy expects that cash dividends will be declared and paid on approximately the same schedule as that now followed by us with respect to our common stock dividends.

Item 6. *Selected Financial Data*

The following table presents selected financial data with respect to our consolidated financial condition and consolidated results of operations and should be read in conjunction with our consolidated financial statements and the related notes in Item 8 of this Form 10-K.

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. Accordingly, in our 2000 consolidated financial statements, we reported the results of our Latin America business segment as discontinued operations in accordance with APB 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 assets were terminated as a result of recent adverse economic developments in Argentina. We will continue to evaluate other 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 Statements of Consolidated 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.

The selected financial data includes the financial statement effect of REMA since its acquisition in May 2000, REPGB since its acquisition in October 1999 and RERC since its acquisition in August 1997. These acquisitions were accounted for under the purchase method. Please read Note 3 to our consolidated financial statements for additional information regarding the REMA and REPGB acquisitions and Note 19 to our consolidated financial statements for additional information regarding our Latin America operations.

	Year Ended December 31,				
	1997(1)	1998(2)	1999(3)(7)	2000(4)(7)	2001(5)(7)
	(In millions, except per share amounts)				
Revenues	$ 6,786	$11,230	$13,794	$28,269	$40,810
Income (loss) before extraordinary items, cumulative effect of accounting change and preferred dividends	$ 421	$ (141)	$ 1,665	$ 440	$ 919
Extraordinary items, net of tax	—	—	(183)	7	—
Cumulative effect of accounting change, net of tax	—	—	—	—	61
Net income (loss) attributable to common stockholders(6)	$ 421	$ (141)	$ 1,482	$ 447	$ 980
Basic earnings (loss) per common share:					
Income (loss) before extraordinary items and cumulative effect of accounting change	$ 1.66	$ (0.50)	$ 5.84	$ 1.54	$ 3.17
Extraordinary items, net of tax	—	—	(0.64)	0.03	—
Cumulative effect of accounting change, net of tax	—	—	—	—	0.21
Basic earnings (loss) per common share	$ 1.66	$ (0.50)	$ 5.20	$ 1.57	$ 3.38
Diluted earnings (loss) per common share:					
Income (loss) before extraordinary items and cumulative effect of accounting change	$ 1.66	$ (0.50)	$ 5.82	$ 1.53	$ 3.14
Extraordinary items, net of tax	—	—	(0.64)	0.03	—
Cumulative effect of accounting change, net of tax	—	—	—	—	0.21
Diluted earnings (loss) per common share	$ 1.66	$ (0.50)	$ 5.18	$ 1.56	$ 3.35
Cash dividends paid per common share	$ 1.50	$ 1.50	$ 1.50	$ 1.50	$ 1.50
Dividend payout ratio	90%	—	26%	97%	47%
Return on average common equity	9.7%	(3.1)%	30.8%	8.3%	16.1%
Ratio of earnings to fixed charges	2.48	—	5.37	1.86	2.77
At year-end:					
Book value per common share	$ 17.28	$ 15.16	$ 18.70	$ 19.10	$ 22.77
Market price per common share	$ 26.75	$ 32.06	$ 22.88	$ 43.31	$ 26.52
Market price as a percent of book value	155%	211%	122%	227%	116%
Total assets	$18,268	$18,967	$26,456	$31,960	$30,681
Long-term debt obligations, including current maturities	$ 5,307	$ 7,049	$ 9,223	$ 6,619	$ 6,403
Trust preferred securities	$ 362	$ 342	$ 705	$ 705	$ 706
Cumulative preferred stock	$ 10	$ 10	$ 10	$ 10	$ —
Capitalization:					
Common stock equity	46%	37%	35%	43%	49%
Cumulative preferred stock	—	—	—	—	—
Trust preferred securities	3%	3%	5%	5%	5%
Long-term debt, including current maturities	51%	60%	60%	52%	46%
Business acquisitions	$ 1,423	$ 292	$ 1,060	$ 2,103	$ —
Capital expenditures	$ 328	$ 712	$ 1,166	$ 1,842	$ 2,053

(1) 1997 net income includes a non-cash, unrealized accounting loss on our indexed debt securities of $79 million (after-tax), or $0.31 loss per basic and diluted share. For additional information on the indexed debt securities, please read Note 8 to our consolidated financial statements.

(2) 1998 net income includes a non-cash, unrealized accounting loss on our indexed debt securities of $764 million (after-tax), or $2.69 loss per basic and diluted share. For additional information on the indexed debt securities, please read Note 8 to our consolidated financial statements. Fixed charges exceeded earnings by $179 million in 1998.

