RELIANT RESOURCES INC
Form 424B4
May 01, 2001

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FILED PURSUANT TO RULE 424(b)(4)
REGISTRATION NO. 333-48038

52,000,000 SHARES

[RELIANT RESOURCES LOGO]

RELIANT RESOURCES, INC.

Common Stock

This is an initial public offering of shares of common stock of Reliant Resources, Inc. All of the 52,000,000 shares of common stock are being sold by Reliant Resources.

Prior to this offering, there has been no public market for the common stock. Our common stock has been approved for listing on the New York Stock Exchange under the trading symbol "RRI," subject to official notice of issuance.

See "Risk Factors" on page 11 to read about factors you should consider before buying shares of common stock.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY OTHER REGULATORY BODY HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Per Share	Total
Initial public offering price.............................	$30.00	$1,560,000,000
Underwriting discount.....................................	$ 1.50	$ 78,000,000
Proceeds, before expenses, to Reliant Resources............	$28.50	$1,482,000,000

To the extent that the underwriters sell more than 52,000,000 shares of common stock, the underwriters have the option to purchase up to an additional 7,800,000 shares from Reliant Resources at the initial public offering price less the underwriting discount.

The underwriters expect to deliver the shares in New York, New York on May 4, 2001.

GOLDMAN, SACHS & CO. CREDIT SUISSE FIRST BOSTON
ABN AMRO ROTHSCHILD LLC
BANC OF AMERICA SECURITIES LLC
DEUTSCHE BANC ALEX. BROWN
MERRILL LYNCH & CO.

UBS WARBURG

Prospectus dated April 30, 2001.

[INSIDE FRONT COVER PAGE -- DESCRIPTION OF ARTWORK]

The words "RETHINK," "RESHAPE" and "RESOURCE" are superimposed on the graphics on the top half of the inside front cover page. The initial two letters "RE" of each word are in 14.5 point font, and the remaining letters of each word are in 115 point font.

Six photographs are arranged across the center of the page in a montage. From left to right and clockwise, the first photograph is of the Etiwanda plant in California, the second is of a lightbulb, the third is of a part of the Etiwanda plant, the fourth is of our trading floor, the fifth is of a gas flame, and the sixth is of the skyline of downtown Houston.

The text "Reliant Resources(TM) 2001" appears in the bottom right corner of the page.

[INSIDE FRONT COVER GATEFOLD -- DESCRIPTION OF ARTWORK]

The word "ASSETS" appears at the top center of the gatefold.

Under the word "ASSETS," text near the top center of the gatefold reads "Net generation capacity has tripled to 12,707 MW since 1998."

A photograph of five of our employees on our trading floor appears in the top left corner of the gatefold.

A photo of two people conducting a business transaction appears in the top right corner of the gatefold.

The words "OUR STRATEGY" appear in the middle center of the gatefold.

Directly under the words "OUR STRATEGY," the text reads "To aggressively pursue growth opportunities in the restructuring electric markets where our skills-based commercial approach provides us with a competitive advantage."

A photograph of the Etiwanda plant appears in the lower center of the gatefold.

The word "TRADING" appears in the lower left corner of the gatefold above text that reads "One of only five companies to rank in the top ten for both power and natural gas trading."

The words "LONG-TERM CONTRACTS" appear in the lower right corner of the gatefold above text that reads "Profit by marketing the capacity of other generators."

[INSIDE BACK COVER -- DESCRIPTION OF ARTWORK]

A photograph of a house appears in the top right corner of the back cover.

Under the photograph, the words "SELECT RETAIL MARKETS" appear above text that reads "Capitalize on the retail opportunities in Texas, and target additional markets with favorable regulatory structures."

The Reliant Resources logo in white on a dark background appears in

the bottom right corner of the back cover page.

PROSPECTUS SUMMARY

This summary highlights selected information described more fully elsewhere in this prospectus. This summary does not contain all the information you should consider before investing in our common stock. You should read the entire prospectus, including the financial statements and related notes, before making an investment decision with respect to our common stock.

OUR BUSINESS

We are a rapidly growing provider of electricity and energy services with a focus on the competitive segments of the electric power industry in the United States and Europe. We acquire, develop and operate electric power generation facilities that are not subject to traditional cost-based regulation and therefore can sell power at prices determined by the market. We acquired our first power generation facilities in 1998 and have grown our aggregate net generation capacity to 12,707 megawatts, or "MW," as of March 31, 2001. We also trade and market power, natural gas and other energy-related commodities and provide related risk management services. We believe our trading, marketing, and risk management skills complement our generation positions. The combination provides greater scale and skill associated with the management of our fuel and power positions, sophisticated commercial insights and an understanding of the key regions in which we participate, and a wider range of ways in which we participate in the market and are able to meet customer needs.

We intend to become a provider of retail electric services in Texas when the market opens to retail competition in January 2002 and in other U.S. markets with favorable regulatory structures and profit opportunities thereafter. We will initially succeed to a significant retail electric customer base in the Houston, Texas metropolitan area. We intend to build our retail business elsewhere by capitalizing on the skills and systems we are building for the competitive market in Houston.

We believe that the combination of our high quality portfolio of power generation assets, our sophisticated trading, marketing and risk management operations and our anticipated retail electric customer base in Texas provides us with the foundation to successfully capitalize on the attractive growth opportunities in the deregulating electric power markets. We also engage in other businesses, specifically eBusiness, communications and venture capital, that we believe provide potential opportunities for future growth.

As of March 31, 2001, we owned or leased electric power generation facilities with an aggregate net generating capacity of 12,707 MW located in five regions of the United States and in the Netherlands. We also had 2,770 MW of generating capacity under construction as of that date. The following table describes our facilities.

	NET GENERATING CAPACITY (IN MW)		
REGION	OPERATING	UNDER CONSTRUCTION	TOTAL
Mid-Atlantic	4,262	--	4,262
Southwest	4,045	563	4,608

Midcontinent	255	962	1,217
Florida	619	464	1,083
Texas(1)	50	781	831
Netherlands	3,476	--	3,476
Total	12,707	2,770	15,477

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(1) We also have an option, which is exercisable in January 2004, to acquire Reliant Energy's 81% interest in a company owning 14,040 MW of net generating capacity in Texas. For additional information regarding this option, which we refer to as the "Texas Genco option," please read "Texas Genco Option."

OUR MARKET OPPORTUNITY

Historically, electricity in the United States has been generated, distributed and sold by regulated, vertically-integrated utilities with government granted franchises to provide electric services to customers within specific geographic areas. Retail electricity rates have traditionally been set by regulatory authorities at levels intended to allow utilities to earn a targeted rate of return on their invested capital. The U.S. electric power industry is experiencing significant changes as a result of varying restructuring initiatives at both the state and federal levels.

The restructuring in the U.S. electric power industry, including the unbundling of many vertically-integrated utilities, creates attractive growth opportunities in the wholesale and retail electric markets. These opportunities are summarized below.

- OPPORTUNITY TO DEVELOP ADDITIONAL GENERATION FACILITIES. Growth in demand for power during the 1990s has significantly outpaced the addition of power generating capacity in many U.S. markets. In addition, environmental regulations continue to impact the economic viability of some existing generating capacity. Consequently, we believe there are significant opportunities for us to develop additional power generation facilities.

- OPPORTUNITY TO ACQUIRE EXISTING GENERATION FACILITIES. From 1997 through January 31, 2001, approximately 132,000 MW of generating capacity have been sold or contracted to be sold by vertically-integrated utilities responding to the changing regulatory environment. We expect additional generating capacity to be sold as states restructure their electric markets and companies continue to refine their strategic directions. We believe that these divestitures will provide considerable opportunities for us to acquire existing generating capacity.

- OPPORTUNITY TO MANAGE ENERGY-RELATED RISKS. Power industry restructuring is changing the manner in which power is purchased and consumed. Under the traditional regulatory framework, customers typically purchase power from a vertically-integrated utility at prices that do not vary as a function of usage pattern or the overall supply/demand balance in the market. However, in competitive markets, customers have the opportunity to purchase electricity from a variety of sources at market prices that reflect the actual price of electricity at a given point in time. As a result, end users are subject to greater volatility in power prices. We

believe that there are attractive opportunities for us, as a retail electric provider and intermediary, to manage these risks for customers and to structure products to meet their demand profiles and risk tolerances.

OUR STRATEGY

Our strategy is to aggressively pursue profitable opportunities in deregulating wholesale and retail electric markets in order to deliver superior value to our stockholders. We actively pursue opportunities where we believe our skills-based commercial approach provides us with a competitive advantage. We currently do not have any plans to invest outside the United States and Europe.

OUR STRATEGY IN THE U.S. WHOLESALE MARKET

We plan to continue to expand our regional asset portfolios and commercial positions in the United States and to maximize their profitability. In order to achieve these goals, we plan to:

- Capitalize on significant market positions in targeted regions of the United States that we believe have attractive market fundamentals and growth opportunities.

- Target strategic asset portfolios in our regional markets based on prevailing supply and demand fundamentals in order to be able to meet the full electricity requirements of customers.

- Grow through a combination of disciplined acquisitions, development of new facilities and long-term contracts.

- Apply our trading, marketing and risk management skills to complement the value of our generation operations.

OUR STRATEGY IN THE EUROPEAN WHOLESALE MARKET

We plan to maximize the value of our European operations and position ourselves for long-term growth opportunities in the European marketplace. In order to achieve these goals, we plan to:

- Optimize our portfolio of generation assets in the Netherlands by reducing operating, maintenance and administrative costs while increasing operational flexibility and commercializing these assets in the deregulating Dutch market.

- Apply our commercial capabilities and incumbent position in the Netherlands to opportunistically participate in additional European markets.

OUR STRATEGY IN THE U.S. RETAIL MARKET

We plan to establish a significant retail electric business in Texas when the market opens to retail competition, and elsewhere in the United States as attractive retail opportunities develop thereafter. In order to achieve these goals, we plan to:

- Maximize retention of customers we will succeed to in Houston by capitalizing on the high level of consumer awareness and positive perception of the Reliant Energy brand name and by offering value-added commodities and services.

- Aggressively pursue Texas customers outside of Reliant Energy's Houston service territory by capitalizing on our competitive strengths and providing creative product offerings to encourage them to choose us as their retail electric provider.

- Leverage our retail experience to pursue opportunities in targeted markets outside Texas that have favorable regulatory structures and profit opportunities.

- Capitalize on our wholesale trading, marketing and risk management expertise to enhance our competitive retail position.

Increasing competition in the wholesale and retail segments of the electric power industry may impede our ability to successfully implement our strategy. We compete with numerous competitors in our wholesale markets. After the beginning of retail electric competition in Texas in January 2002, we expect that our retail electric operations will face significant competition from new retail electric providers entering the Houston metropolitan area as well as retail affiliates of incumbent utilities in other markets in Texas. We expect that we will need to secure external sources of capital to finance our future acquisition and development activities. Any failure to obtain future sources of capital on commercially acceptable terms may limit our ability to successfully implement our growth strategy. Our wholesale and retail energy businesses operate in the deregulating segments of the electric power industry created by restructuring initiatives at both the state and federal levels. We cannot predict the future development of deregulation in these markets or the ultimate effect that the changing regulatory environment will have on our businesses. As a result of recent market volatility in California's power markets, governmental agencies or officials and/or other interested parties in a number of states, including states that had previously adopted laws or regulatory plans providing for future retail electric competition, are urging that deregulation of the retail electric markets of such states be delayed or reconsidered altogether. In addition, existing regulations may be revised or reinterpreted and new laws or regulations, including price regulations, may be adopted that adversely affect our businesses and strategic opportunities.