(3) 1999 net income includes an aggregate non-cash, unrealized accounting gain on our indexed debt securities and our Time Warner (now AOL Time Warner) investment, of $1.2 billion (after-tax), or $4.09 earnings per basic share and $4.08 earnings per diluted share. For additional information on the indexed debt securities and AOL Time Warner investment, please read Note 8 to our consolidated financial statements. The extraordinary item in 1999 is a loss related to an accounting impairment of certain generation related regulatory assets of our Electric Operations business segment. For additional information regarding the impairment, please read Note 4 to our consolidated financial statements.

(4) 2000 net income includes an aggregate non-cash accounting loss on our indexed debt securities and our AOL Time Warner investment of $67 million (after-tax), or $0.24 loss per basic share and $0.23 loss per diluted share. 2000 net income also includes a $331 million (after-tax) charge, or $1.16 loss per basic share and $1.15 loss per diluted share, to reflect the reclassification of our Latin America business segment from discontinued operations to continuing operations as described above. The extraordinary item in 2000 is a gain of $7 million, or $0.03 earnings per basic and diluted share, related to the early extinguishment of $272 million of long-term debt. For additional information on the indexed debt securities and AOL Time Warner investment, please read Note 8 to our consolidated financial statements. For additional information on our Latin America operations, please read Note 19 to our consolidated financial statements.

(5) 2001 net income includes the following: (i) the cumulative effect of an accounting change resulting from the adoption of SFAS No. 133 ($61 million after-tax gain, or $0.21 earnings per basic and diluted share), (ii) a gain related to the revaluation of our European Energy business segment's share of NEA B.V. (formerly known as N.V. SEP), which was the coordinating body for the Dutch electric generation sector prior to the start of wholesale competition, ($51 million after-tax, or $0.17 earnings per basic and diluted share), (iii) a gain related to the settlement of the stranded cost indemnity obligations of former REPGB shareholders ($37 million after-tax, or $0.13 earnings per basic and diluted share), (iv) a non-cash charge related to the redesign of our employee benefit plans in anticipation of the separation of our regulated and unregulated businesses ($65 million after-tax, or $0.23 loss per basic share and $0.22 loss per diluted share), (v) a charge related to the disposition of our Communications business ($42 million after-tax, or $0.14 loss per basic and diluted share) and (vi) an impairment of our Latin America operations ($51 million after-tax, or $0.17 loss per basic and diluted share). These amounts do not reflect the effect of the third-party minority ownership interest in Reliant Resources. For additional information related to the above items, please read Notes 3(b), 5, 12, 19, and 20 to our consolidated financial statements.

(6) Net income attributable to common stockholders for 1999 and 2000 includes minority interest income of $0.6 million and $1 million, respectively. Net income attributable to common stockholders for 2001 includes minority interest expense of $81 million.

(7) As described in Note 1 to our consolidated financial statements, our consolidated financial statements for 1999, 2000 and 2001 have been restated from amounts previously reported. The restatement had no impact on previously reported consolidated cash flows, operating income or net income.

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

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 sole 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 Committees of each of the Board of Directors of Reliant Energy and Reliant Resources also directed an internal investigation by outside legal counsel, with assistance by outside accountants, 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. In addition to the round trip trades reported on May 13, 2002, Reliant Resources also identified an additional transaction in 1999, which based on available information, Reliant Resources believes was also recorded with the sole objective of increasing volumes but also resulted in increased revenues and fuel and cost of gas sold expense.

In addition, during the May 2001 through September 2001 time frame, Reliant Resources 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 (four structured transactions). The four structured transactions were intended to increase future cash flow and earnings and to increase certainty associated with future cash flow and earnings, albeit at the expense of 2001 cash flow and earnings. 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. The transactions that settled in 2001 were previously recorded on a gross basis with such transactions being reported in revenues and expenses which resulted in $1.5 billion of revenues, $364 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, Reliant Resources now believes these transactions should have been accounted for on a net basis.

In the course of Reliant Resources' review, Reliant Resources also identified and determined to record on a net basis several transactions for energy related services (not involving round trip trades) that totaled $85 million over the three year period ended December 31, 2001. These transactions were originally recorded on a gross basis.

During the fourth quarter of 2000, two power generation swap contracts with a fair value of $261 million were terminated and replaced with a substantially similar contract providing for physical delivery and designated to hedge electric generation. The termination of the original contracts and execution of the replacement contract represented a substantive modification to the original contract. As a result, upon termination of the original contracts, a contractual liability representing the fair value of the original contracts and a deferred asset of equal amount should have been recorded. As of January 1, 2001, in connection with the adoption of Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133), the deferred asset should have been recorded as a transition adjustment to other comprehensive loss. The liability and transition adjustment should have been amortized on a straight-line basis over the term of the power generation contract replacing the terminated power generation contracts (through May 2004). We previously did not give accounting recognition to these transactions. As a result, we have restated our Consolidated Balance Sheets as of December 31, 2000 and 2001 and the Statements of Consolidated Stockholders' Equity and Comprehensive Income for the year ended December 31, 2001, to appropriately account for these transactions as described above. The restatement had no impact on our reported consolidated cash flows, operating income or net income.

The consolidated financial statements for 1999, 2000 and 2001 have been restated from amounts previously reported. 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 on our consolidated financial statements for 1999, 2000 and 2001 are set forth in Note 1 to our consolidated financial statements.

The following discussion and analysis has been modified for the restatement and should be read in combination with our consolidated financial statements included in Item 8 of this Form 10-K.

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 utilities in terms of kilowatt-hour (KWh) sales, 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 Operations, Natural Gas Distribution, Pipelines and Gathering, Wholesale Energy, European Energy, Retail Energy, Latin America and Other Operations. Historically, Retail Energy has been reported in the Other Operations business segment. For business segment reporting information, please read Notes 1 and 18 to our consolidated financial statements. For additional information regarding these business segments, please read "Business" in Item 1 of this Form 10-K.

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 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 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. We currently expect to complete the Restructuring and Distribution in the summer of 2002.

Effective December 1, 2000, our board of directors approved a plan to dispose of our Latin America business segment through sales of its assets. Accordingly, in our 2000 consolidated financial statements, we reported the results of our 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 adverse economic developments in Argentina. We 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 Issue No. 90-6. (EITF 90-6). For additional information regarding the disposal of the Latin America business segment, see Note 19 to our consolidated financial statements.

During 2001, we incurred a pre-tax non-cash charge of $101 million relating to the redesign of some of our benefit plans in anticipation of separation of our regulated and our unregulated businesses. This included a curtailment gain of $23 million related to our pension plans, an $84 million loss related to pension benefit enhancements and a $40 million curtailment loss associated with postretirement benefits.

All dollar amounts in the tables that follow are in millions, except for per share and operational data.

Consolidated Results of Operations

	Year Ended December 31,		
	1999	2000	2001
Revenues	$ 13,794	$ 28,269	$ 40,810
Operating Expenses	(12,535)	(26,432)	(38,817)
Operating Income	1,259	1,837	1,993
(Loss) Income from Equity Investments in Unconsolidated Subsidiaries	(1)	43	57
Gain (Loss) on AOL Time Warner Investment	2,452	(205)	(70)
(Loss) Gain on Indexed Debt Securities	(630)	102	58
Operating Results from Equity Investment in Unconsolidated Latin America Assets	(26)	(41)	—
Impairment of Latin America Unconsolidated Equity Investments	—	(131)	(4)
Loss on Disposal of Latin America Assets	—	(176)	—
Interest Expense and other charges	(551)	(768)	(658)
Minority Interest	1	1	(81)
Other Income, net	60	96	124
Income Before Income Taxes, Extraordinary Items and Cumulative Effect of Accounting Change	2,564	758	1,419
Income Tax Expense	(899)	(318)	(500)
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	1,665	440	919
Extraordinary (Loss) Gain, net of tax	(183)	7	—
Cumulative Effect of Accounting Change, net of tax	—	—	61
Net Income Attributable to Common Stockholders	$ 1,482	$ 447	$ 980
Basic Earnings Per Share	$ 5.20	$ 1.57	$ 3.38
Diluted Earnings Per Share	$ 5.18	$ 1.56	$ 3.35

2001 Compared to 2000

Net Income. We reported consolidated net income of $980 million ($3.35 per diluted share) for 2001 compared to $447 million ($1.56 per diluted share) for 2000. The 2001 results included a cumulative effect of accounting change of $61 million, net of tax, related to the adoption of SFAS No. 133. For additional discussion of the adoption of SFAS No. 133, please read Note 5 to our consolidated financial statements. The 2000 results included an extraordinary gain of $7 million, net of tax, related to the early extinguishment of $272 million of long-term debt. For additional discussion of the extraordinary gain, please read Note 10(b) to our consolidated financial statements.