OUR RELATIONSHIP WITH RELIANT ENERGY

We are currently a wholly owned subsidiary of Reliant Energy, Incorporated. Reliant Energy is an international energy delivery and energy services company based in Houston, Texas. Upon the completion of this offering, Reliant Energy will own over 80% of the outstanding shares of our common stock. Reliant Energy has announced that it currently plans to complete a spin-off of our company within twelve months of the completion of this offering by distributing the remaining shares of our common stock it owns to its shareholders. Following the distribution, we expect Reliant Energy will remain engaged in the transmission and distribution of electric power and the transportation and distribution of natural gas. It will also remain engaged in power generation, subject to our Texas Genco option.

We have entered into agreements with Reliant Energy related to the separation of our businesses from Reliant Energy. These separation agreements provide for the transfer of assets and liabilities relating to our businesses. These agreements also govern interim and ongoing relationships with Reliant Energy, including the provision by Reliant Energy to us of various interim services.

Reliant Resources, Inc. was incorporated in Delaware in August 2000 as a

wholly owned subsidiary of Reliant Energy. We are the successor to businesses in which subsidiaries of Reliant Energy have previously been engaged. Our executive offices are located at 1111 Louisiana, Houston, Texas 77002, and our telephone number is (713) 207-3000.

RISK FACTORS

You should carefully consider the competitive factors affecting our businesses as well as the other risks described in the "Risk Factors" section of this prospectus before investing in our common stock. Any of these risks could impair our business, financial condition and operating results, which could cause the trading price of our common stock to decline and could result in a partial or total loss of your investment.

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THE OFFERING

The following information assumes that the underwriters do not exercise the option we granted them to purchase additional shares of common stock in the offering. Please read "Underwriting."

Shares offered..............................	52,000,000 shares
Shares outstanding after the offering........	292,000,000 shares
Shares held by Reliant Energy after the offering..................................	240,000,000 shares
Use of proceeds.............................	We intend to use the net proceeds from this offering for general corporate purposes including development activities and acquisitions. Please read "Use of Proceeds."
New York Stock Exchange trading symbol.......	Our common stock has been approved for listing on the New York Stock Exchange under the trading symbol "RRI," subject to official notice of issuance.

The number of shares outstanding after this offering excludes shares available for issuance upon exercise of options that have been or may be granted in the future under our long-term incentive plan.

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SUMMARY FINANCIAL DATA

You should read the following summary financial data together with our consolidated financial statements and the related notes, "Selected Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus. The summary financial data set forth below for the years ended December 31, 1998, 1999 and 2000 have been derived from our consolidated audited financial statements.

Our pro forma income statement data for the year ended December 31, 2000 give effect to our May 2000 acquisition of 21 generating facilities from Sithe Energies, Inc., or the "Mid-Atlantic Acquisition," the subsequent sale-leaseback of three of these facilities, or the "Sale-Leaseback," and the recapitalization of $1.8 billion of our Net Notes Payable to Affiliates into Stockholder's Equity, or the "Recapitalization." Our pro forma balance sheet data as of December 31, 2000 give effect to the Recapitalization. Our pro forma, as

adjusted balance sheet data as of December 31, 2000 reflect the Recapitalization, the sale of shares of our common stock in this offering, the estimated net proceeds from this offering and the application of a portion of the net proceeds from this offering to repay certain indebtedness we owe Reliant Energy. For further information regarding the pro forma effects of these transactions, please read our unaudited pro forma condensed consolidated financial statements included elsewhere in this prospectus.

	YEAR ENDED DECEMBER 31,		
	1998	1999(2)	2000
	(in millions, except per share inf		
INCOME STATEMENT DATA:			
Revenues	$4,371	$7,956	$19,792
Expenses:			
Fuel and cost of gas sold	2,352	3,948	10,582
Purchased power	1,824	3,729	7,852
Operation and maintenance	65	142	446
General, administrative and development	78	94	280
Depreciation and amortization	15	29	194
Total	$4,334	$7,942	$19,354
Operating Income	$ 37	$ 14	$ 438
Other (Expense) Income:			
Interest expense	(2)	(9)	(42)
Interest income	1	--	21
Interest income (expense) -- affiliated companies, net	2	(10)	(172)
Gains (losses) from investments	--	16	(17)
(Loss) income of equity investment of unconsolidated subsidiaries	(1)	21	43
Gain on sale of development project	--	--	18
Other, net	1	(6)	2
Total Other Income (Expense)	$ 1	$ 12	$ (147)
Income Before Income Taxes and Extraordinary Item	$ 38	$ 26	$ 291
Income Tax Expense	17	2	88
Income Before Extraordinary Item	$ 21	$ 24	$ 203
Extraordinary Item, net of tax	--	--	7
Net Income	$ 21	$ 24	$ 210

PRO FORMA EARNINGS PER SHARE INFORMATION(1):	
Basic and Diluted Earnings Before Extraordinary Item Per Common Share	$ 1.31
Basic and Diluted Weighted Average Shares Outstanding	240,000,000

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	YEAR ENDED DECEMBER 31,		
	1998	1999	2000
	(in millions)		
STATEMENT OF CASH FLOW DATA:			
Cash Flows From Operating Activities	$ (2)	$ 38	$ 325
Cash Flows From Investing Activities	(365)	(1,406)	(3,013)
Cash Flows From Financing Activities	379	1,405	2,724

	AS OF DECEMBER 31, 2000		
	ACTUAL	PRO FORMA	PRO FORMA, ADJUSTED
	(in millions)		
BALANCE SHEET DATA:			
Cash and Cash Equivalents	$ 90	$ 90	$ 1,526
Property, Plant and Equipment, net	4,049	4,049	4,049
Total Assets	13,592	13,592	15,028
Short-term Borrowings	126	126	126
Long-term Debt to Third Parties, including current maturities	892	892	892
Accounts and Notes Payable -- Affiliated Companies, net	1,969	142	106
Stockholder's Equity	2,332	4,159	5,631

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(1) Pro forma earnings per share gives effect to the 240,000 to 1 stock split of our common stock.

(2) The 1999 consolidated financial statements have been revised to reflect the presentation of an acquired business' results of operations for a two-month period in 1999 under the equity method of accounting rather than under the consolidation method. There was no effect on our previously reported net income for 1999 or our total assets as of December 31, 1999. For additional information regarding the acquisition, please read Note 5(b) to our consolidated financial statements.

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RECENT DEVELOPMENTS

	THREE MONTHS ENDED MARCH 31,	
	2000	2001
	(in millions)	

CONSOLIDATED RESULTS OF OPERATIONS:		
Revenues	$2,321	$9,871
Operating Income	2	114
Income of Equity Investments of Unconsolidated Subsidiaries	1	13
Net (Loss) Income	(23)	82
RESULTS OF OPERATIONS BY BUSINESS SEGMENT:		
Wholesale Energy	$ (22)	$ 216
European Energy	35	18
Retail Energy	(8)	(3)
Other Operations	(3)	(117)
Total Consolidated Operating Income	$ 2	$ 114

Revenues increased $7.6 billion for the three months ended March 31, 2001 compared to the same period in 2000. The increase was primarily due to an increase in prices for gas and power sales and to a lesser extent higher volumes of both power and gas sales.

Operating income increased $112 million for the three months ended March 31, 2001 compared to the same period in 2000. The increase was primarily due to higher prices for energy and ancillary services, increased energy sales volumes, additional wholesale operations in the Mid-Atlantic region and strong commercial and operational performance in other regions served by our Wholesale Energy segment. The increase in operating income was partially offset by the following:

- a pre-tax, non-cash charge of $100 million relating to the redesign of some of Reliant Energy's benefit plans in anticipation of our separation from Reliant Energy,

- a $38 million provision against receivable balances related to our energy sales during the three months ended March 31, 2001 in the California market, and

- a decrease in margins for our European Energy segment as the Dutch wholesale electric market was completely opened to competition on January 1, 2001.

Wholesale Energy's wholesale power sales in the first quarter of 2001 increased 171% compared to the first quarter of 2000, from 28 million megawatt hours (MMWh) to 76 MMWh, and its natural gas sales increased 40%, from 549 billion cubic feet (Bcf) to 767 Bcf, over the same periods.

For additional information about the above benefit charge, please read Notes 9(b) and 9(d) to our consolidated financial statements.

As of March 31, 2001, we were owed a total of $337 million by the California Independent System Operator, the California Power Exchange, the California Department of Water Resources and California Energy Resources Scheduling for energy sales in the California wholesale market during the fourth quarter of 2000 through March 31, 2001. For additional information regarding the uncertainties in the California wholesale energy market, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Competition and Restructuring of the Wholesale Electricity Market" as well as Notes 11(e) and 11(h) to our consolidated financial statements.

For additional information on factors that may affect the future operating results of our European Energy segment, please read "Risk Factors -- Risks

Related to Our Wholesale Business -- We will experience a significant decline in our European Energy business segment's

gross margin in 2001" and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Our European Operations."

Wholesale Energy reported income from equity investments for the three months ended March 31, 2001 of $13 million compared to $0.5 million in the same period in 2000. The equity income in 2001 primarily resulted from an investment in an electric generation plant in Boulder City, Nevada. The plant became operational in May 2000.

Net income for the three months ended March 31, 2001 increased by $105 million compared to the same period in 2000. The increase was primarily due to increased operating income, as described above, and a pre-tax impairment loss of $27 million related to certain marketable equity securities in the first quarter of 2000. This increase was partially offset by a $48 million increase in our income tax expense due to higher operating income. For additional discussion of our investment in the equity securities noted above, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Consolidated Results of Operations -- 2000 Compared to 1999" and Note 2(l) to our consolidated financial statements.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This prospectus, including the sections entitled "Prospectus Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Our Business," contains forward-looking statements. These statements relate to future events, our future financial performance or our projected business results and involve known and unknown risks and uncertainties. Actual results may differ materially from those expressed or implied by these statements. In some cases, you can identify our forward-looking statements by the words "anticipates," "believes," "continue," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "should," "will" or other similar words.

The following list identifies some of the factors that could cause actual results to differ from those expressed or implied by our forward-looking statements:

- state, federal and international legislative and regulatory developments, including deregulation, re-regulation and restructuring of the electric utility industry, including the retail electric market in Texas, and changes in or application of environmental and other laws and regulations to which we are subject,

- the effects of competition, including the extent and timing of the entry of additional competitors in our markets,

- our pursuit of potential business strategies, including acquisitions or dispositions of assets or the development of additional power generation facilities,

- state, federal and other rate regulations in the United States and in foreign countries in which we operate or into which we might expand our

operations,

- the timing and extent of changes in commodity prices and interest rates,

- weather variations and other natural phenomena,

- political, legal and economic conditions and developments in the United States and in foreign countries in which we operate or into which we might expand our operations, including the effects of fluctuations in foreign currency exchange rates,

- financial market conditions and the results of our financing efforts,

- the performance of projects undertaken and the success of our efforts to invest in and develop new opportunities, and

- other factors we discuss in this prospectus, including those outlined in "Risk Factors" and in "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings."

We have based our forward-looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that assumptions, beliefs, expectations, intentions and projections about future events may and often do vary materially from actual results. Therefore, actual results may differ materially from those expressed or implied by our forward-looking statements.

RISK FACTORS

You should carefully consider the risks described below as well as other information contained in this prospectus before buying shares of our common stock in this offering. These are the risks we consider to be material to your decision whether to invest in our common stock at this time. There may be risks that you view in a different way than we do, and we may omit a risk that we consider immaterial but that you would consider important. If any of the following risks occur, our business, financial condition or results of operations could be materially harmed. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

RISKS RELATED TO OUR WHOLESALE BUSINESS

OUR REVENUES AND RESULTS OF OPERATIONS ARE SUBJECT TO MARKET RISKS THAT ARE BEYOND OUR CONTROL.

We sell electricity from our power generation facilities into the spot market or other competitive power markets or on a contractual basis. We are not guaranteed any rate of return on our capital investments through mandated rates, and our revenues and results of operations are likely to depend, in large part, upon prevailing market prices for electricity in our regional markets and other competitive markets. These market prices may fluctuate substantially over relatively short periods of time. In addition, the Federal Energy Regulatory Commission, or "FERC," which has jurisdiction over wholesale power rates, as well as independent system operators that oversee some of these markets, may impose price limitations, bidding rules and other mechanisms to address some of the volatility in these markets. Most of our domestic power generation facilities purchase fuel under short-term contracts or on the spot market. Fuel prices may also be volatile, and the price we can obtain for power sales may not change at the same rate as changes in fuel costs. These factors could have an

adverse impact on our revenues and results of operations.

Volatility in market prices for fuel and electricity may result from:

- weather conditions,
- seasonality,
- electricity usage,
- illiquid markets,
- transmission or transportation constraints or inefficiencies,
- availability of competitively priced alternative energy sources,
- demand for energy commodities,
- natural gas, crude oil and refined products, and coal production levels,
- natural disasters, wars, embargoes and other catastrophic events, and
- federal, state and foreign energy and environmental regulation and legislation.

WE DO NOT ATTEMPT TO FULLY HEDGE OUR ASSETS OR POSITIONS AGAINST CHANGES IN COMMODITY PRICES, AND OUR HEDGING PROCEDURES MAY NOT WORK AS PLANNED.

To lower our financial exposure related to commodity price fluctuations, our trading, marketing and risk management operations routinely enter into contracts to hedge a portion of our purchase and sale commitments, weather positions, fuel requirements and inventories of natural gas, coal, crude oil and refined products, and other commodities. As part of this strategy, we routinely utilize fixed-price forward physical purchase and sales contracts, futures, financial swaps and option contracts traded in the over-the-counter markets or on exchanges. However, we do not expect to cover the entire exposure of our assets or our positions to market price volatility and the coverage will vary over time. To the extent we have unhedged positions, fluctuating commodity prices can impact our financial results and financial position, either favorably or unfavorably.

At times we have open trading positions in the market, within established guidelines, resulting from the management of our trading portfolio. To the extent open trading positions exist, fluctuating commodity prices can impact our financial results and financial position, either favorably or unfavorably.

The risk management procedures we have in place may not always be followed or may not always work as planned. As a result of these and other factors, we cannot predict with precision the impact that our risk management decisions may have on our businesses, operating results or financial position. Although we devote a considerable amount of management efforts to these issues, their outcome is uncertain.

Our trading, marketing and risk management operations are exposed to the risk that counterparties which owe us money or energy as a result of market transactions will not perform their obligations. Should the counterparties to these arrangements fail to perform, we might be forced to acquire alternative hedging arrangements or honor the underlying commitment at then-current market prices. In such event, we might incur additional losses to the extent of amounts, if any, already paid to the counterparties.

In connection with our trading and marketing operations, we have guaranteed or indemnified the performance of a portion of the obligations of our trading and marketing subsidiaries. Some of these guarantees and indemnities are for fixed amounts, others have a fixed maximum amount and others do not specify a maximum amount. The obligations underlying these guarantees and indemnities are recorded on our consolidated balance sheet as price risk management liabilities. These obligations make up a significant portion of these line items. We might not be able to satisfy all of these guarantees and indemnification obligations if they were to come due at the same time.

RECENT HIGH PRICES IN THE CALIFORNIA WHOLESALE POWER MARKETS HAVE NEGATIVELY IMPACTED THE OPERATING RESULTS AND FINANCIAL STABILITY OF SOME OF CALIFORNIA'S PUBLIC UTILITIES. THIS HAS LED TO DEFAULTS BY THESE UTILITIES ON THEIR OBLIGATIONS TO PAY FOR PURCHASED POWER AND, IN THE CASE OF PACIFIC GAS AND ELECTRIC COMPANY, THE FILING OF A VOLUNTARY PETITION FOR BANKRUPTCY. AS A RESULT, OUR WHOLESALE POWER OPERATIONS SERVING THE WESTERN MARKET HAVE BEEN CAUGHT UP IN A MAJOR CRISIS IN THE WESTERN WHOLESALE ELECTRIC MARKETS AND NOW FACE DELAYS IN THE COLLECTION OF RECEIVABLES, THE POSSIBILITY OF LESS THAN FULL PAYMENT FOR POWER SOLD IN THOSE MARKETS AND AN INCREASED POSSIBILITY OF RE-REGULATION OF CERTAIN ASPECTS OF SUCH OPERATIONS.

During the summer and fall of 2000, prices for wholesale electricity in California increased dramatically as a result of a combination of factors. Please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Our Future Earnings -- Competition and Restructuring of the Wholesale Electricity Market" for a discussion of the California power crisis.

Although wholesale prices increased, California's deregulation legislation kept retail rates frozen below 1996 levels. This caused two of California's public utilities, which are our customers based on our deliveries to the California Power Exchange, or "Cal PX," and the California Independent System Operator, or "Cal ISO," to accrue billions of dollars of unrecovered wholesale power costs. As a result, the credit ratings of these two public utilities were severely downgraded to below investment grade in January 2001. As their credit lines became unavailable, the two utilities defaulted on payments due to the Cal PX and the Cal ISO, which operate financially as pass-through entities, coordinating payments from buyers and sellers of electricity. As a result, the Cal PX and Cal ISO were not able to pay final invoices to market participants totaling over $1 billion.

Because California's power reserves remain at low levels, in part as a result of the lack of creditworthy buyers of power given the defaults of the California utilities, the Cal ISO has relied on emergency dispatch orders requiring generators to provide at the Cal ISO's direction all

power not already under contract. The power supplied to the Cal ISO has been used to meet the needs of the customers of the utilities, even though two of those utilities do not have the credit required to receive such power under the Cal ISO's tariff and may be unable to pay for it. The Cal ISO had previously obtained a preliminary injunction on March 21, 2001 from a federal district court in California compelling us to comply with emergency dispatch orders despite the utilities' failure to meet credit standards. The district court issued the preliminary injunction based on the conclusion that the Cal ISO's tariff provisions regarding credit were not applicable to emergency dispatch orders. On March 22, 2001, we filed a notice of appeal of the district court's injunction with the Ninth Circuit Court of Appeals and on March 23, 2001, we filed an emergency motion for stay of the injunction. Because we showed a "high likelihood of success on the merits" on the appeal, the Ninth Circuit granted

the stay on April 5, 2001 suspending the district court's preliminary injunction pending its final ruling on the appeal. On April 6, 2001, the FERC issued an order confirming that the credit provisions of the Cal ISO's tariff apply to all sales of electricity under the tariff, including emergency dispatch orders. As a result of the FERC's order, the district court's preliminary injunction expired in accordance with its terms and we expect that the district court will dismiss the Cal ISO's complaint. Therefore, we no longer need to pursue any further appeal to the Ninth Circuit since we will no longer be compelled to comply with emergency dispatch orders in the absence of a creditworthy counterparty. As of March 31, 2001, we were owed $108 million for power provided in compliance with emergency dispatch orders.

As of December 31, 2000, we were owed $101 million by the Cal PX and $181 million by the Cal ISO. In the fourth quarter of 2000, we recorded a pre-tax provision of $39 million against receivable balances related to energy sales in the California market. From January 1, 2001 through March 31, 2001, we had collected $110 million of these receivable balances. As of March 31, 2001, we were owed a total of $337 million by the Cal ISO, the Cal PX, the California Department of Water Resources, or "CDWR," and California Energy Resources Scheduling for energy sales in the California wholesale market during the fourth quarter of 2000 through March 31, 2001. In the first quarter of 2001, we recorded a pre-tax provision of $38 million against receivable balances related to energy sales from January 1, 2001 through March 31, 2001 in the California market. On March 27, 2001, the California Public Utility Commission, or "CPUC," approved an increase in the retail rates of the two defaulting California utilities but ordered the utilities to apply the increase to pay the CDWR for power purchased by the CDWR on the utilities' behalf. Because the CPUC order attempts to prevent use of the increased revenue to pay suppliers for electricity delivered before the date of the decision, the rate increase does not address the existing indebtedness of the utilities. On April 6, 2001, one of these utilities, Pacific Gas and Electric Company, filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of California. In that proceeding, we anticipate that Pacific Gas and Electric will seek to modify or remove the CPUC's limits on the March 27, 2001 rate increase revenues. Along with other creditors, we also expect to seek such modifications or removal of limitations to permit the court to adequately address the utility's existing debts. Although the other utility, Southern California Edison Company, has publicly indicated that it hopes to avoid filing for bankruptcy protection, a number of its creditors have indicated that unless there is more action on a plan to restore the utility's solvency, an involuntary bankruptcy filing may be made by such creditors. Many of these creditors have already filed lawsuits, including attachment lawsuits, over amounts owed. In an effort to avert the possibility of a bankruptcy filing, on April 9, 2001, Southern California Edison announced that it had signed a memorandum of understanding with the state of California providing for the sale of its transmission system to the CDWR or another state agency for approximately $2.76 billion. The bankruptcy filing by Pacific Gas and Electric or a future bankruptcy filing by Southern California Edison could each result in significant delays in collecting our past receivables from these utilities.

A TAX ON "WINDFALL PROFITS" EARNED BY ELECTRIC GENERATORS AND COMPANIES THAT ARE IN THE BUSINESS OF BUYING AND SELLING ELECTRIC POWER IN THE STATE OF CALIFORNIA HAS BEEN PROPOSED IN THE CALIFORNIA STATE LEGISLATURE. IF SUCH A TAX TARGETING THE WHOLESALE SEGMENT OF THE ELECTRIC POWER INDUSTRY IN THE STATE WAS PASSED, THE RESULTS OF OPERATIONS OF OUR WHOLESALE BUSINESS COULD BE MATERIALLY ADVERSELY AFFECTED AND OUR WILLINGNESS TO DEVELOP ADDITIONAL POWER GENERATION FACILITIES IN THE REGION COULD BE DIMINISHED.

In April 2001, a bill was introduced in the California state legislature

that proposed the adoption of a tax on "windfall profits" earned for any taxable year beginning on or after January 1, 2001 by electric generators and companies that are in the business of buying and selling electric power in the state of California. Although many of the significant aspects of the tax, including the proposed tax rates and the definition of "windfall profits," were not completely specified in the bill, the sponsoring legislators have publicly stated that the intent of the bill is to tax revenues earned for selling electric power that "significantly exceed" the cost of producing power. At this time, we cannot predict whether this legislation will be enacted, or if enacted, what form it will take or whether it may be legally applied to our operations. However, if such a tax targeting the wholesale segment of the electric power industry in the state was passed, the results of operations of our Wholesale Energy segment could be materially adversely affected. In addition, if adopted, such a tax could significantly increase the cost of operating power generation facilities serving the California market which could diminish our willingness to develop additional power generation facilities in the region. A reduction of attractive generation opportunities could impair our ability to implement our growth strategy.

OUR ACQUISITION AND PROJECT DEVELOPMENT ACTIVITIES MAY NOT BE SUCCESSFUL, WHICH WOULD IMPAIR OUR ABILITY TO EXECUTE OUR GROWTH STRATEGY.

Our business involves numerous risks relating to the acquisition, development and construction of power generation facilities. We may not be able to identify attractive acquisition or development opportunities or complete acquisitions or development projects that we undertake. If we are not able to identify and complete additional acquisitions and development projects, we will not be able to successfully execute our growth strategy. In addition, the success of our future acquisitions or development projects will depend on the appropriateness of the prices we pay for them. If our assumptions underlying the prices we pay for future acquisitions or development projects prove to be materially inaccurate, there could be a significant impact on the financial performance of the particular facility and possibly our entire company. The following factors could cause our acquisition and development activities to be unsuccessful:

- a limited number of potential acquisitions,
- competition,
- the applicable regulatory environment,
- inability to obtain additional capital on acceptable terms,
- inability to obtain required governmental permits and approvals,
- cost-overruns or delays in development that make continuation of a project impracticable,
- inability to obtain combustion turbines or other key equipment components at reasonable prices,
- inability to negotiate acceptable acquisition, construction, fuel supply or other material agreements, and
- inability to hire and retain qualified personnel.