Our consolidated net income, before cumulative effect of accounting change, was $919 million for 2001 compared to consolidated net income, before extraordinary gain, of $440 million in 2000. The increase of $479 million was primarily due to the following:

- a $674 million increase in gross margins (revenues less fuel and cost of gas sold and purchased power) from our Wholesale Energy business segment, excluding the impact of a $68 million provision related to energy sales to Enron Corp. and its affiliates (Enron) which filed a voluntary petition for bankruptcy during the fourth quarter of 2001;
- a $280 million after-tax decrease in net losses from our Latin America business segment. An additional after-tax impairment of $51 million was recorded in 2001. This business segment had been presented as discontinued operations in 2000;
- a $57 million decrease in operating losses from our Retail Energy business segment;

- a $37 million net gain resulting from the settlement of an indemnity agreement related to certain energy obligations entered into in connection with our acquisition of Reliant Energy Power Generation Benelux N.V. (REPGB), formerly N.V. UNA;

- a $51 million gain recorded in equity income in 2001 related to a preacquisition contingency for the value of NEA B.V. (NEA), the coordinating body for the Dutch electricity generating sector, which is an equity investment in which REPGB holds a 22.5% economic interest;

- a $112 million decrease in net interest expense; and

- a $27 million pre-tax impairment loss on marketable equity securities classified as "available-for-sale" in 2000.

The above items were partially offset by:

- a decrease in operating income of $139 million from our Electric Operations business segment primarily due to the impact of milder weather, reduced rates charged to certain governmental agencies as mandated by the Texas Electric Choice Plan (Texas Electric Restructuring Law), fees paid for the early termination of an accounts receivable factoring agreement and higher benefit expenses;

- a $66 million decrease in our European Energy business segment's gross margins primarily attributable to the Dutch wholesale electric market opening to competition on January 1, 2001, excluding the impact of a $17 million provision related to energy sales to Enron recorded in the fourth quarter of 2001;

- a $101 million pre-tax, non-cash charge relating to the redesign of certain of our benefit plans in anticipation of our separation from Reliant Resources;

- an $85 million pre-tax provision related to energy sales to Enron which was recorded in the fourth quarter of 2001;

- $54 million in pre-tax disposal charges and impairments of goodwill and fixed assets related to the exiting of our Communications business;

- a $37 million decrease in our Wholesale Energy business segment's equity earnings of unconsolidated subsidiaries in 2001 as compared to 2000; and

- an $18 million pre-tax gain in 2000 on the sale of our interest in one of our development-stage electric generation projects.

Net income in 2000 and 2001, excluding the $101 million pre-tax non-cash charge mentioned above, included pension income of $37 million and $5 million, respectively. Pension income declined primarily to a decline in the market value of pension plan assets during 2000. The market value of our pension plan assets continued to decrease during 2001 due primarily to the declines in the U.S. equity markets. As a result of this decline, along with a reduction in the expected return on plan assets and discount rate assumptions, we expect to record pension expense of approximately $40 million in 2002.

During 2001, we contributed to our pension plans approximately 4.5 million shares of Reliant Energy common stock with a fair value of $107 million. As of December 31, 2001, the fair value of Reliant Energy common stock held by these plans was $120 million or 8.7% of the pension plan assets. We do not anticipate a required pension contribution during 2002. Future effects of our pension plans, including effects such as those mentioned above, on our operating results depend on economic conditions, employee demographics, mortality rates and investment performance. For additional information regarding the pension plan assets and the components of pension income, please read Note 12 to our consolidated financial statements.

Operating Income. For an explanation of changes in our operating income for 2001 as compared to 2000, please read the discussion below of operating income (loss) by business segment.

Other Income/Expense. We incurred other expense of $575 million for 2001 compared to other expense of $1.1 billion for 2000. The decrease of $504 million in 2001 as compared to 2000 resulted primarily from the following:

- a $23 million increase in interest income in 2001 earned on under-recovery of fuel costs of our Electric Operations business segment;
- a $51 million gain recorded in equity income with respect to our equity investment in NEA;
- a $112 million decrease in net interest expense, primarily as a result of lower levels of borrowings and lower interest rates in 2001 compared to 2000;
- a $343 million pre-tax decrease in other expense related to reduced losses of our Latin America operations;
- a $103 million pre-tax ($67 million after-tax) non-cash accounting loss on our indexed debt securities and our related AOL Time Warner investment in 2000; and
- a $27 million pre-tax impairment loss on marketable equity securities classified as "available-for-sale" in 2000.

The decrease in other expense noted above was partially offset by:

- minority interest expense of $81 million in 2001 primarily related to minority interest in Reliant Resources as a result of the initial public offering of Reliant Resources' common stock in May 2001 discussed above;
- an $18 million pre-tax gain in 2000 on the sale of our interest in one of our development stage electric generation projects; and
- a $37 million decrease in our Wholesale Energy business segment's equity earnings in unconsolidated subsidiaries in 2001 as compared to 2000. The equity income in both years primarily resulted from an investment in an electric generation plant in Boulder City, Nevada. The plant became operational in May 2000. The equity income related to our investment in the plant declined in 2001 from 2000 primarily due to higher plant outages in 2001 and reduced power prices realized by the project company.