Currently, we have power generation facilities under development or construction and we intend to pursue additional development projects, including

the expansion of some of our existing facilities. Our completion of these facilities is subject to the following substantial risks:

- changes in market prices,
- shortages and inconsistent qualities of equipment, material and labor,
- work stoppages,
- permitting and other regulatory matters,
- adverse weather conditions,
- unforeseen engineering problems,
- environmental and geological conditions, and
- unanticipated cost increases.

Any of these factors could give rise to delays, cost overruns or the termination of the plant expansion, construction or development. Many of these risks cannot be adequately covered by insurance. While we maintain insurance, obtain warranties from vendors and obligate contractors to meet specified performance standards, the proceeds of such insurance, warranties or performance guarantees may not be adequate to cover lost revenues, increased expenses or liquidated damages payments we may owe.

If we were unable to complete the development of a facility, we would generally not be able to recover our investment in the project. The process for obtaining initial environmental, siting and other governmental permits and approvals is complicated, expensive, lengthy and subject to significant uncertainties. In addition, construction delays and contractor performance shortfalls can result in the loss of revenues and may, in turn, adversely affect our results of operations. The failure to complete construction according to specifications can result in liabilities, reduced plant efficiency, higher operating costs and reduced earnings. We may not be successful in the development or construction of power generation facilities in the future.

WE INCUR SIGNIFICANT EXPENSES IN EVALUATING POTENTIAL ACQUISITIONS AND DEVELOPMENT PROJECTS.

To implement our growth strategy, we must continue to actively pursue acquisition and development opportunities. We often incur substantial expenses in investigating and evaluating a potential business development opportunity before we can determine whether the opportunity is feasible or economically attractive. In addition, we expect to participate in many competitive bidding processes or other negotiations for power generation facilities that require us to incur substantial expenses without any assurance that our bids or proposals will be accepted.

SOME OPPORTUNITIES TO ACQUIRE POWER GENERATION ASSETS MAY BE AVAILABLE ONLY IF WE ARE ALSO WILLING TO ACQUIRE REGULATED UTILITY OPERATIONS.

In the current changing environment for the electric power industry, integrated utility companies may become available for acquisition from time to time. These potential acquisitions may present attractive opportunities to acquire additional power generation assets. However, in order to consummate an acquisition of this nature, we may be required to acquire the entire integrated utility company. The entire company may include transmission and distribution operations that continue to be subject to rate regulation. In addition, some power generation assets that are available for acquisition may continue to be subject to state regulation. To address the regulatory issues presented by such

an acquisition, we might seek to find another buyer for regulated operations of the target company that we did not wish to own. Alternatively, if we were to acquire regulated operations ourselves either on an interim or permanent basis, we would need to find acceptable means of addressing constraints or obstacles that may be imposed by applicable state regulatory regimes or by the Public Utility Holding Company Act of 1935, or the "1935 Act." These regulatory issues, or their solutions, may increase the complexity

or reduce the likelihood of closing a transaction of this type and acquiring the targeted power generation assets.

WE HAVE MADE SUBSTANTIAL INVESTMENTS IN OUR RECENT ACQUISITIONS AND DEVELOPMENT PROJECTS, AND OUR SUCCESS DEPENDS ON OUR ABILITY TO SUCCESSFULLY INTEGRATE, OPERATE AND MANAGE THESE ASSETS.

During the period from December 31, 1998 through March 31, 2001, we have expanded our net generating capacity from 3,800 MW to 12,707 MW. In connection with these acquisitions and projects, we have hired a substantial number of new employees. We may not be able to successfully integrate all of the newly hired employees, or profitably integrate, operate, maintain and manage our newly acquired or developed power generation facilities in a competitive environment.

OPERATION OF POWER GENERATION FACILITIES INVOLVES SIGNIFICANT RISKS THAT COULD NEGATIVELY AFFECT OUR REVENUES AND RESULTS OF OPERATIONS.

We are exposed to risks relating to the breakdown or failure of equipment or processes, fuel supply interruptions, shortages of equipment, material and labor, and operating performance below expected levels of output or efficiency. A significant portion of our facilities were constructed many years ago. Older generating equipment, even if maintained in accordance with good engineering practices, may require significant capital expenditures to keep it operating at peak efficiency. This equipment is also likely to require periodic upgrading and improvement. Any unexpected failure to produce power, including failure caused by breakdown or forced outage, could result in reduced earnings.

WE WILL EXPERIENCE A SIGNIFICANT DECLINE IN OUR EUROPEAN ENERGY BUSINESS SEGMENT'S GROSS MARGIN IN 2001.

On January 1, 2001, our Dutch subsidiary, N.V. UNA, or "UNA," began operating in a competitive market. Consistent with our expectations at the time we acquired UNA, we anticipate that UNA will experience a significant decline in gross margin in 2001 attributable to the deregulation of the market and termination of an agreement with the other Dutch generators and the Dutch distributors. In addition, the results of our European Energy segment will be negatively impacted beginning in 2002 due to the imposition of a standard Dutch corporate income tax rate, which is currently 35%, on the income of UNA. In 2000 and prior years, UNA's Dutch corporate income tax rate was zero percent.

OUR COSTS OF COMPLIANCE WITH ENVIRONMENTAL LAWS ARE SIGNIFICANT AND THE COST OF COMPLIANCE WITH NEW ENVIRONMENTAL LAWS COULD ADVERSELY AFFECT OUR PROFITABILITY.

Our wholesale business is subject to extensive environmental regulation by federal, state and local authorities. We are required to comply with numerous environmental laws and regulations, and to obtain numerous governmental permits, in operating our facilities. We may incur significant additional costs to comply with these requirements. If we fail to comply with these requirements, we could be subject to civil or criminal liability and fines. Existing environmental regulations could be revised or reinterpreted, new laws and regulations could be adopted or become applicable to us or our facilities, and future changes in

environmental laws and regulations could occur, including potential regulatory and enforcement developments related to air emissions. If any of these events occur, our business, operations and financial condition could be adversely affected.

We may not be able to obtain or maintain from time to time all required environmental regulatory approvals. If there is a delay in obtaining any required environmental regulatory approvals or if we fail to obtain and comply with them, the operation of our facilities could be prevented or become subject to additional costs.

We are generally responsible for all on-site liabilities associated with the environmental condition of our power generation facilities which we have acquired and developed, regardless of

when the liabilities arose and whether they are known or unknown. These liabilities may be substantial.

WE RELY ON POWER TRANSMISSION FACILITIES THAT WE DO NOT OWN OR CONTROL. IF THESE FACILITIES FAIL TO PROVIDE US WITH ADEQUATE TRANSMISSION CAPACITY, WE MAY NOT BE ABLE TO DELIVER OUR WHOLESALE ELECTRIC POWER PRODUCTS TO OUR CUSTOMERS.

We depend on transmission and distribution facilities owned and operated by utilities and other power companies to deliver the electricity we sell from our power generation facilities to our customers, who in turn deliver these products to the ultimate consumers of the power. If transmission is disrupted, or transmission capacity is inadequate, our ability to sell and deliver our products may be hindered. Please read "Risks Related to Our Businesses Generally" for a discussion of transmission regulation that can affect access to and availability of transmission.

INCREASING COMPETITION IN THE WHOLESALE POWER MARKET MAY ADVERSELY AFFECT OUR ABILITY TO MAKE FUTURE INVESTMENTS OR ACQUISITIONS.

The wholesale power industry has numerous competitors, some of which may have more operating experience, more acquisition and development experience, larger staffs and/or greater financial resources than we do. Like us, many of our competitors are seeking attractive opportunities to acquire or develop power generation facilities, both in the United States and abroad. This competition may adversely affect our ability to make investments or acquisitions.

Industry restructuring often requires or encourages the disaggregation of many vertically-integrated utilities into separate generation, transmission and distribution, and retail businesses. As a result, a significant number of additional competitors could become active in the wholesale power generation segment of our industry.

While demand for electric energy services is generally increasing throughout the United States, the rate of construction and development of new, more efficient electric generation facilities may exceed increases in demand in some regional electric markets. The commencement of commercial operation of new facilities in the regional markets where we have facilities will likely increase the competitiveness of the wholesale power market in those regions, which could have a material negative effect on our business, results of operations and financial condition.

RISKS RELATED TO OUR RETAIL ELECTRICITY BUSINESS

WE MAY LOSE A SIGNIFICANT NUMBER OF THE RETAIL CUSTOMERS WE WILL SUCCEED TO IN

THE HOUSTON METROPOLITAN AREA.

Beginning on January 1, 2002, all customers in Texas of investor-owned utilities, and those of any municipal utility and electric cooperative that opts to participate in the competitive marketplace, will be able to choose their retail electric provider. Beginning on that date, we will provide retail electric services to all customers of Reliant Energy's electric utility division who do not take action to select another retail electric provider. Under the market framework established by the Texas electric restructuring law enacted in 1999, as the affiliated retail electric provider of Reliant Energy's electric utility division, we will initially be required to sell electricity to these Houston area residential and small commercial customers at a specified price, which is referred to in the law as the "price to beat," whereas other retail electric providers will be allowed to sell electricity to these customers at any price. We will not be permitted to offer electricity to these customers at a price other than the price to beat until January 1, 2005, unless before that date the Public Utility Commission of Texas, or "Texas Utility Commission," determines that 40% or more of the amount of electric power that was consumed in 2000 by the relevant class of customers in the Houston metropolitan area is committed to be served by retail electric providers other than us. Because we will not be able to compete for residential and small commercial

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customers on the basis of price in the Houston area, we may lose a significant number of these customers to other providers.

In addition, we intend to provide commodity and value-added energy management services to the large commercial and industrial customers currently served by Reliant Energy who do not take action to select another retail electric provider beginning on January 1, 2002. We or any other retail electric provider can offer to provide services to these customers at any negotiated price. We believe that the market will be very competitive, and therefore, a significant number of these customers may choose to be served by another retail electric provider and any of these customers that select us to be their provider may subsequently decide to switch to another provider.

THE RESULTS OF OUR RETAIL ELECTRIC OPERATIONS IN TEXAS WILL BE LARGELY DEPENDENT UPON THE AMOUNT OF GROSS MARGIN, OR "HEADROOM," AVAILABLE IN THE PRICE TO BEAT. THE INITIAL PRICE TO BEAT AND THE AMOUNT OF HEADROOM AVAILABLE IN THE PRICE TO BEAT WILL NOT BE ESTABLISHED UNTIL LATE 2001. FUTURE ADJUSTMENTS TO THE PRICE TO BEAT MAY BE INADEQUATE TO COVER OUR COSTS TO PURCHASE POWER TO SERVE OUR PRICE TO BEAT CUSTOMERS.

As discussed above, an affiliated retail electric provider may only sell electricity to residential and small commercial customers in the former service territory of its incumbent utility at the price to beat for a period of up to three years. In addition, an affiliated retail electric provider is obligated to offer the price to beat to requesting residential and small commercial customers in the former service territory of its incumbent utility through January 1, 2007. Pursuant to Texas Utility Commission regulations, the initial price to beat for each affiliated retail electric provider will be 6% less than the average rates in effect for its incumbent utility on January 1, 1999, adjusted to take into account a new fuel factor as of December 31, 2001. The fuel factor component of the initial price to beat for the affiliated retail electric providers, including ours, will not be determined until after Texas Utility Commission proceedings scheduled for April through August and October of 2001 have been completed. Therefore, we do not expect the initial price to beat to be established until late 2001.