During 2000, we incurred a pre-tax impairment loss of $27 million on marketable equity securities classified as "available-for-sale". Management's determination to recognize this impairment resulted from a combination of events occurring in 2000 related to this investment. Such events affecting the investment included changes occurring in the investment's senior management, announcement of significant restructuring charges and related downsizing for the entity, reduced earnings estimates for this entity by brokerage analysts and the bankruptcy of a competitor of the investment in the first quarter of 2000. These events, coupled with the stock market value of our investment in these securities continuing to be below our cost basis, caused management to believe the decline in fair value to be other than temporary. During 2001, we recognized a pre-tax gain of $14 million from the sale of a portion of this investment. For additional discussion of this investment, please read Note 2(l) to our consolidated financial statements.

Upon adoption of SFAS No. 133 effective January 1, 2001, we recorded a transition adjustment pre-tax gain of $90 million ($58 million net of tax) related to our investment in AOL Time Warner, Inc. (AOL TW) common stock (AOL TW Common) and our related indexed debt obligation. The transition adjustment gain was reported in the first quarter of 2001 as the effect of a change in accounting principle. During 2001, we recorded a $70 million loss on our investment in AOL TW Common. During 2001, we recorded a $58 million gain associated with the fair value of the derivative component of the indexed debt obligation. A detailed discussion follows in the narrative and table presented below.

In 1997, in order to monetize a portion of the cash value of our investment in Time Warner Inc. (TW) convertible preferred stock (TW Preferred), we issued 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 stock (TW Common). On July 6, 1999, we converted our investment in TW Preferred into 45.8 million shares of TW Common. Prior to the conversion, our investment in the TW Preferred was accounted for under the cost method at a value of $990 million. Effective on the conversion date, the shares of TW Common were classified as trading securities under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (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 our investment in Time Warner securities. On the July 1, 2000 maturity date, we tendered 37.9 million shares of TW Common to fully settle our obligations in connection with our ACES obligation. On September 21, 1999, we issued approximately 17.2 million of 2.0% Zero-Premium Exchangeable Subordinated Notes due 2029 (ZENS) having an original principal amount of $1.0 billion. At maturity the holders of the ZENS will receive in cash the higher of the original principal amount of the ZENS (subject to adjustment) or an amount based on the then-current market value of AOL TW Common, or other securities distributed with respect to AOL TW Common. We used $537 million of the net proceeds from the offering of the ZENS to purchase 9.2 million additional shares of 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, we owned approximately 8 million shares of TW Common that were in excess of the 37.9 million shares needed to economically hedge our ACES obligation. 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 our 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 was 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 Statements of Consolidated Income. During 2001, we recorded a $70 million loss on our investment in AOL TW Common. During 2001, we 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 we hold are expected to substantially offset changes in the fair value of the derivative component of the ZENS.

The following table sets forth summarized financial information regarding our investment in AOL TW securities and the ACES and ZENS obligations (in millions).

	AOL TW Investment	ACES	Debt Component of ZENS	Derivative Component 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

For additional information regarding our investment in AOL TW, our indexed debt securities and the effect of adoption of SFAS No. 133 on January 1, 2001 on our ZENS obligation, please read Note 8 to our consolidated financial statements.

Income Tax Expense. The effective tax rate for 2000 and 2001 was 42.0% and 35.2%, respectively. The decrease in the effective tax rate in 2001 compared to 2000 was primarily due to non-recurring increased tax expense arising from the sales of our Latin American investments in 2000, increased earnings of REPGB and decreased state income taxes in 2001, partially offset by the write-off of goodwill in 2001 associated with our Communications business. In 2001 and prior years, the earnings of REPGB were subject to a zero percent Dutch corporate income tax rate as a result of the Dutch tax holiday in effect for the Dutch electricity industry. After December 31, 2001, all of our European Energy business segment's earnings in the Netherlands will be subject to the standard Dutch corporate income tax rate, which is currently 34.5%.

As discussed in Note 14(h) to our consolidated financial statements, the Dutch parliament has adopted legislation allocating to the Dutch generation sector, including REPGB, financial responsibility for certain stranded costs and other liabilities incurred by NEA prior to the deregulation of the Dutch wholesale market. These obligations include NEA's obligations under an out-of-market gas supply contract and three out-of-market electricity contracts. REPGB's allocated share of these liabilities is 22.5%. As a result, we recorded a net stranded cost liability of $369 million and a related deferred tax asset of $127 million at December 31, 2001 for our statutorily allocated share of these gas supply and electricity contracts. We believe that the costs incurred by REPGB subsequent to the tax holiday ending in 2001 related to these contracts will be deductible for Dutch tax purposes. However, due to uncertainties related to the deductibility of these costs, we have recorded an offsetting liability in other liabilities in our consolidated financial statements of $127 million as of December 31, 2001.

2000 Compared to 1999

Net Income. We reported consolidated net income, before the extraordinary gain of $7 million, of $440 million for 2000 compared to $1.7 billion, before an extraordinary loss of $183 million, in 1999. The extraordinary gain in 2000 related to the retirement of certain debt obligations of our REPGB subsidiary. The extraordinary loss in 1999 related to an accounting impairment of certain generation related regulatory assets of our Electric Operations business segment. The 2000 results included the following unusual items:

- an aggregate after-tax, non-cash accounting loss of $67 million on our indexed debt securities and our related AOL TW investment;
- an after-tax loss of $172 million from operations of our Latin America business segment; and
- an after-tax loss of $159 million on the anticipated disposal of our Latin America business segment.

The 1999 results included the following unusual items:

- an aggregate after-tax, non-cash accounting gain of $1.2 billion on our indexed debt securities and our AOL TW investment as discussed above; and
- an after-tax loss of $9 million from operations of our Latin America business segment.

In 1999, the Texas legislature adopted the Texas Electric Restructuring Law. In connection with the implementation of the Texas Electric Restructuring Law, we evaluated the recovery of our generation related regulatory assets and liabilities. We determined that a pre-tax accounting loss of $282 million existed because we believed only the economic value of our generation related regulatory assets (as defined by the Texas Electric Restructuring Law) would be recovered. Therefore, we recorded a $183 million after-tax extraordinary loss in the fourth quarter of 1999. For information regarding the $183 million extraordinary loss, please read "— Certain Factors Affecting Our Future Earnings — Factors Affecting the Results of Our Electric Operations — Generation" and Note 4(a) to our consolidated financial statements.

In the fourth quarter of 2000, the Latin America business segment sold its investments in El Salvador, Colombia and Brazil for an aggregate $790 million in after-tax proceeds. We recorded a $242 million after-tax loss in connection with the sale of these investments.

In the fourth quarter of 2000, we recorded an additional pre-tax impairment related to our remaining Latin America investments in Argentina of $172 million, based on the expected net realizable value of the businesses upon their disposition.

Operating Income. For an explanation of changes in our operating income for 2000 as compared to 1999, please read the discussion below of operating income (loss) by business segment.

Other Income/Expense. We incurred net other expense of $1.1 billion for 2000 compared to net other income of $1.3 billion for 1999. The decrease in other income/expense of $2.4 billion in 2000 as compared to 1999 resulted primarily from the following:

- a net aggregate pre-tax, non-cash accounting gain in 1999 of $1.8 billion on our indexed debt securities and our AOL TW investment;
- a $322 million pre-tax increase in other expense in 2000 related to losses of our Latin America operations;
- a $214 million increase in net interest expense in 2000 compared to 1999 primarily due to increased levels of short-term borrowings. These increases were associated in part with borrowings to fund the purchase obligation for the acquisition of REPGB in the fourth quarter of 1999 and the first quarter of 2000, the acquisition of the REMA entities in the second quarter of 2000, other acquisitions, capital expenditures and increased margin deposits on energy trading activities; and
- an impairment loss of $27 million on marketable equity securities classified as "available-for-sale" in 2000, distributions of $9 million from venture capital investments in marketable securities classified as "trading" in 1999 and a decline of $19 million in dividend income from our AOL TW investment.

These increases in net other expense were partially offset by the following:

- an increase in interest income of $57 million primarily related to income tax refunds received in 2000 and margin deposits on energy trading activities;
- a pre-tax gain of $18 million in 2000 on the sale of our interest in one of our development stage electric generation projects; and
- a $44 million increase in our Wholesale Energy business segment's equity earnings in unconsolidated subsidiaries in 2000 as compared to 1999.

Income Tax Expense. The effective tax rate for 1999 and 2000 was 35.1% and 42.0%, respectively. The increase in the effective tax rate in 2000 compared to 1999 was primarily due to book/tax basis differences realized on the sale of our Latin American investments, including the write-off of deferred tax assets related to the Latin America business segment, partially offset by the increased earnings of REPGB. Under Dutch corporate income tax laws, the earnings of REPGB were subject to a zero percent Dutch corporate income tax rate as a result of the Dutch tax holiday in effect for the Dutch electricity industry.