The results of our retail electric operations in Texas will be largely dependent upon the amount of headroom available in the price to beat. The

available headroom will equal the difference between the price to beat and the sum of the charges, fees and transmission and distribution utility rate approved by the Texas Utility Commission and the price the affiliated retail electric provider pays for power to serve its price to beat customers. The larger the amount of headroom, the more incentive new market entrants should have to provide retail electric services in a given market. Currently, we do not know nor can we estimate the amount of headroom in our initial price to beat or in the initial price to beat for the affiliated retail electric provider in each other Texas retail electric market. Headroom may be a positive or negative number. If the amount of headroom in our price to beat is a negative number, we would be selling power to our price to beat customers in the Houston metropolitan area at a price below our costs of purchasing and delivering power to those customers.

The Texas Utility Commission's regulations allow an affiliated retail electric provider to adjust its price to beat fuel factor based on the percentage change in the price of natural gas. 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 its initial price to beat fuel factor was set by the Texas Utility Commission. An affiliated retail electric provider may not request that its price to beat be adjusted more than twice a year. Currently, we cannot estimate with any certainty the magnitude and frequency of the adjustments required, if any, and the eventual impact of such adjustments on the amount of headroom available in our price to beat. Consequently, if our price to beat is set at a level such that the amount of headroom is less than we currently expect or future adjustments to our price

to beat are inadequate to cover future increases in our costs to purchase power to serve our price to beat customers, our business, results of operations and financial condition could be materially adversely affected.

IN MARKETS OUTSIDE OF HOUSTON, WE MAY FACE STRONG COMPETITION FROM INCUMBENT UTILITIES AND OTHER COMPETITORS.

In most retail electric markets outside the Houston area, our principal competitor may be the local incumbent utility company or its retail affiliate. The incumbent utilities have the advantage of long-standing relationships with their customers. In addition to competition from the incumbent utilities and their affiliates, we may face competition from a number of other energy service providers, including start-up companies focusing on Internet marketing and online services, and other energy industry participants who may develop businesses that will compete with us in both local and national markets. We also may face competition from nationally branded providers of consumer products and services. Some of these competitors or potential competitors may be larger and better capitalized than we are.

AS A RESULT OF RECENT MARKET CONDITIONS IN CALIFORNIA, SOME STATES MAY DELAY OR RECONSIDER THE DEREGULATION OF THEIR RETAIL ELECTRIC MARKETS. ANY DELAY OR RECONSIDERATION COULD LIMIT THE NUMBER OF COMPETITIVE RETAIL ELECTRIC MARKETS IN THE UNITED STATES AND THEREBY IMPAIR OUR ABILITY TO SUCCESSFULLY IMPLEMENT OUR STRATEGY TO EXPAND OUR RETAIL OPERATIONS OUTSIDE OF TEXAS.

As a result of recent volatility in California's power markets, governmental agencies or officials and/or other interested parties in a number of states are urging that deregulation of the retail electric markets of such states be delayed or reconsidered altogether. As of February 2001, four of the nine states that had previously adopted laws or regulatory plans providing for future retail electric competition by 2002 have initiated bills or proceedings

or adopted laws or regulatory plans to delay the implementation of retail electric competition beyond the original date. The extent to which states delay or reconsider the deregulation of their retail electric markets will limit the number of potential retail electric markets outside of Texas into which we may expand our retail operations. As a result, our strategy to expand our retail operations into targeted competitive retail markets outside of Texas may not be successful.

WE MAY BE REQUIRED TO MAKE A SUBSTANTIAL PAYMENT TO RELIANT ENERGY IN EARLY 2004.

To the extent the price to beat exceeds the market price of electricity, we will be required to make a payment to Reliant Energy in early 2004 unless the Texas Utility Commission determines that, on or prior to January 1, 2004, 40% or more of the amount of electric power that was consumed in 2000 by residential or small commercial customers, as applicable, within Reliant Energy's Houston service territory is committed to be served by retail electric providers other than us. If the 40% test is not met and a payment is required, the amount of this payment will not exceed, but could be up to, $150 per customer multiplied by the number of residential or small commercial customers, as the case may be, that we serve on January 1, 2004 in Reliant Energy's traditional service territory, less the number of new retail electric customers we serve in other areas of Texas. As of December 31, 2000, Reliant Energy had approximately 1.5 million residential and small commercial customers. In the master separation agreement, we have agreed to make this payment, if any, to Reliant Energy.

WE WILL RELY ON THE INFRASTRUCTURE OF LOCAL UTILITIES OR INDEPENDENT TRANSMISSION SYSTEM OPERATORS TO PROVIDE ELECTRICITY TO AND TO OBTAIN INFORMATION ABOUT OUR RETAIL CUSTOMERS. ANY INFRASTRUCTURE FAILURE COULD NEGATIVELY IMPACT OUR CUSTOMERS' SATISFACTION AND COULD HAVE A MATERIAL NEGATIVE IMPACT ON OUR BUSINESS AND RESULTS OF OPERATIONS.

In Texas, we will be dependent on the local transmission and distribution utilities for maintenance of the infrastructure through which we will deliver electricity to our customers. Any infrastructure failure that interrupts or impairs delivery of electricity to our customers could negatively impact the satisfaction of our customers with our service. Additionally, in Texas, we will be dependent on the local transmission and distribution utilities for the reading of our customers' energy meters. We will be required to rely on the local utility or, in some cases, the independent transmission system operator, to provide us with our customers' information regarding energy usage, and we may be limited in our ability to confirm the accuracy of the information. The provision of inaccurate information by the local utilities or system operators could have a material negative impact on our business and results of operations.

In connection with our entry into retail electric markets outside of Texas, we may be required under the regulatory structure of the relevant market to rely on utilities with which we may be competing to perform billing and collection services, the services and functions described in the prior paragraph or other services and functions. In addition, we may be required to enter into agreements with local incumbent utilities for use of the local distribution systems and for the creation and operation of functional interfaces necessary for us to serve our customers. Any delay in these negotiations or our inability to enter into reasonable agreements could delay or negatively impact our ability to serve customers in those markets.

WE PLAN TO OFFER BUNDLED SERVICES TO OUR RETAIL CUSTOMERS AT FIXED PRICES AND FOR FIXED TERMS. IF OUR COSTS TO OBTAIN THE COMMODITIES INCLUDED IN THESE BUNDLED SERVICES EXCEED THE PRICES PAID BY OUR CUSTOMERS, OUR OPERATING RESULTS

COULD BE ADVERSELY AFFECTED.

We plan to offer retail customers a bundle of services that will include, at a minimum, the electric commodity itself plus transmission, distribution and related service charges. To the extent that the prices we charge for this bundle of services or for the various components of the bundle, either of which may be fixed by contract with the customer for a period of time, differ from our underlying cost to obtain the commodities or services, our results of operations would be affected. We will encounter similar risks in selling bundled services that include non-energy-related services, such as telecommunications, Internet access, appliance repair, facilities management, and the like. In some cases, we have little, if any, prior experience in selling these non-energy-related services.

IF THE SYSTEMS AND PROCESSES WE ARE DEVELOPING FOR OUR RETAIL BUSINESS ARE MORE EXPENSIVE TO COMPLETE THAN EXPECTED OR DO NOT WORK AS PLANNED, OUR OPERATING RESULTS MAY BE ADVERSELY AFFECTED.

The information systems and processes necessary to support sales, customer service and electricity supply in competitive retail markets as envisioned in Texas and elsewhere are new, complex and extensive. We are still developing these systems and processes, and they may prove more expensive to complete than planned and may not work as planned.

IF WE ARE DESIGNATED AS A "PROVIDER OF LAST RESORT" BY THE TEXAS UTILITY COMMISSION, WE MAY BE OBLIGATED TO PROVIDE RETAIL ELECTRIC SERVICES AT PRICES BELOW THOSE WE WOULD OTHERWISE CHARGE, WHICH COULD ADVERSELY AFFECT OUR OPERATING RESULTS.

The Texas electric restructuring law requires the Texas Utility Commission to determine procedures and criteria for designating retail electric providers to serve as providers of last resort in areas of the state in which retail competition is in effect. A provider of last resort is required to

offer a standard retail electric service package for each class of customers designated by the Texas Utility Commission at a fixed, nondiscountable rate approved by the Texas Utility Commission. It is also required to provide the service package to any requesting retail customer in the territory for which it is the provider of last resort. In the event that another retail electric provider fails to serve any or all of its customers, the provider of last resort is required to offer that customer the standard retail service package for that customer class with no interruption of service to the customer. As a condition to maintaining our certificate as a retail electric provider, we may be designated as a provider of last resort by the Texas Utility Commission. If we are designated as the provider of last resort and the approved rate at which we are required to offer the standard retail electric service package is less than the price we would otherwise charge, our results of operations may be materially adversely affected.

IF THE TEXAS UTILITY COMMISSION DELAYS THE OPENING OF THE TEXAS RETAIL ELECTRIC MARKET TO COMPETITION, OUR RETAIL ELECTRIC BUSINESS MAY NOT GENERATE ANY REVENUES DURING THE PERIOD OF DELAY.

While the Texas electric restructuring law calls for the implementation of a competitive retail electric market in Texas beginning on January 1, 2002, the law authorizes the Texas Utility Commission to delay the date on which the retail electric market is opened to competition in any power region in Texas if it determines that the region is unable to offer fair competition and reliable service to all retail customer classes on that date. Most of the significant

dates in the Texas electric restructuring law are specified anniversaries of the date on which the retail electric market is opened to competition. We have assumed throughout this prospectus that open retail electric competition in Texas will begin on January 1, 2002 and that the specified anniversaries are January 1 of the appropriate year. To the extent that the Texas Utility Commission delays the implementation of a competitive market beyond that date, all references to the January 1, 2002 open competition date and the anniversaries of that date shall refer to the date on which a competitive retail electric market is implemented by the Texas Utility Commission and the appropriate anniversary of that date, respectively. During any delay period, we may not earn any revenue from our retail electric business.

RISKS RELATED TO OUR BUSINESSES GENERALLY

OUR WHOLESALE AND RETAIL ENERGY BUSINESSES OPERATE IN THE DEREGULATING SEGMENTS OF THE ELECTRIC POWER INDUSTRY CREATED BY RESTRUCTURING INITIATIVES AT BOTH STATE AND FEDERAL LEVELS. IF THE PRESENT TREND TOWARDS COMPETITIVE RESTRUCTURING OF THE ELECTRIC POWER INDUSTRY IS REVERSED, DISCONTINUED OR DELAYED, OUR BUSINESS PROSPECTS AND FINANCIAL CONDITION COULD BE MATERIALLY ADVERSELY IMPAIRED.

The regulatory environment applicable to the U.S. electric power industry is experiencing significant changes as a result of varying restructuring initiatives at both the state and federal levels. These initiatives have had a significant impact on the nature of the industry and the manner in which its participants conduct their business. We have targeted deregulating wholesale and retail segments of the electric power industry created by these initiatives. These changes are ongoing and we cannot predict the future development of deregulation in these markets or the ultimate effect that this changing regulatory environment will have on our business.

Moreover, existing regulations may be revised or reinterpreted, new laws and regulations may be adopted or become applicable to us or our facilities, and future changes in laws and regulations may have a detrimental effect on our business. For example, a bill was recently voted out of a committee of the Texas House of Representatives for approval by the Texas House which would amend the Texas electric restructuring law to require an electric utility, its affiliated transmission and distribution utility and its affiliated retail electric provider to credit the excess of the market value of the utility's generation assets over the net book value of those assets, or

"negative stranded costs," to customers. The bill does not allocate the credit amongst the entities but requires the Texas Utility Commission to prescribe the manner in which the credit of negative stranded costs is made. The bill must pass from the Calendars Committee of the Texas House before it can go before the full House for approval. At this time, we cannot predict whether this legislation will be enacted, or if enacted, what form it will take. In certain circumstances involving a modification of the time periods used in the generation asset value methodology set forth in the Texas electric restructuring law and contemplated by the Texas Genco option agreement, conforming changes to the option agreement will be made.