RESULTS OF OPERATIONS BY BUSINESS SEGMENT

The following table presents operating income (loss) for each of our business segments for 1999, 2000 and 2001 (in millions). Some amounts from the previous years have been reclassified to conform to the 2001 presentation of the financial statements. These reclassifications do not affect consolidated earnings.

Operating Income (Loss) by Business Segment

	Year Ended December 31,		
	1999	2000	2001
		(In millions)	
Electric Operations	$ 981	$1,230	$1,091
Natural Gas Distribution	158	118	130
Pipelines and Gathering	131	137	137
Wholesale Energy	27	479	899
European Energy	32	89	56
Retail Energy	(14)	(70)	(13)
Latin America	(4)	(44)	(75)
Other Operations	(52)	(102)	(232)
Total Consolidated Operating Income	$1,259	$1,837	$1,993

Electric Operations

For a discussion of the factors that may affect the future results of operations of our Electric Operations business segment, please read "— Certain Factors Affecting Our Future Earnings — Factors Affecting the Results of Our Electric Operations."

The following table provides summary data regarding the results of operations of our Electric Operations business segment for 1999, 2000 and 2001 (in millions, except electric sales data):

	Year Ended December 31,		
	1999	2000	2001
Operating Revenues:			
Base revenues(1)	$ 2,968	$ 3,141	$ 3,022
Reconcilable fuel revenues(2)	1,515	2,353	2,483
Total operating revenues	4,483	5,494	5,505
Operating Expenses:			
Fuel and purchased power	1,559	2,412	2,538
Operation and maintenance	926	963	1,047
Depreciation and amortization	667	507	453
Other operating expenses	350	382	376
Total operating expenses	3,502	4,264	4,414
Operating Income	$ 981	$ 1,230	$ 1,091
Electric Sales (gigawatt-hours (GWh)):			
Residential	21,144	22,727	21,371
Commercial	16,616	17,594	17,967
Industrial — Firm	26,020	27,707	26,761
Industrial — Interruptible	5,460	5,542	4,298
Other	2,867	1,724	928
Total	72,107	75,294	71,325

(1) Includes miscellaneous revenues, non-reconcilable fuel revenues and purchased power-related revenues.

(2) Includes revenues collected through a fixed fuel factor and surcharges net of adjustments for over/under recovery of fuel.

2001 Compared to 2000. Our Electric Operations business segment's operating income for 2001 decreased $139 million compared to 2000. The decrease was primarily due to milder weather, decreased customer demand, increased contract services and benefit expenses and a charge recorded in the fourth quarter of 2001 resulting from the early termination of an accounts receivable factoring agreement. The decrease was also due to the implementation of the pilot program for Texas deregulation in August 2001, reduced rates for certain governmental agencies and increased administrative expenses related to the separation of our regulated and unregulated businesses. These decreases were partially offset by decreased amortization expense and customer growth.

Base revenues decreased $119 million in 2001 due to decreased customer demand as a result of the effect of milder weather compared to 2000 and decreased customer usage on a weather normalized basis. The weather impact represented approximately $84 million of the decrease in base revenues in 2001 as compared to 2000.

The 6% increase in reconcilable fuel revenue in 2001 resulted primarily from increased fuel costs as discussed below. The Texas Utility Commission provides for recovery of certain fuel and purchased power costs through a fixed fuel factor included in electric rates. Revenues collected through this factor are adjusted monthly to equal expenses; therefore, these revenues and expenses have no effect on earnings unless fuel costs are subsequently determined not to be recoverable. The adjusted over/under recovery of fuel costs is recorded in our Consolidated Balance Sheets as regulatory liabilities or regulatory assets, respectively. For information regarding the effect of the Texas Electric Restructuring Law on fuel recovery beginning in 2002, please read

"Business — Regulation — State and Local Regulations — Texas — Electric Operations — The Texas Electric Restructuring Law" in Item 1 of this Form 10-K and Note 4(c) to our consolidated financial statements for information regarding Reliant Energy HL&P fuel filings.

Fuel and purchased power expenses in 2001 increased by $126 million, or 5%, over 2000 expenses. This increase is due to increased purchased power volume related to the load balancing requirements associated with the Electric Reliability Council of Texas, Inc. (ERCOT) adapting to a single control area, with a slightly higher cost for purchased power ($44.26 and $44.42 per MWh in 2000 and 2001, respectively). The purchased power increase was partially offset by the decline in the volume of natural gas used at a slightly higher rate ($3.98 and $4.23 per MMBtu in 2000 and 2001, respectively).