In addition, some restructured markets have recently experienced supply problems and price volatility. These supply problems and volatility have been the subject of a significant amount of press coverage, much of which has been critical of the restructuring initiatives. In some of these markets, including California, proposals have been made by governmental agencies and/or other interested parties to re-regulate areas of these markets which have previously been deregulated. Governmental agencies or officials and/or other interested parties in a number of states, including states that had previously adopted laws

or regulatory plans providing for future retail electric competition, are urging that deregulation of the retail electric markets of such states be delayed or reconsidered altogether. We cannot assure you that other proposals to re-regulate will not be made or that legislative or other attention to the electric power restructuring process will not cause the process to be delayed or reversed. If the current trend towards competitive restructuring of the wholesale and retail power markets is reversed, discontinued or delayed, our business prospects and financial condition could be materially adversely impaired.

IF WE FAIL TO OBTAIN OR MAINTAIN ANY NECESSARY GOVERNMENTAL PERMIT OR APPROVAL, OUR RESULTS OF OPERATIONS MAY BE ADVERSELY AFFECTED.

Our operations are subject to complex and stringent energy, environmental and other governmental laws and regulations. The acquisition, ownership and operation of power generation facilities require numerous permits, approvals and certificates from federal, state and local governmental agencies. The operation of our generation facilities must also comply with environmental protection and other legislation and regulations. At present, our operations are subject to regulation in California, Florida, Illinois, Maryland, Nevada, New Jersey, Pennsylvania and Texas. Most of our existing domestic generation facilities are exempt wholesale generators, or "EWGs," which sell electricity exclusively into the wholesale market. These facilities are subject to regulation by the FERC regarding rate matters and by state public utility commissions regarding non-rate matters. The FERC has authorized us to sell our generation from these facilities at market prices. The FERC retains the authority to modify or withdraw our market-based rate authority and to impose "cost of service" rates if it determines that market pricing is not in the public interest. Any reduction by the FERC of the rates we may receive for our generation activities may materially adversely affect our results of operations.

CHANGES IN TECHNOLOGY MAY IMPAIR THE VALUE OF OUR POWER PLANTS AND MAY SIGNIFICANTLY IMPACT OUR BUSINESS IN OTHER WAYS AS WELL.

Research and development activities are ongoing to improve alternative technologies to produce electricity, including fuel cells, microturbines and photovoltaic (solar) cells. It is possible that advances in these or other alternative technologies will reduce the costs of electricity production from these technologies to a level below that which we have forecasted. In addition, electricity demand could be reduced by increased conservation efforts and advances in technology, which could likewise significantly reduce the value of our power generation assets. Changes in technology could also alter the channels through which retail electric customers buy electricity.

OUR RESULTS ARE SUBJECT TO QUARTERLY AND SEASONAL FLUCTUATIONS, WHICH MAY ADVERSELY AFFECT THE MARKET PRICE OF OUR COMMON STOCK.

Our quarterly operating results have fluctuated in the past and will continue to do so in the future as a result of the following factors:

- variations in levels of production due to price changes, weather and seasonality,

- volatility of market prices of open trading positions,

- the timing and size of acquisitions, and

- the completion of development projects.

THE VALUE OF OUR FOREIGN GENERATING FACILITIES AND BUSINESSES MAY BE REDUCED BY RISKS RELATED TO LAWS OF OTHER COUNTRIES, TAXES, ECONOMIC CONDITIONS, FLUCTUATIONS IN CURRENCY RATES, POLITICAL CONDITIONS, POLICIES OF FOREIGN GOVERNMENTS AND LABOR SUPPLY AND RELATIONS.

We currently have generation facilities in the Netherlands and trading, marketing and risk management operations in Northwest Europe. Operations outside the United States entail the following significant political and financial risks, which vary by country:

- changes in laws or regulations,

- changes in foreign tax laws and regulations,

- changes in U.S. laws, including tax laws, related to foreign operations,

- changes in general economic conditions affecting each country,

- fluctuations in inflation and currency exchange rates,

- changes in government policies or personnel, and

- changes in labor relations in operations outside the United States.

Our actual results may be affected by the occurrence of any of these events. The occurrence of any of these events could substantially reduce the value of the impacted generating facilities or businesses.

RISKS RELATED TO OUR CORPORATE AND FINANCIAL STRUCTURE

IF WE ARE UNABLE TO ARRANGE FUTURE FINANCINGS ON ACCEPTABLE TERMS, OUR ABILITY TO PURSUE ATTRACTIVE ACQUISITION AND DEVELOPMENT ACTIVITIES COULD BE LIMITED.

Our business strategy anticipates significant future acquisitions and development of additional generating facilities. We are continually reviewing potential acquisitions and development projects, and may enter into significant acquisitions or development projects in the near future. Any acquisition or development project will likely require access to substantial capital from outside sources on acceptable terms. We may also need external financing to fund capital expenditures, including capital expenditures necessary to comply with air emission regulations or other regulatory requirements. Depending on our performance and market conditions prevailing at the time of any of these acquisitions and development projects, we may not be able to arrange for necessary financing on terms that are acceptable to us, which could have the effect of limiting our ability to pursue desirable acquisitions and development opportunities.

Our ability to arrange debt financing and the costs of debt capital are dependent on the following factors:

- general economic and capital market conditions,

- credit availability from banks and other financial institutions,

- investor confidence in us and our regional wholesale power markets,

- maintenance of acceptable credit ratings,

- the success of current projects,

- the perceived quality of new projects, and

- provisions of relevant tax and securities laws.

Future indebtedness may include terms that are more restrictive or burdensome than those of our current indebtedness. This may negatively impact our ability to operate our business, or severely restrict or prohibit distributions from our subsidiaries.

In the past, a significant amount of our debt and equity capital needs has been satisfied by Reliant Energy. Reliant Energy and some of its subsidiaries have also periodically provided credit support to us. In addition, we believe that we have obtained third-party financing on relatively favorable terms based in part on Reliant Energy's ownership interest in us. Following this offering, Reliant Energy will no longer provide financing or credit support except for specified transactions or for a limited period of time. As a result, we may not be able to obtain third-party financing on terms that are as favorable as we have experienced in the past.

WE MAY WISH TO FINANCE FUTURE ACQUISITIONS BY ISSUING ADDITIONAL EQUITY SECURITIES, WHICH COULD RESULT IN SIGNIFICANT DILUTION OF OUR STOCKHOLDERS. ALSO, PRIOR TO OUR SEPARATION FROM RELIANT ENERGY, WE WILL GENERALLY BE UNABLE TO ISSUE EQUITY SECURITIES WITHOUT RELIANT ENERGY'S PRIOR CONSENT.

In order to finance future acquisitions, we may wish to issue additional equity securities in amounts which could be substantial. If we issue additional equity securities, it may result in dilution of our stockholders, which could be significant.

In order for the distribution of the remaining shares of our common stock to be tax-free to Reliant Energy and its shareholders, Reliant Energy must own at least 80% of all classes of our outstanding capital stock at the time of the distribution. Therefore, prior to our separation from Reliant Energy, we will not be able to issue equity or voting debt without Reliant Energy's prior consent, and Reliant Energy is unlikely to give that consent so long as it still intends to distribute the remaining shares to its shareholders. This limitation could have the effect of limiting our ability to pursue desirable acquisitions and development opportunities.

IF WE EXERCISE OUR OPTION TO PURCHASE THE CAPITAL STOCK OF TEXAS GENCO OWNED BY RELIANT ENERGY, WE WILL OWE FIDUCIARY DUTIES TO TEXAS GENCO'S MINORITY STOCKHOLDERS, WHICH MAY RESTRICT OUR CONTROL OVER TEXAS GENCO'S COMMERCIAL RELATIONSHIPS AND OPERATIONS.

Reliant Energy has granted us an option to purchase in 2004 the 81% interest it is expected to own in the entity owning the Texas generating assets of Reliant Energy's electric utility division, which we refer to as "Texas Genco." If we exercise this option, we will own a majority interest in a substantial subsidiary that has public shareholders owning the remaining amount of its common stock. Upon exercise of this option, we will owe fiduciary duties to Texas Genco's minority stockholders, which may restrict our control of Texas Genco and the commercial relationships between Texas Genco and our other subsidiaries.

OUR HOLDING COMPANY STRUCTURE LIMITS OUR ACCESS TO THE FUNDS OF SOME OF OUR SUBSIDIARIES WHICH WE MAY NEED TO SERVICE PARENT-LEVEL INDEBTEDNESS AND OTHER CASH REQUIREMENTS.

Substantially all of our operations are conducted by our subsidiaries. Our cash flow and our ability to service parent-level indebtedness when due is dependent upon our receipt of cash dividends, distributions or other transfers from our subsidiaries. The terms of some of our subsidiaries' indebtedness restrict their ability to pay dividends or make restricted payments to us in some circumstances. Specifically, our Channelview and El Dorado Energy subsidiaries are each party to credit agreements used to finance construction of their generation plants. Both the Channelview credit agreement and the El Dorado Energy credit agreement allow the respective subsidiary to pay dividends or make restricted payments only if specified conditions are satisfied, including maintaining specified debt service coverage ratios and debt service reserve account balances. In both cases, the amount of the dividends or restricted payments that may be paid if the conditions are met is limited to a specified level and may be paid only from a particular account. The Channelview cogeneration facility is currently under construction and is not expected to begin commercial operations until the third quarter of 2001. As of December 31, 2000, all of the specified conditions in the El Dorado Energy credit agreement were satisfied.

In addition, the ability of our subsidiary that owns our Mid-Atlantic power generation facilities to pay dividends or make restricted payments to us is restricted under the terms of three facility interest lease agreements. These agreements allow our Mid-Atlantic subsidiary to pay dividends or make restricted payments only if specified conditions are satisfied, including maintaining specified fixed charge coverage ratios. As of December 31, 2000, all of the specified conditions in these agreements were satisfied.

RISKS RELATED TO OUR SEPARATION FROM RELIANT ENERGY

OUR BUSINESS AND YOUR INVESTMENT IN OUR STOCK MAY BE ADVERSELY AFFECTED IF RELIANT ENERGY DOES NOT COMPLETE THE DISTRIBUTION OF OUR COMMON STOCK TO ITS SHAREHOLDERS, BECAUSE WE WOULD REMAIN SUBJECT TO CONTROL BY RELIANT ENERGY.

Although Reliant Energy has advised us that it currently intends to complete the distribution of our common stock to its shareholders within twelve months of this offering, we cannot assure you whether or when the distribution will occur. Reliant Energy is not obligated to complete the distribution, and it may decide not to do so.

Reliant Energy has filed a request with the Internal Revenue Service to seek a ruling that the distribution will be tax-free to Reliant Energy and its shareholders and will qualify as a reorganization. At the time of this offering, Reliant Energy does not have a ruling from the Internal Revenue Service regarding the tax treatment of the distribution. If Reliant Energy does not obtain a favorable tax ruling, it is not likely to make the distribution in the expected time frame or, perhaps, at all. In order for the distribution to be tax-free, Reliant Energy must satisfy various requirements, including owning at least 80% of all classes of our outstanding capital stock at the time of the distribution.

Additionally, in connection with our separation from Reliant Energy and the distribution of our stock by Reliant Energy, Reliant Energy plans to restructure its remaining businesses and to register as a public utility holding company under the 1935 Act or to seek an exemption from the registration requirements of the 1935 Act. Both the restructuring and a registration under the 1935 Act will require SEC approval. The restructuring will also require the approval of the Louisiana Public Service Commission and the Nuclear Regulatory Commission. If an exemption from registration is to be obtained, approval from other state utility commissions which regulate Reliant Energy's gas distribution operations may also be required. We cannot assure you that those approvals will be obtained.

If Reliant Energy becomes a registered public utility holding company under the 1935 Act and does not complete the distribution of our common stock, our businesses would be adversely affected. We would:

- be subject to regulatory restrictions as a subsidiary of a registered public utility holding company,

- not be able to raise equity capital without compliance with regulatory requirements, as well as approval by Reliant Energy, and

- be subject to limits on investments in EWGs and foreign utility companies.

In addition, until the distribution occurs, the risks discussed below relating to Reliant Energy's control of our company and the potential business conflicts of interest between Reliant Energy and us will continue to be relevant to you. If the distribution is delayed or not completed at all, the liquidity of shares of our common stock in the market may be constrained unless and until Reliant Energy elects to sell some of its significant ownership into the public market. A lack of liquidity in our common stock may affect our stock price.

WE WILL BE CONTROLLED BY RELIANT ENERGY AS LONG AS IT OWNS A MAJORITY OF OUR COMMON STOCK, AND OUR NEW MINORITY STOCKHOLDERS WILL BE UNABLE TO AFFECT THE OUTCOME OF STOCKHOLDER VOTING DURING THAT TIME.

After the completion of this offering, Reliant Energy will own over 80% of our outstanding common stock. As long as Reliant Energy owns a majority of our outstanding common stock, Reliant Energy will continue to be able to elect our entire board of directors without calling a special meeting. Investors in this offering, by themselves, will not be able to affect the outcome of any stockholder vote prior to the planned distribution of our common stock to Reliant Energy's shareholders. As a result, Reliant Energy, subject to any fiduciary duty owed to our minority stockholders under Delaware law, will be able to control all matters affecting our company, including:

- the composition of our board of directors and, through the board, any determination with respect to our business direction and policies, including the appointment and removal of officers,

- determination of incentive compensation, which may affect our ability to retain key employees,

- the allocation of business opportunities between Reliant Energy and us,

- any determinations with respect to mergers or other business combinations,

- our acquisition or disposition of assets,

- our financing decisions and our capital raising activities,

- the payment of dividends on our common stock,

- amending our restated certificate of incorporation, and

- determinations with respect to our tax returns.

In addition, Reliant Energy may enter into credit agreements, indentures or other contracts that limit the activities of its subsidiaries. While we would not likely be contractually bound by these limitations, Reliant Energy would

likely cause its representatives on our board to direct our business so as not to breach any of these agreements. Moreover, the Texas Utility Commission and the state regulatory commissions of Arkansas and Minnesota have imposed limitations on the amount Reliant Energy or its subsidiaries may invest in foreign utility companies and, in some

cases, foreign electric wholesale generating companies. These limitations are based upon Reliant Energy's consolidated net worth, retained earnings, and debt and stockholders' equity.

OUR HISTORICAL FINANCIAL RESULTS AS A SUBSIDIARY OF RELIANT ENERGY MAY NOT BE REPRESENTATIVE OF OUR RESULTS AS A SEPARATE COMPANY.

The historical financial information we have included in this prospectus does not necessarily reflect what our financial position, results of operations and cash flows would have been had we been a separate, stand-alone entity during the periods presented. Our costs and expenses reflect charges from Reliant Energy for centralized corporate services and infrastructure costs. These allocations have been determined based on what we and Reliant Energy considered to be reasonable reflections of the utilization of services provided to us or for the benefits received by us. This historical financial information is not necessarily indicative of what our results of operations, financial position and cash flows will be in the future. We may experience significant changes in our cost structure, funding and operations as a result of our separation from Reliant Energy, including increased costs associated with reduced economies of scale, and increased costs associated with being a publicly traded, stand-alone company.

WE MAY HAVE POTENTIAL BUSINESS CONFLICTS OF INTEREST WITH RELIANT ENERGY WITH RESPECT TO OUR PAST AND ONGOING RELATIONSHIPS, AND BECAUSE OF RELIANT ENERGY'S CONTROLLING OWNERSHIP PRIOR TO THE DISTRIBUTION, WE MAY NOT BE ABLE TO RESOLVE THESE CONFLICTS ON TERMS COMMENSURATE WITH THOSE POSSIBLE IN ARMS' LENGTH TRANSACTIONS.

Conflicts of interest may arise between Reliant Energy and our company in a number of areas relating to our past and ongoing relationships, including:

- solicitation and hiring of employees from each other,

- the timing and manner of any sales or distributions by Reliant Energy of all or any portion of its ownership interest in our company,

- the nature and quality of transitional services Reliant Energy has agreed to provide us,

- the business operations of Texas Genco,

- our business operations within Reliant Energy's Houston service territory or other business opportunities that would compete with Reliant Energy,

- actions and decisions of legislative bodies and administrative agencies, and

- our dividend policy.

Following this offering, the agreements we have entered into with Reliant Energy may be amended upon agreement of the parties. While we are controlled by Reliant Energy, Reliant Energy may be able to require us to agree to amendments to these agreements. We may not be able to resolve any potential conflicts with

Reliant Energy, and even if we do, the resolution may be less favorable than if we were dealing with an unaffiliated party.

OUR EXECUTIVE OFFICERS AND SOME OF OUR DIRECTORS MAY HAVE POTENTIAL CONFLICTS OF INTEREST BECAUSE OF THEIR OWNERSHIP OF RELIANT ENERGY COMMON STOCK. IN ADDITION, SOME OF OUR DIRECTORS WILL ALSO BE DIRECTORS OF RELIANT ENERGY.

Our executive officers and some of our directors own a substantial amount of Reliant Energy common stock and options to purchase Reliant Energy common stock. Ownership of Reliant Energy common stock by our directors and officers after our separation from Reliant Energy could create, or appear to create, potential conflicts of interest when directors and officers are faced with decisions that could have different implications for Reliant Energy than they do for us.

We expect that even after Reliant Energy distributes the shares of our common stock it owns to its shareholders, two or three of our directors will also be directors of Reliant Energy. One of these directors will be our chairman, president and chief executive officer. These directors will owe fiduciary duties to the stockholders of each company. As a result, in connection with any transaction or other relationship involving both companies, these directors may need to recuse themselves and to not participate in any board action relating to these transactions or relationships.

OUR ABILITY TO OPERATE OUR BUSINESSES MAY SUFFER IF WE DO NOT DEVELOP OUR OWN INFRASTRUCTURE QUICKLY AND COST-EFFECTIVELY, AND WE CANNOT ASSURE YOU THAT THE TRANSITIONAL SERVICES THAT RELIANT ENERGY HAS AGREED TO PROVIDE US WILL BE SUFFICIENT FOR OUR NEEDS.

We currently use Reliant Energy's systems to support some of our operations, including legal, accounting and treasury, human resources, payroll and wide-area computer networks. We are in the process of creating our own systems to replace Reliant Energy's systems. Any failure or significant downtime in Reliant Energy's or our own information systems could prevent us from paying our employees, billing our customers or performing other administrative services on a timely basis and could harm our business.

Following this offering, Reliant Energy has agreed to provide some transition services to us. For a description of these transition services, please read "Agreements Between Us and Reliant Energy -- Transition Services Agreement." The transition services agreement provides that interim corporate support services will terminate no later than the time Reliant Energy completes the disposition of the shares of our common stock it continues to own after this offering. The agreement provides that information technology services and other interim shared services may continue to be provided until December 31, 2004. After the expiration of these various arrangements, we may not be able to replace the transitional services with a comparable quality of service or on terms and conditions as favorable as those we will receive from Reliant Energy.

Reliant Energy has wide discretion on what employees it will utilize to provide services to us. Consequently, the quality and quantity of the services we receive from Reliant Energy may not be as good as the services we received prior to the effectiveness of the separation agreements.

OUR CREDIT RATING COULD DECLINE AS A RESULT OF OUR SEPARATION FROM RELIANT ENERGY, AND AS A RESULT, WE MAY FACE INCREASED BORROWING COSTS, MORE RESTRICTIVE COVENANTS AND REDUCED AMOUNTS OF CREDIT, WHICH MAY MAKE IT MORE DIFFICULT OR EXPENSIVE TO PURSUE OUR GROWTH STRATEGY.

Our operation as a separate entity from Reliant Energy may have a negative impact on our ability to obtain credit on terms similar to those we were able to obtain prior to our separation from Reliant Energy. Historically, Reliant Energy has provided financing and credit support to us and our project financing activities. Following this offering, Reliant Energy will no longer provide financing or credit support for our operations except for specified transactions or for a limited period of time. In addition, we may increase the proportion of debt in our overall capital structure as part of our growth plan. Increases in our debt level may negatively affect our credit rating.

We have performance guarantees related to our trading, marketing and risk management operations that require us to maintain an investment grade credit rating. If our credit rating declines below investment grade, we will likely be obligated to provide credit enhancement to the guaranteed party in the form of a pledge of cash collateral, a letter of credit or other similar credit enhancement. Furthermore, if our credit ratings decline below an investment grade credit rating, our trading partners may refuse to trade with us or trade only on terms less favorable to us.

Any of these events would likely result in increased borrowing costs, more restrictive covenants and reduced lines of credit from lenders, suppliers and counterparties, all of which

would adversely affect our business and results of operations and our ability to raise capital to pursue our growth strategy.

IF WE TAKE ACTIONS WHICH CAUSE THE DISTRIBUTION OF OUR STOCK BY RELIANT ENERGY TO ITS SHAREHOLDERS TO FAIL TO QUALIFY AS A TAX-FREE TRANSACTION, WE WILL BE REQUIRED TO INDEMNIFY RELIANT ENERGY FOR ANY RESULTING TAXES. THIS POTENTIAL OBLIGATION TO INDEMNIFY RELIANT ENERGY MAY PREVENT OR DELAY A CHANGE OF CONTROL OF OUR COMPANY AFTER RELIANT ENERGY DISTRIBUTES OUR COMMON STOCK TO ITS SHAREHOLDERS.

Reliant Energy intends to distribute its shares of our common stock to its shareholders within twelve months of the completion of this offering. Prior to the distribution, Reliant Energy intends to obtain a ruling from the Internal Revenue Service that the distribution will be tax-free to Reliant Energy and its shareholders and will qualify as a reorganization. Under an agreement between our company and Reliant Energy, if we breach any representations in the agreement relating to the ruling, take any action that causes our representations in the agreement relating to the ruling to be untrue or engage in a transaction after the distribution that causes the distribution to be taxable to Reliant Energy, we will be required to indemnify Reliant Energy for any resulting taxes. The amount of any indemnification payments would be substantial, and we likely would not have sufficient financial resources to achieve our growth strategy after making such payments.

Current tax law provides that, depending on the facts and circumstances, the distribution of our stock by Reliant Energy, if it occurs, may be taxable to Reliant Energy if our company undergoes a 50% or greater change in stock ownership within two years after the distribution. Under agreements between our company and Reliant Energy, Reliant Energy is entitled to require us to reimburse any tax costs incurred by Reliant Energy as a result of a transaction resulting in a change in control of our company. These costs may be so great that they delay or prevent a strategic acquisition or change in control of our company.

OUR DECONSOLIDATION FROM THE RELIANT ENERGY CONSOLIDATED TAX GROUP MAY RESULT IN ADVERSE TAX CONSEQUENCES TO US.

Subsequent to the distribution of our common stock by Reliant Energy, if it occurs, we will cease to be a member of the Reliant Energy consolidated tax group. This separation will have both current and future income tax implications to us. The event of deconsolidation itself will result in the triggering of deferred intercompany gains. We will recognize taxable income related to these gains, which will not have a material impact on our net income and cash flow.