Operation, maintenance and other operating expenses increased $78 million in 2001 compared to 2000 primarily due to the following items:

- a $32 million increase in benefits expense primarily driven by medical and pension costs;
- a $16 million increase in contract services due to additional major and solid fuel outages at our generating plants in 2001 compared to shorter, routine outages in 2000;
- an $11 million increase in administrative expenses related to the separation of our regulated and unregulated businesses; and
- a $20 million charge recorded in the fourth quarter of 2001 resulting from the early termination of an accounts receivable factoring agreement.

Depreciation and amortization expense decreased $54 million primarily due to a decrease in amortization of the book impairment regulatory asset recorded in June 1999 and decreased amortization expense due to regulatory assets related to cancelled projects being fully amortized in June 2000, partially offset by accelerated amortization of certain regulatory assets related to energy conservation management as required by the Texas Utility Commission. In June 1998, the Texas Utility Commission issued an order approving a transition to competition plan (Transition Plan) filed by Reliant Energy HL&P in December 1997. In order to reduce Reliant Energy HL&P's exposure to potential stranded costs related to generation assets, the Transition Plan permitted the redirection of depreciation expense to generation assets that Reliant Energy HL&P otherwise would apply to transmission, distribution and general plant assets. In addition, the Transition Plan provided that all earnings above a stated overall annual rate of return on invested capital be used to recover Reliant Energy HL&P's investment in generation assets. Reliant Energy HL&P implemented the Transition Plan effective January 1, 1998. For information regarding items that affect depreciation and amortization expense of our Electric Operations business segment pursuant to the Texas Electric Restructuring Law and the Transition Plan, see Notes 2(g) and 4(a) to our consolidated financial statements, which are incorporated herein by reference.

2000 Compared to 1999. Our Electric Operations business segment's operating income for 2000 increased $249 million compared to 1999. The increase was primarily due to decreased depreciation and amortization expense, strong customer growth and warmer weather, partially offset by increased operation and maintenance expenses and other taxes.

Base revenues increased $173 million in 2000 due to continued customer growth and increased demand from the effects of weather as compared to 1999. Growth in usage per customer and number of customers contributed $132 million of the increase in base revenues in 2000.

Fuel and purchased power expenses in 2000 increased by $853 million, or 55%, over 1999 expenses. The increase is primarily the result of higher reconcilable costs for natural gas ($2.47 and $3.98 per MMBtu in 1999 and 2000, respectively), higher costs for purchased power ($26.46 and $44.26 per MWh in 1999 and 2000, respectively) and higher sales due to customer growth and increased demand, which led to increased production.

Operation, maintenance and other operating expenses increased $69 million in 2000 compared to 1999 primarily due to the following items:

- a $25 million increase due to transmission expenses resulting from the wholesale rates established by the Texas Utility Commission;
- a $22 million increase in state franchise taxes and municipal franchise fees due to increased earnings and cash receipts;
- a $24 million assessment for the 1999 and 2000 System Benefit Fund, which was established by the Texas Electric Restructuring Law to insure that public schools were not impacted by the loss of taxes related to the lower property values of generation assets, substantially offset by a decrease in property taxes of $21 million; and
- a $22 million increase in other operation and maintenance expense.

Depreciation and amortization expense decreased $160 million primarily due to our discontinuance of recording additional depreciation and redirected depreciation pursuant to the Transition Plan, the extension of electric generation assets' depreciable lives, fully amortizing some investments in lignite reserves associated with a cancelled generation station and ceasing amortization of regulatory assets pursuant to the Texas Electric Restructuring Law.

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 a discussion of the factors that may affect future results of operations of our Natural Gas Distribution business segment, please read "— Certain Factors Affecting Our Future Earnings — Factors Affecting the Results of RERC's Operations — Natural Gas Distribution."

The following table provides summary data regarding the results of operations of our Natural Gas Distribution business segment for 1999, 2000 and 2001 (in millions, except throughput data):

	Year Ended December 31,		
	1999	2000	2001
Operating Revenues	$2,788	$4,504	$4,742
Operating Expenses:			
Natural gas	1,936	3,590	3,814
Operation and maintenance	470	553	541
Depreciation and amortization	137	145	147
Other operating expenses	87	98	110
Total operating expenses	2,630	4,386	4,612
Operating Income	$ 158	$ 118	$ 130
Throughput Data (in billion cubic feet (Bcf)):			
Residential and commercial sales	286	320	310
Industrial sales	53	57	50
Transportation	47	50	49
Retail	400	565	445
Total Throughput	786	992	854