In addition to the current income tax consequences triggered by the act of deconsolidation discussed above, our separation from the Reliant Energy consolidated tax group will change our overall future income tax posture. As a result, we could be limited in our future ability to effectively use future tax attributes. We have agreed with Reliant Energy that we may carry back net operating losses we generate in our tax years after deconsolidation to tax years when we were part of the Reliant Energy consolidated group subject to Reliant Energy's consent. Reliant Energy has agreed not to unreasonably withhold such consent. Additionally, we may also be able to utilize such net operating losses in our tax years after deconsolidation (subject to the applicable carryforward limitation periods) but only to the extent of our income in such tax years.

RISKS RELATED TO THE SECURITIES MARKETS AND OWNERSHIP OF OUR COMMON STOCK

SUBSTANTIAL SALES OF OUR COMMON STOCK MAY OCCUR IN CONNECTION WITH THE DISTRIBUTION TO RELIANT ENERGY'S SHAREHOLDERS. THESE SALES COULD CAUSE OUR STOCK PRICE TO DECLINE.

Reliant Energy currently intends to distribute all of the shares of our common stock it owns to its shareholders within twelve months of this offering. Substantially all of these shares will be

eligible for immediate resale in the public market. We cannot predict whether significant amounts of our common stock will be sold in the open market in anticipation of, or following, the distribution, or will be sold by Reliant Energy if the distribution does not occur. We also cannot predict what level of demand there will be for shares of our common stock. In addition, we have entered into a registration rights agreement, which provides that if Reliant Energy does not distribute all of the shares of our common stock that it owns to its shareholders, Reliant Energy and its transferees will have the right to require us to register these shares under the U.S. securities laws for sale into the public market. Any sales of substantial amounts of our common stock in the public market, or the perception that these sales might occur, whether as a result of the distribution or otherwise, could lower the market price of our common stock. Further, if we issue additional equity securities to raise additional capital, your ownership interest in our company may be diluted and the value of your investment may be reduced. Please read "Shares Eligible for Future Sale" for information about the number of shares that will be outstanding and could be sold after this offering.

THE INITIAL PUBLIC OFFERING PRICE OF OUR COMMON STOCK MAY NOT BE INDICATIVE OF THE MARKET PRICE OF OUR COMMON STOCK AFTER THIS OFFERING. IN ADDITION, OUR STOCK PRICE MAY BE VOLATILE.

Prior to this offering, Reliant Energy held all of our outstanding common stock, and therefore, there has been no public market for our common stock. We cannot assure you that an active market for our common stock will develop or be sustained after this offering. The initial public offering price of our common stock was determined by negotiations between us and representatives of the underwriters, based on numerous factors which we discuss in the "Underwriting" section of this prospectus. This price may not be indicative of the market price for our common stock after this initial public offering. The market price of our

common stock could be subject to significant fluctuations after this offering, and may decline below the initial public offering price. You may not be able to resell your shares at or above the initial public offering price. The following factors could affect our stock price:

- our operating and financial performance and prospects,
- quarterly variations in the rate of growth of our financial indicators, such as earnings per share, net income and revenues,
- changes in revenue or earnings estimates or publication of research reports by analysts,
- speculation in the press or investment community,
- strategic actions by us or our competitors, such as acquisitions or restructurings,
- developments regarding the restructuring of the electric power industry, including re-regulation of previously deregulated markets,
- default and/or non-payment by buyers of power purchased from us in California or other markets,
- sales of our common stock by stockholders,
- actions by institutional investors or by Reliant Energy prior to its distribution of our common stock,
- general market conditions, including fluctuations in commodity prices, and
- domestic and international economic, legal and regulatory factors unrelated to our performance.

The stock markets in general have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

OUR RIGHTS AGREEMENT AND PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW MAY INHIBIT A TAKEOVER, WHICH COULD ADVERSELY AFFECT THE VALUE OF OUR COMMON STOCK.

Our restated certificate of incorporation, bylaws and rights agreement, as well as Delaware corporate law, contain provisions that could delay or prevent a change of control or changes in our management that a stockholder might consider favorable. These provisions generally become effective at the time Reliant Energy ceases to own a majority of our outstanding common stock. These provisions apply even if the offer may be considered beneficial by some of our stockholders. If a change of control or change in management is delayed or prevented, the market price of our common stock could decline.

OUR SEPARATION FROM RELIANT ENERGY

In July 2000, Reliant Energy announced its intention to divide itself into two publicly traded companies in order to separate its unregulated businesses

from its regulated businesses. This offering of our common stock is part of Reliant Energy's separation plan. Within twelve months of the completion of this offering, Reliant Energy intends to distribute our remaining stock to its shareholders as part of its separation plan. Until Reliant Energy completes the distribution of our common stock to its shareholders, we will continue to be a subsidiary of Reliant Energy.

Reliant Energy is an international energy delivery and energy services company based in Houston, Texas. Following the distribution of our shares, we expect Reliant Energy will remain engaged in the transmission and distribution, as well as generation, of electric power and the transportation and distribution of natural gas.

SEPARATION AND TRANSITION SERVICES AGREEMENTS

We have entered into agreements with Reliant Energy providing for the separation of its businesses, including a master separation agreement. These agreements generally provide for the transfer from Reliant Energy to us of assets relating to our businesses and the assumption by us of associated liabilities. We have also entered into agreements governing various interim and ongoing relationships between us and Reliant Energy, including transitional services Reliant Energy will provide to us. For a summary description of these agreements, please read "Agreements Between Us and Reliant Energy."

THE DISTRIBUTION BY RELIANT ENERGY OF OUR COMMON STOCK

After completion of this offering, Reliant Energy will own over 80% of the outstanding shares of our common stock. Reliant Energy has announced that it currently plans to complete its divestiture of our company within twelve months of the completion of this offering by distributing all of the shares of our common stock it owns to its shareholders. However, Reliant Energy is not obligated to complete the distribution. For a description of consequences that may result if Reliant Energy does not complete the distribution, please read "Risk Factors -- Risks Related to Our Separation from Reliant Energy."

BUSINESS SEPARATION PLAN

The Texas Utility Commission has approved a business separation plan that contemplates that our company will be the successor to Reliant Energy's retail electric operations in the Houston metropolitan area when the Texas market opens to competition. Reliant Energy filed the plan with the Commission to meet the requirements of the Texas electric restructuring law adopted in 1999. The law requires investor-owned electric utilities to separate their Texas electric utility operations into three segments -- generation, transmission and distribution, and retail sales -- under either common or separate ownership. Reliant Energy will retain its Houston-area transmission and distribution business, which will remain subject to traditional utility rate regulation, and its associated generation assets, subject to the option described below.

TEXAS GENCO OPTION

In connection with the separation, Reliant Energy has granted us an option to purchase the 81% interest it will have in the entity owning the Texas generating assets of Reliant Energy's electric utility division, which we refer to as "Texas Genco." These assets consist of 14,040 MW of aggregate net generation capacity. This option will be exercisable by us in January 2004. For a summary description of this option, please read "Texas Genco Option."

USE OF PROCEEDS

We estimate that our net proceeds from this offering will be approximately $1.5 billion (approximately $1.7 billion if the underwriters' over-allotment option is exercised in full) based on the initial public offering price of $30.00 per share and after deducting underwriting discounts and commissions and our estimated offering expenses.

In the master separation agreement, we have agreed that to the extent the net proceeds of this offering (including proceeds from the exercise of the underwriters' over-allotment option) exceed $1.4 billion, we will use 50% of the net proceeds above such amount to repay certain indebtedness we owe Reliant Energy aggregating Euro 560 million (approximately $528 million based on the December 31, 2000 exchange rate of 1.0616 Euros per U.S. dollar). This indebtedness was incurred in the fourth quarter of 1999 in connection with the funding of the UNA purchase obligation. This indebtedness bears interest at the inter-bank offered rate for Euros (EURIBOR) plus 0.75% per annum. This indebtedness is included in the $1.9 billion of our indebtedness owed to Reliant Energy that Reliant Energy has agreed to convert to equity as a capital contribution prior to the closing of this offering.

We intend to use the net proceeds from this offering initially to increase our working capital. We expect to use these proceeds to fund capital expenditures, including the funding of construction costs of, and combustion turbine payments relating to, our generating facilities currently under construction. We have estimated 2001 capital requirements of $1.0 billion, including capital expenditures relating to four generating facilities under construction with total remaining estimated costs of construction of $436 million. We also plan to continue to expand our portfolio of generation assets through acquisitions of generation facilities. Depending on the timing of any of these acquisitions, we may use a portion of the net proceeds from this offering to finance one or more future acquisitions if the proceeds have not yet been used to finance capital expenditures as of the date of such acquisitions. We expect to finance future capital expenditures that are not paid for with net proceeds from this offering with cash from operations or other financing alternatives. For a discussion of these alternatives, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources -- Capital Requirements -- Other Sources/Uses of Cash."

DIVIDEND POLICY

We do not intend to declare or pay any dividends on our common stock in the foreseeable future. Instead, we intend to retain any future earnings for use in our business. Our board of directors will determine the payment of future dividends on our common stock, if any, and the amount of any dividends in light of:

- any applicable contractual restrictions limiting our ability to pay dividends,
- our earnings and cash flows,
- our financial condition, and
- other factors our board of directors deems relevant.

The terms of some of our subsidiaries' indebtedness restrict their ability to pay dividends or make restricted payments to us in some circumstances. Specifically, our Channelview and El Dorado Energy subsidiaries are each party

to credit agreements used to finance construction of their generation plants. Both the Channelview credit agreement and the El Dorado Energy credit agreement allow the respective subsidiary to pay dividends or make restricted payments only if specified conditions are satisfied, including maintaining specified debt service coverage ratios and debt service reserve account balances. In both cases, the amount of the dividends or restricted payments that may be paid if the conditions are met is limited to a specified level and may be paid only from a particular account. The Channelview cogeneration facility is currently under construction and is not expected to begin commercial operations until the third quarter of 2001. As of December 31, 2000, all of the specified conditions in the El Dorado Energy credit agreement were satisfied.

In addition, the ability of our subsidiary that owns our Mid-Atlantic power generation facilities to pay dividends or make restricted payments to us is restricted under the terms of three facility interest lease agreements. These agreements allow our Mid-Atlantic subsidiary to pay dividends or make restricted payments only if specified conditions are satisfied, including maintaining specified fixed charge coverage ratios. As of December 31, 2000, all of the specified conditions in these agreements were satisfied.

DILUTION

Our pro forma net tangible book value at December 31, 2000 was approximately $2.9 billion, or $11.95 per share. Net tangible book value per share represents our total tangible assets reduced by our total liabilities and divided by the aggregate number of shares of our common stock outstanding. Dilution in net tangible book value per share represents the difference between the amount per share that you pay in this offering and the net tangible book value per share immediately after this offering.

After giving effect to our sale of 52,000,000 shares of common stock in this offering at the initial public offering price of $30.00 per share and after deducting underwriting discounts and commissions and estimated offering expenses payable by us, our pro forma as adjusted net tangible book value at December 31, 2000 would have been approximately $4.3 billion, or $14.86 per share. This represents an immediate increase in pro forma net tangible book value of $2.91 per share to our existing stockholder and an immediate dilution in pro forma net tangible book value of $15.14 per share to new investors purchasing shares of common stock in this offering. The following table illustrates this dilution per share:

Initial public offering price per share....................		$30.00
Pro forma net tangible book value per share as of December 31, 2000...	$11.95	
Increase in pro forma book value per share attributable to new investors..	$ 2.91	
Pro forma as adjusted net tangible book value per share after this offering.....................................		$14.86